New Zealand Mergers and Acquisitions

Trends and insights

March 2017

New Zealand Deal Team of the Year – 2016 & 2015 Australasian Law Awards

National Law Firm of the Year, New Zealand – 2016 IFLR Asia Awards

Large Law Firm of the Year – 2016 New Zealand Law Awards

Contents

In this publication we look back at New Zealand's mergers and acquisitions activity in 2016 and identify likely trends for the year ahead.

Optimism amid uncertainty?

With Brexit and Trump, and further disruptions on the horizon, the world has entered an unexpected period of geopolitical and economic volatility. Trump's election left the Trans Pacific Partnership dead in the water – demonstrating that New Zealand, with its export-led economy, will not be immune from the effects of these developments on the M&A front.

With 2017 well underway;

- M&A volumes appear to be holding up, both internationally and in New Zealand.
- Domestically, several large transactions completed or kicked off late last year, including the sale of Sistema Plastics to Newell Brands.
- Deal momentum is continuing this year, with ANZ's sale of UDC Finance to HNA Group for $660m, Spark's $22.7m takeover offer for TeamTalk, Tenon Clearwood LP's purchase of Tenon's New Zealand-based Clearwood operations, and the $197m acquisition of Tower by Fairfax Financial, now being contested by Suncorp.

2017 – expected trends at a glance

- A gap between the number of cashed-up investors and the availability of good quality New Zealand assets will see a sellers' market in 2017, resulting in strong price expectations, but without a return to the irrational exuberance of 2007.
- Robust private equity (*PE*) interest driven by cashed up PE firms on both sides of the Tasman.
- An improved Overseas Investment Act consent process will result in less competitive advantage for domestic buyers in contested transactions as shorter timeframes reduce the regulatory hurdle of gaining Overseas Investment Office (*OIO*) consent.
- Iwi will be more active dealmakers as they look to diversify their investments.
- A slow-down in activity as the New Zealand general election, scheduled for 23 September, nears, with a potential burst of post-election activity to follow.

Expected trends continued

- Trade sales will be the preferred exit route in a cooler IPO market.
- Schemes being preferred to conventional takeovers in negotiated acquisitions of listed companies.
- Price expectations leading to an increase in true mergers, rather than buyouts.
- Technological disruption will provide challenges for the Commerce Commission.
- Continued and growing interest in New Zealand from Chinese investors, with further diversification in target assets.
- A desire for price certainty will lead to increasing use of "locked box" purchase price mechanisms, instead of traditional completion accounts.
- Debt pricing will continue on an upward curve, with banks being increasingly selective in where they place debt to maximise profitability and capital efficiency.

Key sectors to watch

- **Aged care** – our ageing population and strong property market will continue to make this a popular sector
- **Construction** – demand for both commercial and residential property exceeds supply, making construction an obvious growth sector
- **Financial institutions** – the need for higher return on capital will lead to a shedding of non-core assets
- **Food and beverages** – with increased demand for "added value" assets (such as wine and craft beer), rather than just primary produce
- **Media and Telecoms** – technological disruption will continue to drive activity in this sector
- **Natural health and nutraceuticals** – deal-led consolidation driven by offshore capital

2016 – a dip from high volumes

2016 was another big year for New Zealand M&A, though not quite on par with the record highs reached in 2015.

Global M&A activity in 2016 by deal value fell in comparison to 2015 (US$ 3.2tn versus US$4.0tn) but was nonetheless at its third highest level since 2007. Activity in the Asia-Pacific region reflected this, with a 25.5% decline in deal value year on year.

Overall, the New Zealand market was consistent with the global picture. Disregarding demergers (such as TrustPower and APN/NZME) and the unsuccessful Sky Television/Vodafone transaction, announced deals by value decreased by approximately 17% from 2015 levels.

Activity in New Zealand was concentrated in the second half of the year, after a sluggish start. By contrast to 2015, a year dominated by private, cross-border transactions, 2016 saw a significant swing towards domestic deals, often involving listed counterparties.

> “Announced deals by value decreased by approximately 17% from 2015 levels.”

2016 New Zealand highlights

High activity in the consumer and manufacturing sectors

- Allnex acquired Nuplex for approximately $1b
- The founder of Sistema Plastics exited for $660m
- BrewGroup was sold by Pencarrow Private Equity to Jacobs Douwe Egberts for more than $100m
- Waterman Capital invested in food bag provider My Food Bag
- Higgins Group Holdings was sold to Fletcher Building for $315m

Changes to the financial services landscape

- NZ Post sold 47% of Kiwibank to the New Zealand Superannuation Fund and ACC for $494m
- Blackstone invested $200m in life insurer Partners Life
- Turners acquired the Autosure insurance business from Australian insurer Suncorp

Transactions turning on Commerce Commission approval

- Z Energy acquired Chevron's New Zealand downstream assets
- Sky TV announced a proposed merger with Vodafone, which subsequently failed to receive Commerce Commission approval
- NZME pursued a merger with Fairfax New Zealand, following NZME's demerger from APN News & Media

