KPMG

Mergers & Acquisitions Predictor

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What is KPMG's M&A Predictor?

The Predictor is a forward-looking tool that helps our clients consider trends and expectations in merger and acquisition (M&A) activity. By tracking important analyst indicators up to 12 months forward, it examines the appetite and capacity for M&A deals. The rise or fall of forward price to earnings (P/E) ratios offers a guide to overall market confidence, while net debt to EBITDA (earnings before tax, depreciation and amortisation) ratios help gauge the capacity of NZ firms to fund future acquisitions.

The KPMG NZ M&A Predictor is produced every six months, and incorporates analyst data on all companies in the NZX50.*

KPMG International also releases a Global M&A Predictor twice a year which provides a similar analysis by sector and country across the globe, using 1,000 of the largest companies in the world by market capitalisation.* Within this publication we consider how trends in New Zealand mirror those being experienced globally. This can be accessed via kpmg.com.

*The financial services and property sectors are excluded from both the NZ and global analysis as net debt/EBITDA ratios in these sectors would distort the analysis. All the raw data used within the NZ and Global Predictors is sourced from S&P Capital IQ, supplemented by broker research. Where possible, earnings and EBITDA data has been sourced on a pre-exceptionals basis.

Local economic and M&A climate resilient despite global volatility

Welcome to this latest edition of KPMG's M&A Predictor.

While many key local economic indicators are relatively unchanged since our last M&A Predictor in March, there has been quite some change at a macro level, and interestingly some material changes in the key forward indicators covered included in this edition.

New Zealand's softening in market confidence is lower (down 3%) relative to Asia Pacific (down 7%) and globally (down 4%). Similarly, New Zealand has seen little change in capacity (measured by net debt to EBITDA). This compares to material changes across Asia Pacific (up 18%) and globally (up 12%) reflecting a conservative stance by offshore corporates in light of various global uncertainties.

We discuss the above movements further in this publication, as well as other topical matters (local IPO volatility, local valuation levels, economic indicators and M&A activity from China amongst other things), which all collectively shape New Zealand's M&A climate.

If you are a business owner and considering an exit, the KPMG Deal Advisory team are happy to discuss the merits of various exit paths, as well as how your business can best prepare for an exit event. More often than not, we see owners considering a transaction following an unsolicited approach – understanding your exit options generally, and being sale-ready is most important to be well prepared to capitalise on an attractive approach, or alternatively seek to exit at your preferred time.

Lastly, if you are considering inorganic growth opportunities, whether by acquisition, a merger, joint venture or strategic alliance – we'd be delighted to explore this further with you.

Regards,

Ian Thursfield	**Gary Ivory**	**Nick Mckay**
Head of Deal Advisory	Partner – Mergers & Acquisitions	Director – Mergers & Acquisitions

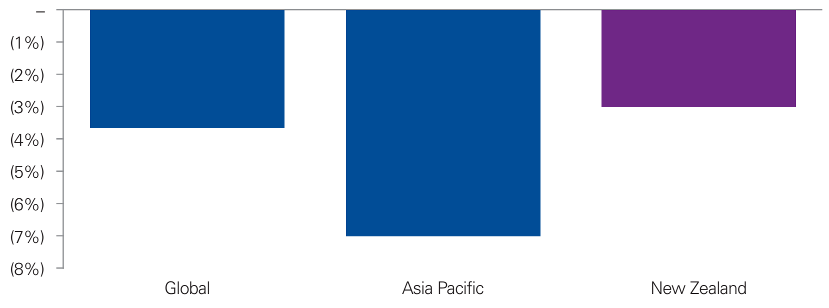
New Zealand	DOWN 3%	**Appetite: forward P/Es** (Market confidence) Since Dec 2015	UP 1%	**Capacity** (Net debt/EBITDA) By Jun 2017
Global	DOWN 4%	**Appetite: forward P/Es** (Market confidence) Since Dec 2015	UP 12%	**Capacity** (Net debt/EBITDA) By Jun 2017

Introduction

Major shifts in global indicators…

"Market confidence" (measured by the change in forward P/E multiples) globally is down c.4%, and across Asia Pacific down c.7%.

