Deloitte.

Private Capital
Making more possible

M&A recovery... is now the right time to buy or exit?

After an extended period of conservatism following the global financial crisis, M&A activity has rebounded strongly in the last 12 months – in Australia and globally.

Growing deal volumes, cashed-up corporates, inbound activity and the return of private equity

Improving business and consumer sentiment, continued low interest rates, growing risk appetites and demand for growth by investors has seen corporates increase their willingness to deploy surplus cash. Private businesses that can provide access to new markets or products for corporates are particularly attractive, as evidenced by Unilever's acquisition of the very successful T2 tea retail brand and chain.

Foreign buyers continue to look to Australia as a stable investment environment despite the stubbornly high Australian dollar, particularly as the recent stellar growth in markets such as China starts to slow.

The 'Asia's delicatessen' story rings true here, with notable recent private treaty transactions including the sale of dip maker Black Swan to Philippines-based Monde Nissin Corporation, and the sale of milk processer United Dairy Power to Hong Kong entrepreneur William Hui.

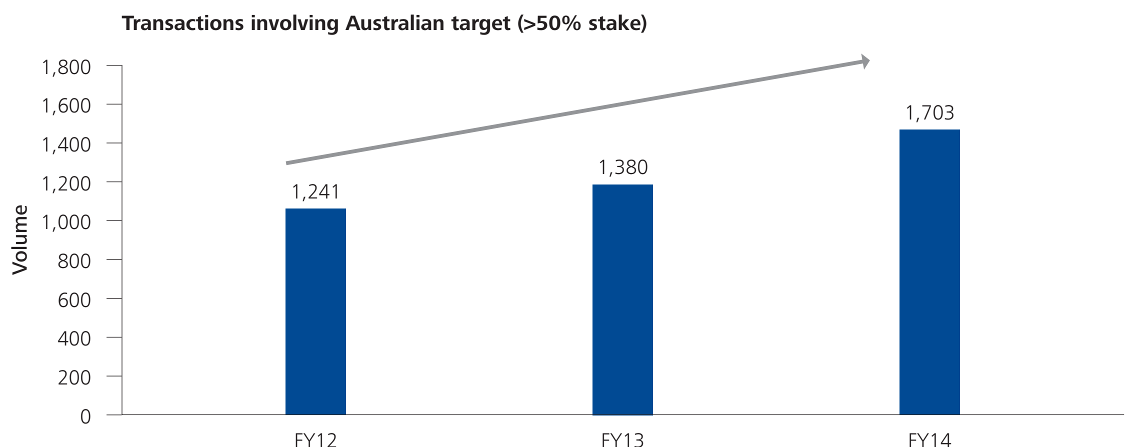
Similarly, the high profile losses of some private equity investors are becoming a distant memory as PE investments make headlines. Private equity continues to acquire interesting and growth orientated businesses in the mid-market.

This activity has been even more pronounced in the mid-market, with scores of dedicated funds seeking quality private businesses such as Online Courses Australia's sale to Arowana Capital-backed Intueri Education, Archer's sale of Keycorp, the sale of Queensland's largest radiation therapy business, Premion, to KKR-backed GenesisCare, Global Orthopaedic Technologies sale to Riverside Company and Quadrant's recent investment in Canberra Data Centre (CDC).

The total value of transactions involving Australian companies amounted to $79 billion in August 2014 (2014 year to date), the highest since 2011, according to Dealogic data. This includes outbound transactions as well as inbound deals by foreign acquirers. The number of M&A deals involving a controlling stake (e.g. >50%) of an Australian target that completed during FY14 increased by 23 per cent compared to FY13[1].

International players are contributing to a larger proportion of this deal flow. FY14 saw a 45 per cent increase in inbound deals, which made up almost half of total deal value – and $42.9 billion of investment was made in the June 2014 quarter alone. By comparison, private equity deals made up six per cent of volume in FY14, and contributed nine per cent of total deal value for the year[2].