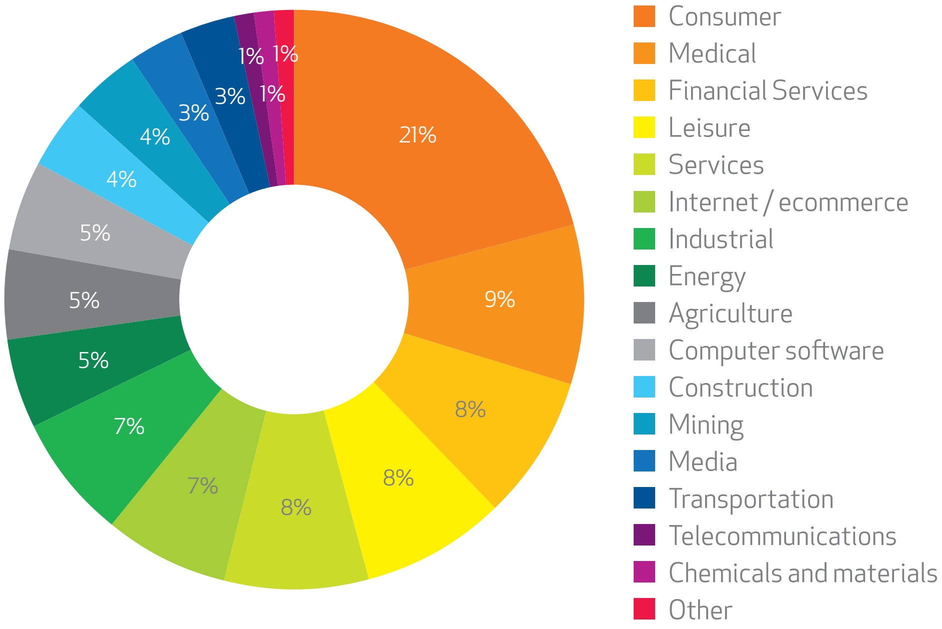
Increased inbound investment from China

- Shanghai Maling Aquarius' $261m acquisition of a half stake in Silver Fern Farms, New Zealand's largest meat processor
- The Chinese owners of New Zealand's largest waste management and disposal business, Waste Management, increased their holding by 20%, in a deal listed as being worth US$234m.

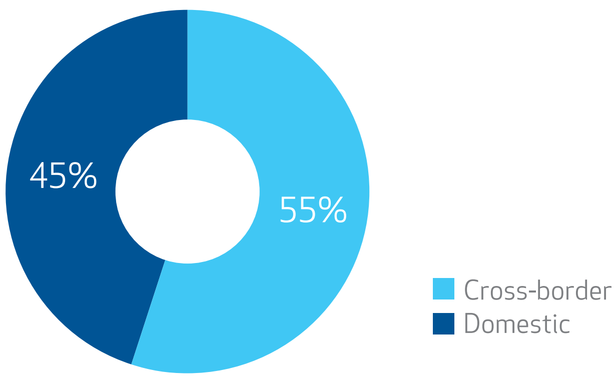
For more information about China M&A activity, refer to our supplementary *M&A trends and insights – China/New Zealand* publication.

Top 40 New Zealand deals in 2016

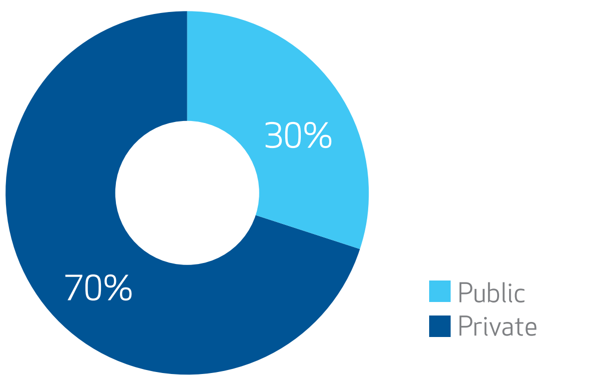
By sector



Domestic vs cross-border by volume



Public vs private by volume



> 2016 saw a significant swing towards domestic deals, often involving listed counterparties.

Source: Mergermarket

M&A deal terms

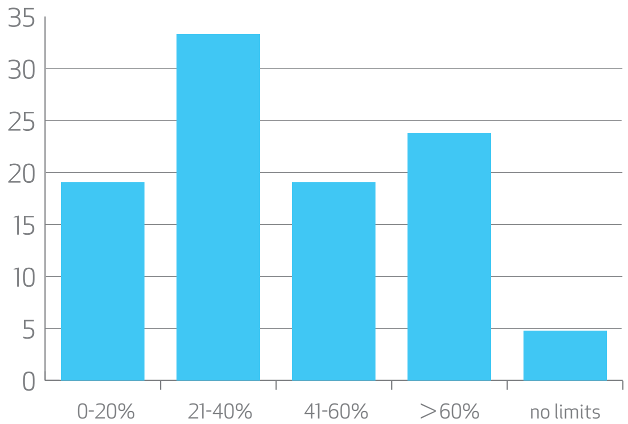
M&A deal terms continued to consolidate around "market" positions in 2016, a process we see continuing in 2017, together with a rise in the use of "locked box" purchase price mechanisms.

Warranty thresholds – limits, minimum claims and baskets

In the deals Chapman Tripp acted on in 2016:

- the minimum individual claim threshold (de minimis) averaged around 0.17% and ranged from 0.01% to 0.45% of the total purchase price
- the minimum aggregate claim threshold (basket) averaged approximately 1.24% and ranged from 0.08% to 2.9% of the total purchase price, and
- excluding title and tax, the maximum aggregate claim limit typically fell within the 20% - 60% bracket (with fewer than a quarter of deals above 60%), with the percentage typically falling in line with increases in deal value.

Warranty liability caps (as a % of total purchase price)



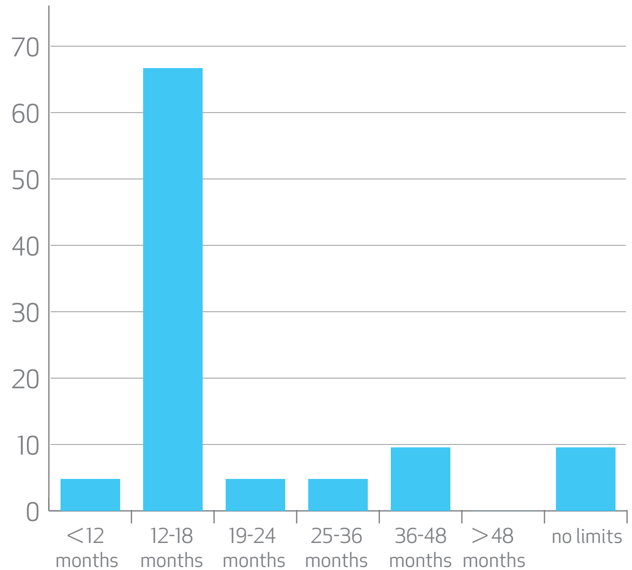
Non-title warranty limits

Warranty claim time limits

Warranty claim time limits (excluding tax) were generally consistent with previous years, ranging from six to 36 months from settlement (12 months was the most common position, followed by 18 months).

Time limits for claims under tax indemnities tended to line up with tax limitation periods, so were typically six to seven years, with a few fact-specific exceptions.