Change in appetite (market confidence) (since Dec-15)

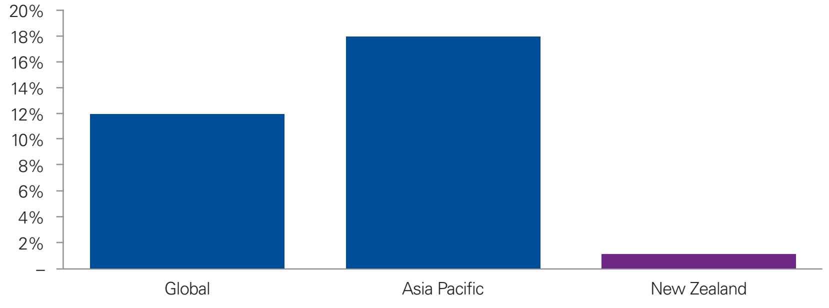


Globally, and not surprisingly, we've seen a significant increase in balance sheet strength as corporates take a fairly conservative stance in light of various global uncertainties such as:

- U.S. election outcome;
- Brexit (although equity markets rebounded fairly swiftly);
- timing of any rise in interest rates (following a period of aggressive quantitative easing as a means to stimulating growth); and
- sustained pressure on commodity and oil prices.

The change in "capacity" (measured by net debt / EBITDA) is up a significant c.12% globally, and c.19% across Asia Pacific.

Change / increase in capacity (by Jun-17)



Source: S&P Capital IQ excluding financial services and property sectors.

Current local climate

Despite recent pressures for dairy farmers (although we've seen four price increases out of the last five GDT auctions), New Zealand's economy has held up relatively well. Our economic growth of 3.5% (June 2016 quarter) places us 3rd in the OECD.

Consumer confidence continues to build and help support expectations of sustained GDP growth in the vicinity of 3-4% for the next few quarters. In fact, September's ANZ – Ray Morgan NZ consumer survey found growth in net optimism regarding both short-term and long-term economic prospects.

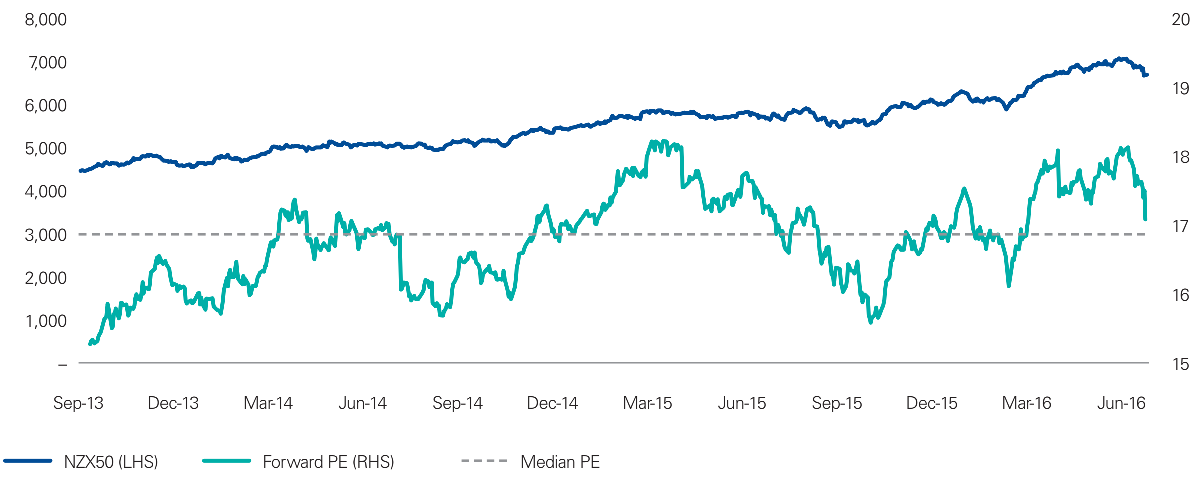
Retail spend statistics in New Zealand echo recent consumer confidence statistics. In fact, the June 2016 quarter had the highest growth in total sales volume and value compared with quarterly results over the past five years at 2.3%, with growth greatest in hardware, building supplies and garden supplies.