Buoyant equity capital markets are also encouraging M&A activity. A broad range of sectors are experiencing this IPO activity, including financial services, healthcare and retail. High profile IPOs such as PACT Group, Spotless, iSentia, PAG, Healthscope and the proposed Medibank IPO have all grabbed the headlines.



Source: CapitalIQ

[1]Source: CapitalIQ
[2]Source: Dealogic

Differing valuations across sectors – where do you sit?

It's important to note, however, that strong M&A markets do not necessarily deliver optimal outcomes for vendors or buyers and deal volumes alone do not convey the entire picture.

Understanding valuation metrics are vital when deciding whether now is the right time to execute a divestment strategy or conversely, whether the time is right to deploy available capital in the next investment opportunity.

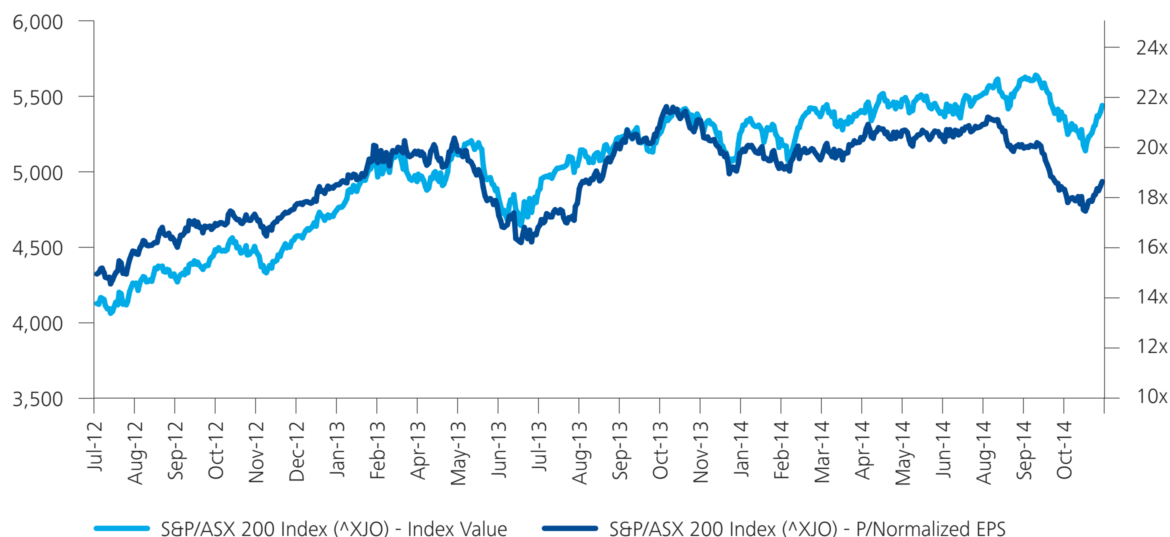
The S&P/ASX200 Index price to earnings multiple (a simple metric for estimating the relative value of equity) has increased by 37 per cent over FY12 to FY14. This trend is consistent with rising M&A activity and increasing business and consumer sentiment, and shows that investors are willing to pay increasingly higher prices relative to the earnings of those companies.

However, not all sectors are created equal, with differing risk profiles and growth prospects, industries can display highly divergent valuation trends.

Over the same period, the S&P/ASX200 Health Care Index grew 68 per cent, representing a sector price earnings ratio of over 30 times, on par with the highest sectors. At the same time the materials sector collapsed by 25 per cent to an ASX200 sector low valuation of 16 times price/earnings.

Falls in the S&P/ASX200 Index since September have decreased the price to earnings ratio as investors react to weak global economic data. This reinforces that knowing where a business sits in terms of macro and sector trends and what that might mean for future performance is critical – value is more than just a multiple.

S&P/ASX200 price index vs S&P/ASX200 normalised PE multiple



Source: CapitalIQ

How can owners make more possible?