Warranty claim time limits



Purchase price adjustments – rise of the locked box

New Zealand lagged in the adoption of locked box mechanisms as an alternative to the traditional "completion accounts" approach to determining final purchase price. However, in recent years locked boxes have become more commonly used, as they become better understood in the market and their benefits (for certain transactions) are recognised. We expect this trend to continue.

Completion accounts adjustment vs locked box price mechanisms

Completion accounts adjustment	*Locked box*
Economic risk and benefit transfer to buyer at completion	Economic risk and benefit transfer to buyer at locked box accounts date
Final purchase price not known at signing	Final purchase price known at signing, providing certainty to parties
Post completion purchase price adjustment for difference in target's actual net working capital or net assets at completion against agreed expected figure	No purchase price adjustment, except for "leakage" (e.g. distributions to shareholders prior to completion)
Completion accounts need to be prepared and agreed (or determined by a third party, if disputed), with associated cost and timing implications	Avoids cost and delay involved in preparation and agreement or determination of completion accounts
Credit risk for payment of adjustment amount by buyer or seller (as applicable)	No credit risk (assuming no leakage)

What are completion adjustments?

In most M&A transactions there is a gap in time between signing and closing. Put simply, so that neither the buyer nor seller is disadvantaged by any upward or downward movement in the position of the target between signing and completion, parties will often agree a target value of a relevant metric (typically net working capital) as at closing.

"Completion accounts" will then be prepared post-closing to confirm what the actual position was at closing. Any difference between the estimated and actual positions will then be payable by the buyer or the seller to the other party, as applicable, by way of an increase to, or partial refund of, the purchase price.

Deposits

Rarely a feature of M&A transactions, but we saw a few last year, primarily where the purchaser was a Chinese entity and there was perceived regulatory risk.

Retention amounts

In half the deals we acted on last year, a portion of the purchase price was held in escrow for a period to cover warranty claims or purchase price adjustments. Retentions tended to be used where the seller was expecting to distribute sale proceeds immediately upon settlement.

Material adverse change conditions

Clauses permitting the buyer to exit a deal upon the occurrence of a material adverse change (*MAC*) in respect of the target were a feature of just over half of the M&A transactions we worked on in 2016. Understandably, these tended to be heavily negotiated, with sellers pushing back hard against "kitchen sink" MAC clauses in favour of clearly defined financial and other metrics.

Warranty & Indemnity (*W&I*) insurance

W&I insurance remained a frequent feature of deals last year, particularly in private equity exits but also in deals involving trade participants. Underwriters continued to focus on whether warranty packages were reasonable and "arm's length" and on the robustness of the parties' due diligence.

Coverage for certain warranties (particularly in relation to tax, environmental, regulatory and product liability matters) was occasionally difficult or impossible to obtain, forcing buyers and sellers to agree which party would bear the risk where there was a gap in coverage – and somewhat undermining one of the primary benefits of W&I insurance (a "clean exit" for the seller).

Sellers would be well advised to consider the possibility of being stuck with uninsurable warranties up front, as the issue may only come to light when deep into a sale process.

> "Clauses permitting the buyer to exit a deal upon the occurence of a material adverse change were a feature of over half the transactions we worked on."

A private equity powder keg

Worldwide, it is estimated that private equity firms have more than US$800b in "dry powder", the highest amount since 2008.

Private equity firms in New Zealand, Australia and worldwide are sitting on massive pools of committed capital following a big fundraising year in 2016. This could lead to a significant uptick in investment activity this year.

Fundraising activity at record levels

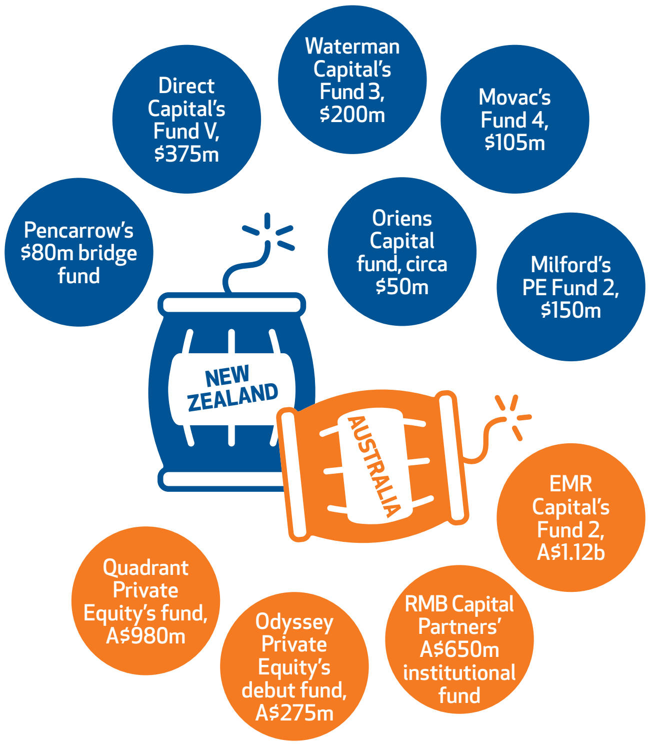
New Zealand marked its largest fundraising year since 2005, with more than $1b in new capital committed. The story was similar in Australia. Total capital raised by Australian private equity and venture capital funds in 2016 was approximately A$2.74b, the third highest level of fundraising in these sectors since 2008. Some 17 PE and VC funds secured new investor commitments.

Demand for high quality assets exceeds supply

PE firms will necessarily feel pressure from their investors to deploy all this cash. However, it has been observed (particularly in Australia) that there is an imbalance between the supply of capital and the number of high quality assets in the market. The same is likely to be true in New Zealand.

Together with the ready availability of debt finance, a weaker New Zealand dollar and continued high levels of interest from Chinese investors, this abundance of PE cash could lead to a "sellers' market", increased investment activity by domestic and offshore PE firms in New Zealand and historically high prices (on an earnings multiple basis).

Many of the Australian PE firms' investment mandates include New Zealand, and competition for quality investment opportunities in Australia may see these firms increasingly looking this side of the Tasman. Pacific Equity Partners, for example, has already demonstrated a renewed appetite for New Zealand assets, having recently acquired Manuka Health and Academic Colleges Group, and CHAMP Private Equity acquired the Bluebridge ferry business in December.