Our listed markets exhibit some interesting insights;

- Strong financial performance in sectors such as building materials and tourism; reflecting fundamentals such as population growth, strong net migration to New Zealand and of course a very strong residential and non-residential construction pipeline forecast for the next 10 years.
- Valuation levels remain strong with the forward NZX50 P/E multiple c.17x, reflecting:
  - A fairly positive reporting season:
  - Low interest rates (and therefore returns on fixed income investments); and
  - Robust economic growth in New Zealand.

While endlessly publicised, it's difficult to ignore household debt – approximately 2.5x the level 20 years ago (measured relative to disposable income) fuelled by the infamous Auckland house price – climbing to 10x the average income (approximately 2x the same ratio 20 years ago).

NZX50 trading performance (LHS) and forward PE ratio (RHS)



Source: Bloomberg.

M&A implications

New Zealand M&A activity strong despite deal completion rates slowing offshore

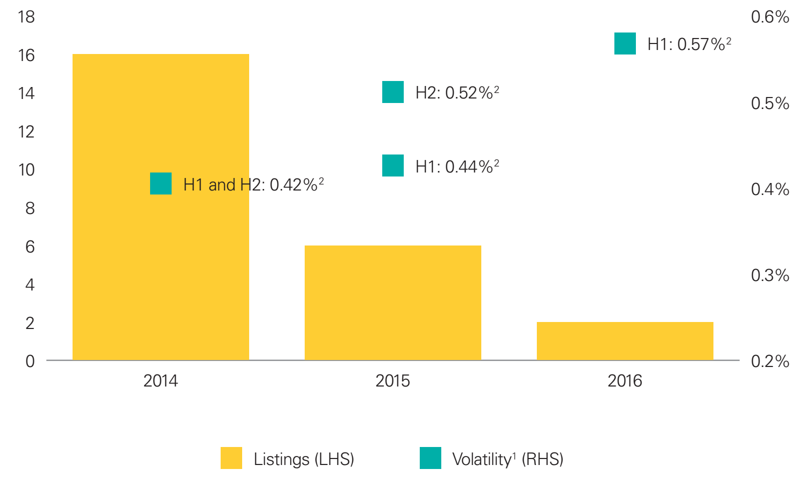
New Zealand

Reflecting global uncertainties (as previously mentioned), our listed markets have also seen sustained volatility.

In spite of strong valuations, the NZ IPO market has remained quiet given the sustained volatility.

In fact, only Tegel and Investor Property have listed so far this year – although we are aware of three prospective listings that could come to market this year or early 2017.

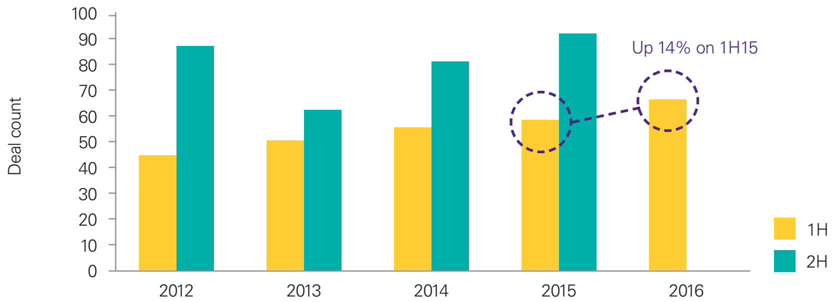
Volatility of NZX 50 returns and new listings 2014 – 2016 (YTD)



1 Volatility calculated based on standard deviation of daily returns of the NZX50
2 First half (H1) and Second half (H2) median standard deviations

In New Zealand, we have seen strong activity in 1H16 with completed and announced deals (by volume) up 14%.