Making money on entry, not just on exit

In M&A, there is a significant focus on the value derived on exit, with stories of high multiples and bidding wars capturing the attention of business owners. But this is only a part of the capital optimisation picture.

Private equity investors live by the adage that 'money is made on entry, not just on exit', something clearly true of private businesses as well. In practice, this is achieved by ensuring that any inorganic growth path fits with the buyer's strategic objectives.

Once those objectives are understood, it is important to develop a logic-driven acquisition strategy that identifies and filters the available opportunities. This may focus on categories such as strategic fit, financial and non-financial metrics, ability to execute and risk. Having a clearly defined approach ensures that emotional factors which can be prevalent in transactions are not factored into the decision-making process.

The next steps in the acquisition life cycle focus on the execution of a transaction: due diligence, negotiation, completion and integration. These steps require an integrated approach where due diligence findings inform negotiations and strategy to integrate the target post completion.

Capitalising on a life's work – what private businesses can do to prepare for sale

For many owners, their business is their most valuable asset and represents the culmination of years of dedication and hard work. Preparation for sale is everything as there is generally a one and only chance to optimise their capital investment.

Understanding value and value drivers early in this process is critical as it helps set expectations up front before the emotion and heat of the deal. This process also helps identify weaknesses that may impact value on exit and maximising the business's strengths. This ranges from relatively simple things like optimising working capital and disposing of surplus assets to more complex issues such as identifying opportunities to 'groom' the business for strategic buyers.

Finding the right strategic buyer is paramount in attracting a premium that incorporates strategic and/or synergistic value. Business owners need to ask themselves what are the internal and external factors that make their business worth more to someone else than to themselves? Next is understanding the right time to sell in the buyers' eyes – the best outcome is achieved when the buyers want to buy, not when the owners want to sell.

In the end, timing can be everything.

Contacts

Tony Garrett
Partner and National Leader,
Deloitte Corporate Finance Advisory
Tel: +61 2 9322 5491
tgarrett@deloitte.com.au

Damien Tampling
Partner – Sydney
Tel: +61 2 9322 5890
dtampling@deloitte.com.au

Katherine Howard
Partner – Sydney
Tel: +61 2 9322 3428
kahoward@deloitte.com.au

Paul Childers
Partner – Western Sydney
Tel: +61 2 9840 7202
pchilders@deloitte.com.au

Xander Alpherts
Partner – Melbourne
Tel: +61 3 9671 7669
xalpherts@deloitte.com.au

Jeremy Cooper
Partner – Melbourne
Tel: +61 3 9671 7663
jecooper@deloitte.com.au

Victoria Brilliant
Partner – Melbourne
Tel: +61 3 9671 7611
vbrilliant@deloitte.com.au

David Egan
Partner – Adelaide
Tel: +61 8 8407 7150
daegan@deloitte.com.au

Omesh Motiwalla
Partner – Perth
Tel: +61 8 9365 7118
omotiwalla@deloitte.com.au

Ben Wilson
Director – Brisbane
Tel: +61 7 3308 7304
bwilson@deloitte.com.au

This publication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively the "Deloitte Network") is, by means of this publication, rendering professional advice or services.

Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this publication.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/au/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte has in the region of 200,000 professionals, all committed to becoming the standard of excellence.

About Deloitte Australia

In Australia, the member firm is the Australian partnership of Deloitte Touche Tohmatsu. As one of Australia's leading professional services firms, Deloitte Touche Tohmatsu and its affiliates provide audit, tax, consulting, and financial advisory services through approximately 6,000 people across the country. Focused on the creation of value and growth, and known as an employer of choice for innovative human resources programs, we are dedicated to helping our clients and our people excel. For more information, please visit Deloitte's web site at www.deloitte.com.au.

Liability limited by a scheme approved under Professional Standards Legislation.

Member of Deloitte Touche Tohmatsu Limited

© 2014 Deloitte Touche Tohmatsu.

MCBD_HYD_10/14_51032