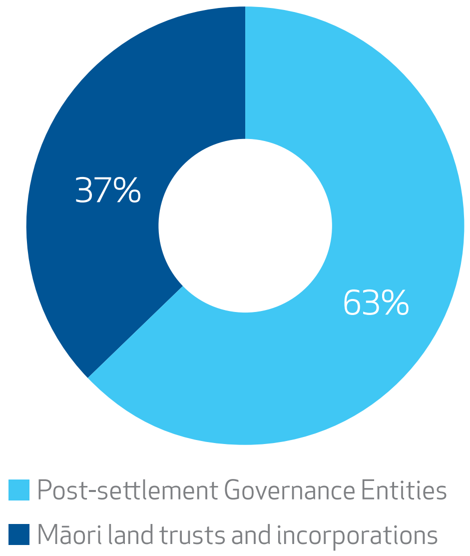
> "New Zealand marked its largest fundraising year since 2005, with more than $1b in new capital committed."

The Māori economy

The size of the Māori economy has been estimated at $43b, with 30% held by Māori collectives (including post-settlement governance entities, Māori land trusts and incorporations).

Te Puni Kokiri (the Ministry of Māori Development) estimates Māori collectives hold more than $12b of assets. These assets are largely concentrated in property and primary industries located in their rohe (tribal region). As Māori collectives mature, they are becoming increasingly active in the domestic M&A market as they seek to diversify their investment portfolios.

The make-up of $12b collective assets



The diversification is being led by Ngāi Tahu and Waikato-Tainui, both of which settled with the Crown in the 90s and have had 20 years to move from settling their Treaty claims to investing for the future, to bed in investment and distribution frameworks and to build the confidence and momentum to diversify out of property, out of primary industry and also into other regions around New Zealand.

Examples of recent M&A and investment activity include:

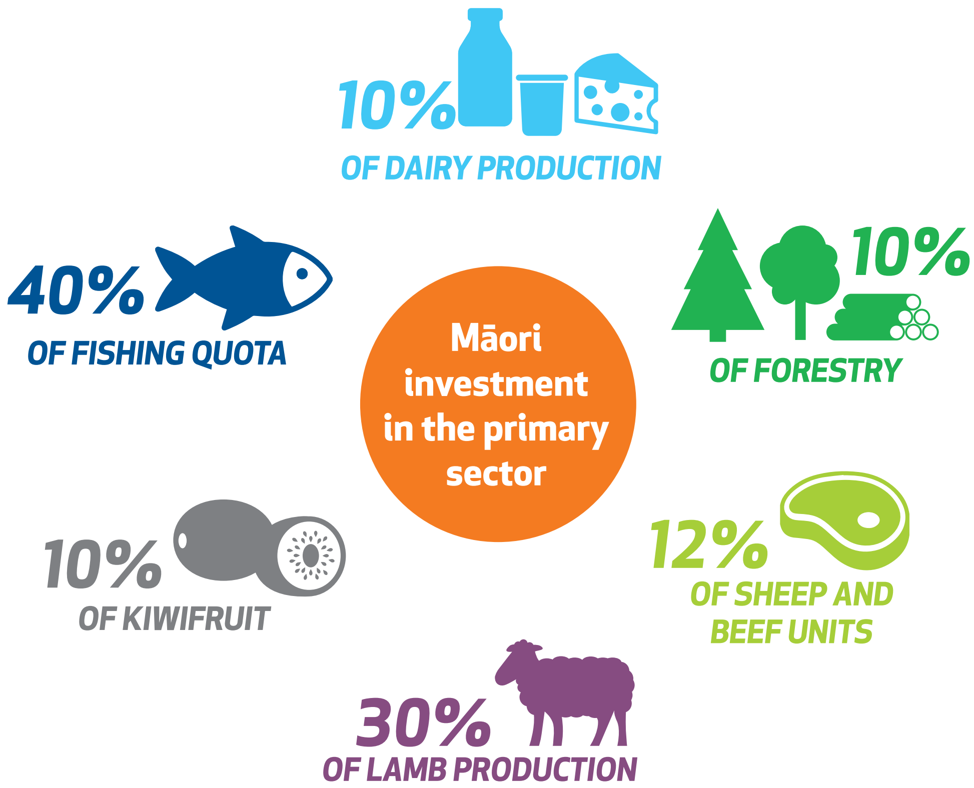
- Ngāi Tahu Holdings investing in the recent Movac capital raising and acquiring 50% of mānuka honey producers Watson & Son, and
- Tainui Group Holdings selling 50% of Te Awa (The Base) to Kiwi Property for $192.5m, with proceeds being used to reduce debt and ultimately re-invest in a balanced range of investment classes.

Iwi such as Ngāti Porou, Ngāti Whātua Ōrākei and Tūhoe have only settled in the last five years but we expect them also to pursue diversification policies once they have the necessary experience and structures in place.

Other trends in the Māori economy that will continue to grow and gather momentum include:

- Māori working in joint ventures with or co-investing alongside non-Māori entities that bring speciality investment skills, expertise and/or capital to a transaction
- Māori working together to create critical mass and spread the risk (as Ngāi Tahu and Waikato-Tainui have done on a number of transactions to date), and
- a move from passive asset management (through investments in funds) to active asset management (through direct investment).

While the Crown has made good progress in recent years negotiating and settling Treaty claims, there are still 44 iwi that have not settled, including Ngāpuhi, which is the largest iwi in NZ (by population) and is set to receive a sizeable redress package.



Selected iwi settlement amounts 2014-2016

Name	Year of deed of settlement	Financial and commercial redress amount
Ngāti Tūwharetoa	2016	$25m
Ngāti Tamaoho	2016	$10.3m
Ahuriri Hapū	2016	$19.5m
Rangitāne o Wairarapa and Rangitāne Tamaki nui-ā-Rua	2016	$32.5m
Rangitāne o Manawatū	2015	$13.5m
Ngāi Tai ki Tāmaki	2015	$12.7m
Ngāti Kahungunu ki Heretaunga Tamatea	2015	$100m
Taranaki iwi	2015	$70m
Whanganui River	2014	$80m
Te Ātiawa (Taranaki)	2014	$87m
Ngāruahine	2014	$67.5m
Raukawa	2014	$50m

> "As the wealth of Māori collectives continues to accumulate and diversify, they will play an increasingly important role in the domestic M&A market."