New Zealand *completed* and *announced* deal count



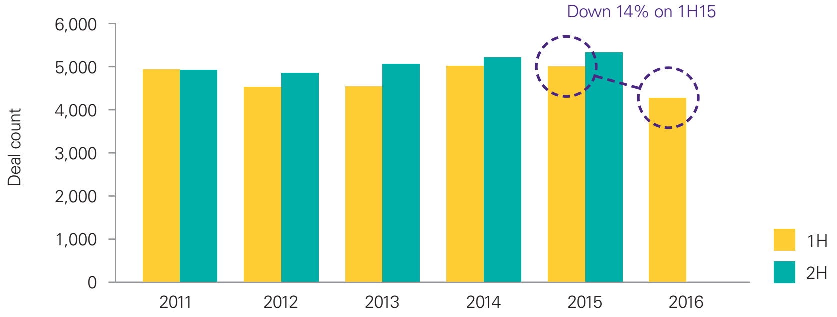
Source: Bloomberg.

Global

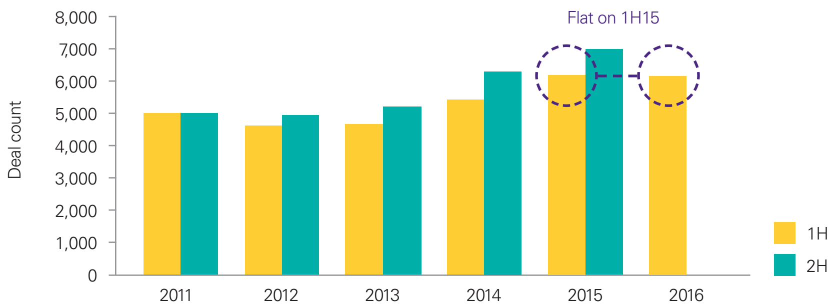
Globally, while completed and announced deals is flat for 1H16, what is interesting is the 14% decline in 1H16 if we look at just completed deals. This illustrates that many deals in 1H16 have been either parked or withdrawn.

The recent slow down in completion rates is well publicised and is a reflection of the previously mentioned global uncertainty and events that have played out during 1H16.

Global *completed* deal count



Global *announced* and *completed* deal count



Source: Bloomberg.

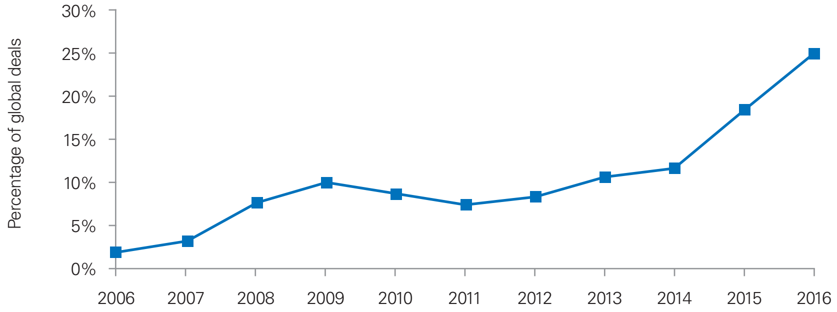
China M&A insights

Both private entities from China and SOEs have been heavily involved in outbound investment in recent years. The overall contribution that China is making in terms of global M&A volume is staggering – 10 years ago China represented c.2% of M&A volume (both domestic and outbound) and, according to Bloomberg, now c.24%.

Entities from China are very acquisitive and continue to explore New Zealand opportunities. While this has not yet represented a significant portion of deal volumes in New Zealand, this number could grow – China accounted for c.7% of deal volume in New Zealand over the past two years.

Once focused on energy and resources, China is now turning to meet the more diverse needs of its rising middle class. Investment from China is increasingly focusing on value-added targets which deliver new technologies, premium products and brands which can leverage an existing supply chain and route to market, as well as sustain competitive positions.

Portion of Global M&A deals where China is the acquirer (by value)



Source: Bloomberg.