Central and local government – quiet innovation

We expect government M&A activity this year to be modest, in part because of the general election on 23 September 2017.

Public sector divestments in 2016 were limited to the partial sell-down of Kiwibank by NZ Post, the sale of most of the remaining assets of bankrupt state-owned coal miner Solid Energy, and a continuation of the Government's social housing reform programme.

The Kiwibank transaction

The sale by NZ Post of 47% of the shares in Kiwi Group Holdings Limited (the owner of the Kiwibank group of financial services companies) to the New Zealand Super Fund and the Accident Compensation Corporation (*ACC*) for $494m will ease pressure on NZ Post's balance sheet and allow NZ Post to focus on its parcels, logistics and mail business. Established in 2001, Kiwibank is New Zealand's fifth largest (and only major non-Australian owned) bank. This sale allowed NZ Post and the Government to recoup some of the capital invested in Kiwibank without recourse to private ownership, as the New Zealand Super Fund and ACC are both also owned by the Crown.

A new approach to managing Crown assets?

The influential ex-Labour Finance Minister, Sir Michael Cullen, has advocated that other government-owned commercial enterprises should be owned by the New Zealand Super Fund. This could include the Crown's remaining shares in the large power generators and national flag carrier, Air New Zealand, as well as state-owned media and communications entities (Television New Zealand and Kordia) and farming company, Landcorp.

This restructuring of Crown-owned assets could serve multiple objectives, releasing cash from funds managed by the New Zealand Super Fund and ACC to the Crown, allowing those entities to reorient their portfolios towards New Zealand assets, and freeing the government to focus on the direct management of non-commercial or mixed-objective Crown assets.

> "The restructuring of Crown-owned assets could free the Government to focus on the direct management of non-commercial and mixed-objective Crown assets."

Room for further innovation?

The Australian government is currently exploring the privatisation of the ASIC database and the UK Government was until recently investigating a sale of the Land Registry, although in each case those plans have been criticised as potentially creating powerful private sector monopolies and impairing the Government's ability to manage important regulatory functions.

However, we would be surprised if the New Zealand Government were not watching these sale processes with interest. The New Zealand equivalents – the Companies Office and Land Information New Zealand – are potential candidates for different approaches to management if public concerns around private sector involvement can be addressed. Ultimately, if public ownership can be maintained, it is possible that alternative approaches to management of these assets might be explored, with the benign political reaction to the Kiwibank transaction an example of an alternative model that has been well received.

Local authorities – continued need to refresh the portfolio but no sign of asset sales yet

Although New Zealand's overall fiscal position remains sound, the continuing need to respond to an ongoing series of large earthquakes and the desire to run a series of surpluses mean the Government is unlikely to be able to meet all of the demands for infrastructure commitments in Auckland, Wellington, Christchurch and other major centres. With New Zealand's population continuing to surge due to record immigration levels and local authority balance sheets in many cases strained due to high debt levels, we predict continued questions about the long term ownership of many local assets – but no announced sales.

Local authorities remain heavily involved in the ownership of airports, ports and lines companies – as well as myriad other, non-core, assets – but public sentiment is marginally opposed to sales of "community assets". This will continue to puzzle and frustrate private sector investors, given the need for local authorities to release capital for other projects and the relative performance of assets where private ownership has been introduced (such as the Port of Tauranga and Auckland and Wellington airports). We think there is a need, and certainly there is room, for local authorities to explore alternatives to full privatisation, similar to the mixed-ownership model programme rolled out by central government. The likelihood of that occurring seems low for now.

> "There is room for local authorities to explore alternatives to full privatisation, similar to the mixed-ownership model programme rolled out by central government."

New Zealand has

Source: LGNZ

11 REGIONAL COUNCILS

12 CITY COUNCILS

54 DISTRICT COUNCILS

1 AUCKLAND COUNCIL

That together contribute 3.6% ($8.7b) of NZ's total GDP

Competition/antitrust – the ComCom flexes its muscles

Rapidly-changing technologies and concentrated markets mean New Zealand merger clearances are more complex, and slower, than ever before.

> Pressure is on applicants to produce clear and compelling evidence to support their disruption story in order to minimise delays and mitigate the risk of their applications being declined.

Big deals and big decisions

The Commerce Commission has recently had to deal with three of the most complex and high-profile deals of recent times; applicants are currently one up and one down, with the third hanging in the balance.

- **Z/Chevron** – By far the most complex clearance decision of 2016, involving numerous markets, the Commission's investigation took 196 working days to complete (the longest investigation to result in a successful clearance) and was cleared subject to retail and truck stop divestments. One Commissioner wrote a lengthy dissent – she would have blocked the deal, but was outvoted 3:1.
- **Sky/Vodafone** – On 23 February, the Commission declined to grant clearance for the $3.4b merger which would have created a leading New Zealand telecommunications and media group. The Commission was primarily concerned with the ability of the merged entity to leverage Sky's premium content to the detriment of Vodafone's broadband and mobile competitors. This theory is controversial to the extent it cuts across the growing trend where Sky subscribers are switching away in significant numbers.
- **NZME/Fairfax** – A proposed media merger which would combine New Zealand's two largest newspaper and online news networks. The Commission's draft determination to decline authorisation rested heavily on its public interest concerns around media concentration and loss of plurality. A final determination is due in March.

Disruption vs competition

Increasingly, the Commission is being asked to make decisions in markets where there is the threat, or presence, of technological disruption. This can involve businesses attempting to re-position either by consolidating to achieve scale (e.g. NZME/Fairfax, or Cavalier's acquisition of NZWSI in the face of the alleged risk of the imminent collapse of the wool scouring industry); or by converging to find synergies throughout the value chain (e.g. Sky/Vodafone).

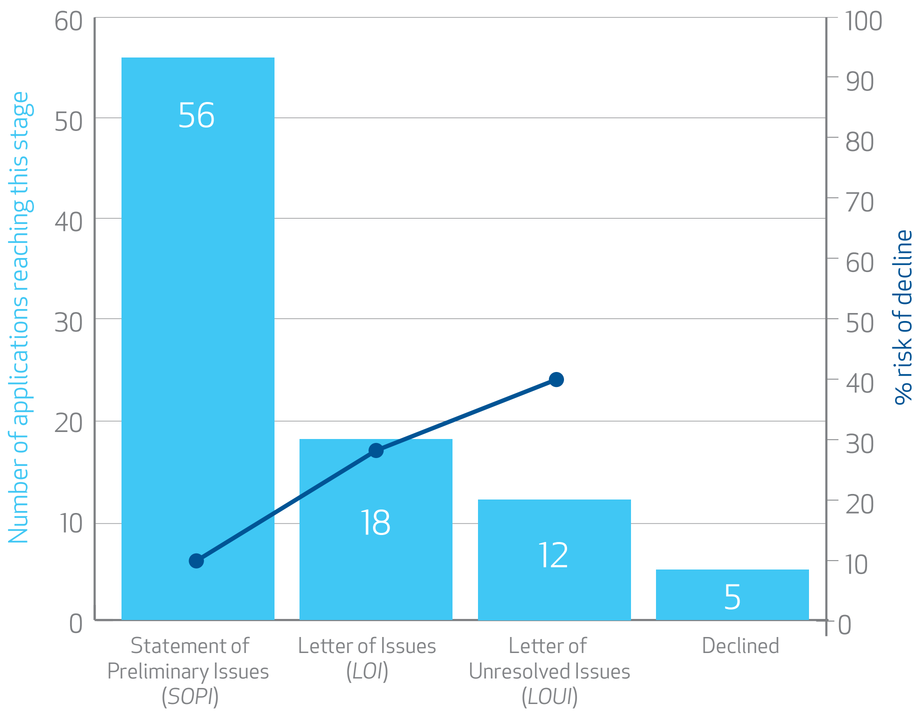
These types of transaction are daunting for the Commission, requiring it to make much more complex predictions than in traditional merger analyses. This has resulted in lengthy regulatory processes that have put significant strain on commercial deals. As illustrated by Sky/Vodafone, the Commission requires a high degree of confidence in the picture of the future painted by applicants in order to be satisfied and grant clearance. They can spook at the mere "real chance" of a problem. This places even more onus on applicants to ensure their disruption stories are backed up by clear and tangible evidence. It also requires a carefully considered strategy for Commission engagement to maximise chances of success.

NZ Commerce Commission: merger clearances 2011-2016

2016 saw the first Commission release of stage-by-stage statistics on its merger clearance rates. The Commission adopts a phased approach under which it quickly assesses "straightforward" applications, relying primarily on the application information; in more complex transactions the Commission will send a Letter of Issues setting out its (potential) competition concerns and requesting further information from the parties. In rare cases, the Commission will then list any unresolved issues and request still more information from the applicants.

As the Commission's data shows (chart opposite), both merger clearance timeframes – and the risk of decline – materially increase once a Letter of Issues is on the table. Again, these data highlight the need for applicants to deliver a clear and compelling application to minimise the risk of delays or a decline.

Applications by stage vs % risk of decline



Overseas investment regime – some promising developments

Increased resourcing of the Overseas Investment Office (*OIO*) and the office's willingness to work with market participants to mitigate some of the issues with the regime should lead to better processing timeframes in 2017 and beyond.

Update on OIO consent timeframes

OIO statistics show applications are taking an average of 97 days to be processed from the date they are accepted (of which active OIO engagement is taking 42 days). This is a significant decrease on previous years, but there is still room for improvement.

In particular, the OIO is screening consent applications to confirm whether it will take them further. This has allowed any process or documentation deficiencies to be ironed out early, resulting in a quicker turnaround once the application is under active consideration by the OIO.

Average timeframes observed by Chapman Tripp for processing consent applications:

90 working days

"significant business assets" *only applications*

105 working days

applications including ***"sensitive land"***

110 working days

applications including ***"special land"***

Getting your application right

Applicants must take utmost care when preparing their consent applications, as the OIO will not place an application in its processing queue until it has accepted it as complete and fully compliant.

We make the following suggestions to applicants:

- *Keep your application as specific, clear and concise as possible – vague applications are routinely knocked back.*
- *For "sensitive land" applications, cover a smaller number of core key benefits to New Zealand in detail, rather than looking to tick off all the categories.*
- *Do not assume that the OIO will accept a "status quo" counterfactual; applicants must overcome a strong but rebuttable presumption that the assets will be acquired by a competent and adequately funded New Zealand purchaser.*
- *Be aware that any proposed expenditure detailed in your application may become a consent condition, which the OIO will rigorously monitor and enforce.*

Incremental refinements

The OIO is pursuing a number of initiatives to make the consent process more transparent, efficient and timely. These include:

- offering pre-application meetings with applicants so that the OIO can get an understanding of the applicant and the assets to be acquired
- releasing new standardised application templates
- working with Treasury to implement targeted exemptions to certain requirements under the Overseas Investment Act 2005 – including the following exemptions, which have already come into force and exempt:
  - custodians who are overseas persons but who hold investments on behalf of New Zealand investors from the requirement for consent for those investments only
  - the granting of leases which are substantially mere renewals of existing leases on the same terms
  - certain transfers of small parcels of urban land between overseas persons, where the transferor has already obtained OIO consent in respect of the acquisition of that land
  - acquisitions of leasehold farm land (where the cumulative duration of the lease is for a term of not more than 20 years) from the requirement to first advertise land on the open market, and
- consulting with stakeholders in relation to further potential targeted exemptions, which are currently under consideration.

> "The Government will be reluctant to risk bad publicity in the run up to the election, so potentiallycontroversial applications will be scrutinised closely."

A note of caution – the general election is coming

With Prime Minister Bill English having recently carried out a Cabinet reshuffle and the general election scheduled to take place on 23 September 2017, applicants for OIO consent should note:

- Mark Mitchell replaced Louise Upson as Minister for Land Information in December which, based on past experience, will likely result in a period where applications that require Ministerial approval will take longer to be reviewed and approved (and the same issue will obviously arise if there is a change of Government following the election), and
- the Government will likely be reluctant to risk bad publicity in the run up to the election, so any applications that are potentially controversial (by virtue of the nature of the applicant or the asset being acquired) will be scrutinised particularly closely – resulting in delay and a higher likelihood that consent might not be granted.

Applicants should file their consent applications as far out from the general election date as possible.