Other points of interest

We are seeing emerging M&A interest in the Engineering & Construction space. This is a reflection of strong fundamentals, Australians looking for diversification opportunities, and possibly a result of potential change in retention regulation.

Over the past 18 months there has been significant activity in the Honey and Vitamins / Supplements / Neutraceuticals sectors (reflecting strong demand by China based investors). With several large transactions now being completed, activity in these sectors is a little cooler presently, reflecting a slim field of reasonably sized and actionable opportunities.

Two new private equity funds have recently been established (Milford and Oriens) and we understand a couple of existing New Zealand private equity funds are contemplating raising new funds over the coming 6-12 months.

Australia and the U.S. have been acquisitive in the local market – both doing c.50% more deals in New Zealand (relative to the prior year comparable period).

So does hiring an M&A advisor add value?

We recently came across an interesting academic paper (using empirical analysis) published by Agrawal, Cooper, Lian and Wang in May 2016, which analyses a sample of 3,281 transactions over the 1993-2010 period using five different methodologies (various regression analysis).

They find that private sellers receive higher acquisition premiums when they retain advisors, specifically between 6% and 25% (depending on which of the five primary methodologies is used).

Our Deal Advisory services include

Divestment Assistance

Are you focussed on maximising the sale value of your business?

We regularly act as lead adviser providing guidance on: deal timing, sourcing and contacting likely buyers, valuation, bid management and negotiating key terms. We also provide vendor due diligence, tax and sell side support services.

Infrastructure and Financing

Are you a public or private party needing advice on primary procurement?

This includes deal structuring, value for money, and structured finance solutions.

Acquisition Advice

Are you looking to secure a target asset?

We review whether the target fits your strategic direction, offer valuation guidance, assist in formulating your offer, perform due diligence and negotiate your offer to completion.

Takeovers and Mergers

Are you looking for a trusted partner in this area?

We provide lead financial advisory assistance in complex and high profile public takeovers and mergers across the capital markets. This includes both those agreed between the parties, and those which are unsolicited or hostile.

Management Buyouts (MBO)

Do you need unbiased and objective input on MBO feasibility?

We deliver lead advisory guidance on deal structuring, offer creation, capital raising (equity and debt) and negotiations to completion.

Valuations

Do you require specialist valuation advice?

We take a collaborative, cross disciplinary approach to provide you with commercial, rigorously prepared valuation advice. We take care to balance our technical methodologies with ‘real world’ inputs that draw on our proprietary transaction, royalty and impairment databases.

Debt Advisory

Are you looking for independent, borrower-focused debt advice?

We analyse alternative structuring options, facilitate access to a wider range of lenders, navigate credit committees and advise on negotiations to completion.

Dispute Advisory

Are you facing a commercial dispute?

KPMG’s Dispute Advisory team provides commercial clarity and focus to help clients navigate the challenges of disputes and litigation effectively. Our team specialises in valuations for dispute purposes, assessment of financial losses, fraud investigations and purchase price disputes.

Contact us

Ian Thursfield
Partner in Charge, Deal Advisory
T: +64 (0) 9 367 5858
E: ithursfield@kpmg.co.nz

Gary Ivory
Partner, Deal Advisory – Mergers & Acquisitions
T: +64 (0) 9 367 5943
E: givory@kpmg.co.nz

Troy Newton
Partner, Deal Advisory – Corporate Finance (Wlg)
T: +64 (0) 4 816 4710
E: twnewton@kpmg.co.nz

Justin Ensor
Partner, Deal Advisory – Corporate Finance (Akl)
T: +64 (0) 9 367 5934
E: jmensor@kpmg.co.nz

Simon Wilkins
Partner, Deal Advisory – Corporate Finance (Akl)
T: +64 (0) 9 363 3480
E: swilkins1@kpmg.co.nz

Nick Mckay
Director, Deal Advisory – Mergers & Acquisitions
T: +64 (0) 9 363 3638
E: nmckay@kpmg.co.nz

kpmg.com/nz