Schemes here to stay

Schemes can be used to structure takeovers, provided the directors of the target are in support, and for mergers and other complex transactions requiring precision in timing and features not readily achievable under a takeover, such as a partial return of capital.

	Scheme of arrangement	Code takeover
Role of target	A negotiated transaction. The active involvement and consent of the target's board is essential. Cannot be hostile.	Not a negotiated transaction. The target's shareholders are the counterparty. Can be hostile.
Compulsory acquisition/ take private	Can be achieved with the support of 75% of the votes in each interest class and a simple majority of all votes entitled to vote.	Requires an offer to hold or control 90% of the voting rights in the target.
Flexibility	Can be coupled with other transactions, such as capital raisings, on an all or nothing basis.	A stand-alone process.

Schemes in 2016

One of the largest transactions in the New Zealand market last year, the takeover of Nuplex, was conducted without controversy through a scheme of arrangement, indicating that schemes have now become an accepted part of the public M&A landscape.

Recent and current Schemes include:

Tower
– competing proposals from Fairfax and Suncorp – ongoing

Radius
– for a full takeover by existing controlling shareholder Montagu – ongoing

Trustpower
– to give effect to a demerger into "Tilt Renewables"and "New Trustpower" – successful

Michael Hill International
– to give effect to a re-domicile from New Zealand to Australia – successful

Nuplex
– for a full takeover by Allnex – successful

Why pursue a scheme?

From a bidder's perspective the key advantages of a scheme include:

- an all-or-nothing transaction, which will either proceed in full or fail, and
- a lower threshold to achieve success, although the need to obtain the affirmative votes of a majority of the target's voting shares (regardless of the number of shares actually voted) may make gaining approval difficult in certain situations.

From a target's perspective a scheme puts the target's board in the centre of the action, as a scheme is a negotiated transaction requiring target co-operation. A target's board may be able to use this position to leverage better deal terms that would be achievable through a traditional takeover offer.

> "The Takeovers Panel recently reaffirmed its view that a scheme is "a legitimate and valuable means for undertaking corporate transactions"."

New guidance clarifies rules applicable to schemes

The Takeovers Panel recently reaffirmed its view that a scheme is "a legitimate and valuable means for undertaking corporate transactions" which "provides economically sensible commercial flexibility".

The Panel also made clear that entry by shareholders into a voting agreement with the promoter will not automatically result in those shareholders being deemed associates of the promoter or placed into a separate interest class for voting purposes. This is a critical consideration in terms of whether a scheme will receive the necessary shareholder support and whether the shareholder can acquire more shares.

The clarification is consistent with the Panel's evolving position that lock-up agreements will not necessarily result in association and, in the case of interest classes, with the wording of Schedule 10 of the Companies Act which states that:

> *the issue is similarity and dissimilarity of shareholders' legal rights against the company (not similarity or dissimilarity of any interest not derived from legal rights against the company)...*

Timing the vote

Parties to a scheme should pay special attention to the timing of the shareholder vote(s), particularly in cases where the transaction requires regulatory approval from the Overseas Investment Office or the Commerce Commission.

Regulatory hurdles can drag out the completion of a transaction until many months after the shareholder vote has been taken, as happened in the Sky/Vodafone and Shanghai Maling/Silver Fern Farms transactions.

Should significant divestments be required after the vote to secure the necessary regulatory approvals, issues might arise as to whether the shareholders have validly approved the deal given the change in circumstances.

NZME and Fairfax have prudently delayed their merger vote, until after completion of the Commerce Commission authorisation process.

The year in takeovers

Contested takeover activity back on the radar

The Hellaby and Abano bids faced active target opposition – an uncommon feature in the New Zealand market.

Hellaby's board ultimately recommended that shareholders accept Bapcor's offer, following an increase in the offer price and after more than half of its shareholders chose to accept it. By contrast, Abano's board continues to resist Healthcare's bid on a number of fronts, including:

- repeatedly urging shareholders to reject the bid
- withholding payment of an interim dividend to Healthcare on a tenuous legal basis (purporting to set it off against unpaid invoices for costs incurred by Abano in relation to the bid), and
- making technical complaints to the Takeover Panel and refusing to consent to minor changes to takeover notices.

Whether this recent increase in hostile takeover activity and the increasingly activist nature of target boards are part of a broader trend remains to be seen, but signs so far are that it may continue.

Recent and current Takeovers include:

TeamTalk

Spark's hostile unsolicited bid for TeamTalk – just started

Abano

Healthcare Partners' hostile unsolicited bid for Abano – stalemate

Blue Sky Meats

NZ Binxi Foods' offer for Blue Sky Meats – likely to be successful

Airwork

Zhejiang RIFA's 75% partial offer for Airwork Holdings – likely to be successful

Hellaby Holdings

Bapcor's hostile unsolicited bid for Hellaby Holdings – successful

Wellington Merchants

Mercantile Investment Co's (Sir Ron Brierly) second attempt to take over Wellington Merchants – successful

Chatham Rock Phosphate

Antipodes Gold full scrip for scrip takeover of Chatham Rock Phosphate – successful

Improving documentation

We have seen a move towards excessive advocacy over facts in takeover documentation, particularly in hostile transactions. This comes at the expense of giving shareholders the information they need to make their own, informed decisions.

A shareholder's task is only made harder by the length of these materials which, as the table opposite indicates, can be surprisingly weighty. Often repetitive and containing extraneous materials (such as court orders that could better be placed on the internet), much of this material is exhibiting the kinds of problems that led to the radical reform of securities disclosure documentation under the Financial Markets Conduct Act.

Shareholders, the Takeovers Panel and the Financial Markets authority are likely to expect clearer and more concise disclosure, akin to that seen in recent product disclosure statements. An example of a transaction that moves towards this standard is the recent Radius scheme, the documentation for which was noticeably shorter and more accessible compared to earlier schemes.

We also expect that Rule 64 of the Takeovers Code, which prohibits misleading and deceptive conduct in takeovers, will increasingly be used as a sword to combat bidder or target advocacy that crosses the line. This does not mean that bidders and targets cannot forcefully express their views. Rather, it means that in doing so participants must be careful to ensure that shareholders are not misled.

Page length of document (excluding blank pages)	"Additional information"	Contractual terms and prescribed disclosures	Experts' report	Court orders	Total
Healthcare Partners' offer	10	23	N/A	N/A	33
Abano's response	34	20	52 Grant Samuel	N/A	106
NZ Binxi (Oamaru) Foods' offer	1	17	N/A	N/A	18
Blue Sky Meats' response	2	6	50 Campbell MacPherson	N/A	58
Bapcor's offer	5	20	N/A	N/A	25
Hellaby's response	19	15	69 Grant Samuel 11 Northington Partners	N/A	114
RIFA's offer	3	21	N/A	N/A	24
Airwork's response	3	14	46 Grant Samuel	N/A	64
Montagu/Radius scheme	32	17	39 Simmons	20	108
Allnex/Nuplex scheme	43	70	50 Grant Samuel	27	190

Debt funding – a new cycle

With "lower for longer" rates now in the rear view mirror, the financing challenge has taken a new shape, bringing diversity and duration into increasing focus.

The impact of increased bank funding costs began to be felt in 2016, in margins and more recently in base rates as well. The corporate and acquisition funding market remains engaged, but is in a more selective phase with capital costs driving an increased focus on cross-sell opportunities and the overall profitability of the banking relationship as opposed to pure balance sheet growth.

With the end of a long monetary policy cycle, reinforced by the re-emergence of inflation, this trend is unlikely to reverse in the short term. Diversification of funding sources and locking in duration in an uncertain environment are an increasing focus for borrowers.

The overall domestic corporate loan market in 2016 was down 30% year-on-year, reflecting a shortage of blockbuster new money deals and a reversal of the lowering rate logic that drove "amend and extend". Meanwhile the domestic debt capital markets delivered healthy new issuance of $17.5b, a number widely expected to be topped this year. The emerging Asian debt capital market will continue to attract the attention of investment grade issuers.

The past year has also seen the Chinese bank subsidiaries in expansion mode, while acting as a connecting point between New Zealand and one of its most important export and FDI markets.

M&A and banking

M&A bankers report a strong pipeline with a greater level of confidence that deals will close. There is plenty of liquidity to respond to the burgeoning demand, but banks are becoming increasingly discerning in where it is utilised.

Lenders are also seeing an increasing tension among private equity and trade buyers, with resulting pressure on both acquisition price and the debt multiples being sought. However, with memories of the GFC still relatively fresh, there is a limit to the leverage that underwriters and banking syndicates will entertain, even on the basis of tighter covenant headroom. This "line of resistance", together with rising debt funding costs, has opened up opportunities for subordinated or mezzanine debt to complement the senior tranches.

> "Lenders are seeing an increasing tension among private equity and trade buyers, with resulting pressure on both acquisition price and the debt multiples being sought."

Sitting beside the trend of higher funding costs, there is greater variability of pricing among lenders, including broader disparities across the duration curve. Other emerging trends include:

- Underwriters are beginning to come back into the market.
- Amortisation is more important, as banks focus on leverage and capital efficiency.
- There is a trend toward larger syndicates, and particularly the inclusion of offshore banks which can assist borrowers in their global operations and don't necessarily have the same expectations about cross-sell.

Chapman Tripp's M&A team

Chapman Tripp's national M&A team partners with clients to successfully execute some of the biggest, most complex and challenging transactions in New Zealand.

Our team has advised on more M&A work than any other New Zealand firm, including many of New Zealand's most significant cross-border deals.

Clients value our long history of innovation, strong relationships with regulators and proven ability to get even the most challenging deals across the line. We maximise opportunity, identify and manage risk early on and work strategically with our clients to achieve the outcome they want.

We play a significant role in merger, acquisition and disposal transactions for international and New Zealand clients, large multinationals and leading private equity players across many industries. We regularly advise on the structure, strategy and implementation of takeovers, schemes, joint ventures and other complex transactions. Chapman Tripp's work for international clients has involved some of the most high profile OIO applications in recent times.

Ranked New Zealand's top law firm by M&A deal volume

Mergermarket 2016

"They are a cohesive unit and appear to discuss current issues and problem-solve to reach solutions – as a client you really feel like you are getting their best advice."

Band 1, Corporate and Commercial, Chambers Asia Pacific 2017

Chapman Tripp recent M&A highlights

In the past 12 months, we have advised:

- Tower and its directors in relation to the $197m negotiated full takeover being made by Fairfax Financial Holdings by scheme of arrangement, and the competing $219m offer made by Suncorp
- Canada Pension Plan Investment Board on its acquisition of 50% of the shares in Waiheke Inc., for $580m
- NZ Post on its sale of 47% of Kiwi Group Holdings to the New Zealand Superannuation Fund and the ACC for $494m
- Infratil on its acquisition of 48% of Canberra Data Centres from Quadrant Private Equity for $A392m
- Pencarrow Private Equity on the sale of Brewgroup to Jacobs Douwe Egberts
- NZME on its demerger from APN News & Media, and its proposed merger with Fairfax New Zealand
- Blue Sky Meats on its proposed sale, including its response to Binxi's $25.3m takeover offer
- Partners Life on The Blackstone Group's $200m investment
- Arvida Group on the acquisition of Landsdowne Park, Bethlehem Views, Copper Crest Village Estate, Lauriston Park and Cascades Retirement Resort retirement villages
- Todd Corporation on the sale of Ara vineyard to InDevin
- Waterman Capital on its investment in My Food Bag
- Direct Capital and Scales Corporation on the sale of Direct Capital's 15.3% stake in Scales to China Resources Ng Fung for $55.9m
- Airwork Holdings in response to the $211.4m partial takeover offer by Zhejiang Rifa to acquire 75% of Airwork
- The independent trustees of the Hugh Green Trust in connection with the lock-up agreement, and acceptance, for 27.1% by investment company Castle Investments of Bapcor's successful $351.8m full takeover offer for Hellaby Holdings
- Turners on its acquisition of Autosure for $34m
- Bartel Holdings on the sale of a 10.74% strategic stake in T&G Global for $38.8m to Golden Wing Mau Agricultural Produce Corporation
- Direct Capital IV Management and George H Investments on the sale of a 9.25% strategic stake in T&G Global for $33.4m to Golden Wing Mau Agricultural Produce Corporation
- Higgins Group Holdings on its sale to Fletcher Building for $315m
- Academic Colleges Group and its shareholders on the sale of ACG to Pacific Equity Partners

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