Simpson Grierson

Expanding Horizons 2021

A review of New Zealand M&A trends in 2021 and the outlook for 2022

October 2021

Introduction

Welcome to Expanding Horizons 2021.

2021 has been another bumper year for M&A in New Zealand, and it's only October. After a frenetic second-half of 2020, and with Covid-19 uncertainties remaining, the resilience of the M&A market is remarkable.

There are a number of drivers of this. The actions taken by most countries and central banks to keep economies going despite various stages of lockdown were enough to stabilise markets in 2020, and markets have now boomed with record amounts of capital flowing. New Zealand has benefited from the market activity, highlighting the large number of high quality businesses the country produces.

M&A activity this year has delivered, or exceeded, expectations from the offshore investors we spoke to a year ago in our 2020 Expanding Horizons report:

- There was a strong intention to invest in New Zealand in the short-term, driven by our strong fundamentals (political and regulatory stability, favourable competitive environment, advanced technology and good targets) – borne out this year with deal numbers from offshore buyers likely to be significantly higher than the previous two years
- Technology, pharma/health and consumer were the most favoured sectors – borne out in 2021 with the technology and consumer sectors accounting for well over half of deals for offshore buyers
- The majority of investors did not see the Government's foreign investment regime as being a deterrent – highlighted by the ongoing strong offshore demand for New Zealand assets.

But it hasn't been just a year for offshore investors. Domestic investors have been very active, with 2021 volumes also set to be well up on 2020.

A development that slightly surprised us this year was that border closures and other Covid-19 restrictions have not materially impacted deal flow. Last year, offshore investors told us that they thought the thing that would make the biggest difference to M&A activity in New Zealand was re-opening of the borders. That factor did not, in the end, feature. Aside from a few months of a full trans-Tasman 'bubble', the borders have been closed and deal making has surged. Necessity prompted the market to adapt quickly to virtual deal-making.

In this report we analyse the key trends from 2021 deal activity and offer our thoughts on why 2022 will continue to be a strong year for New Zealand M&A.

I hope you enjoy reading it.

Andrew Matthews | Head of Corporate
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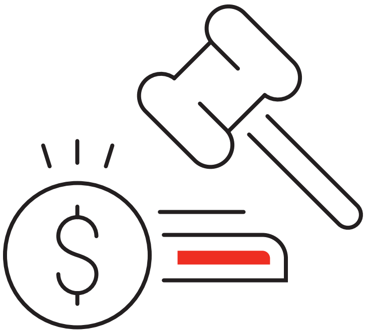
CONTENTS

What you need to know



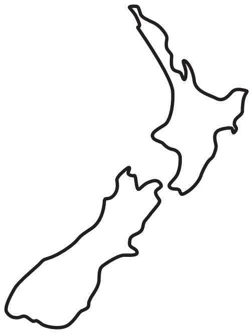
20% increase in deal volume

The M&A market has rebounded strongly from the Covid-19 slowdown – with 70 deals already announced this year we're anticipating around 95 deals for the full year, up 20% on 2020.

US$10bn

total value of deals

A total deal value of over US$10bn year-to-date is the result of a significant number of large deals, and the high valuations achieved through competition for attractive targets.



44%

of deals domestic

Offshore investors still dominate, but domestic activity is the highest for a number of years accounting for 31 deals year-to-date, 44% of the total.

2022 prospects strong

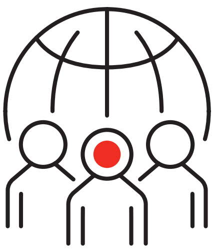
M&A activity will remain strong in 2022, driven by available capital, New Zealand's strong investment fundamentals and good targets.

Life-style and ESG key deal drivers

2021 deals reflect changing life-styles globally and increasing ESG considerations – hot sectors include technology, consumer, medical and energy.

Key sectors for savvy investors

Technology, energy, health, agri-tech and carbon farming assets offer good investment opportunities.



Offshore investors will remain dominant

Offshore investors will continue to lead the charge, unphased by border restrictions and changes to New Zealand's overseas investment regime.

Section 1
M&A rebounds strongly from Covid-19 slowdown

New Zealand's M&A market has shown real robustness in 2021, shaking off any slowdown prompted by the initial onset of Covid-19 in 2020.

We expect deal count for 2021 to be around 20% higher than 2020 or 2019, and the total value of deals to be significantly higher than any of the last three years.

More deals, and three times higher total value

- 70 deals year-to-date, compared with 79 deals in full year 2020.
- Around 95 deals expected for 2021 (based on 2019 and 2020 Q4 activity levels).
- Deal value is US$10.1bn year-to-date, compared with US$2.8bn in full-year 2020.

Figure 1: M&A activity – volume of deals

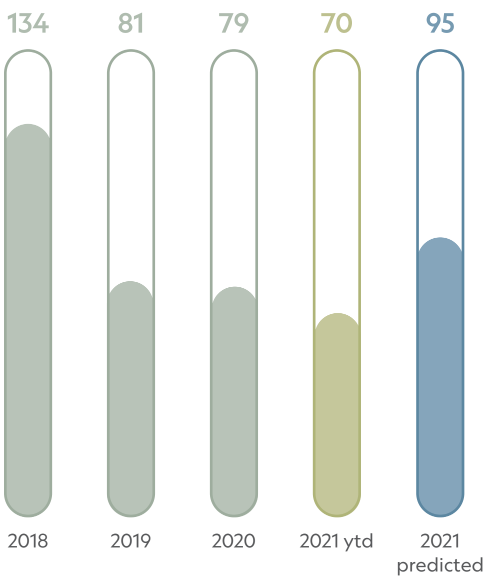
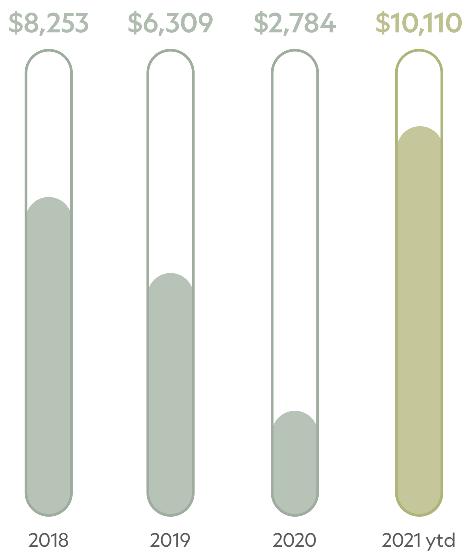


Figure 2: M&A activity – value of deals (US$bn)



Source: MergerMarket. 2021 year-to-date figures to end September. Criteria: announced deals with a New Zealand target. Predicted volume of deals reflects number of Q4 deals in past two years.

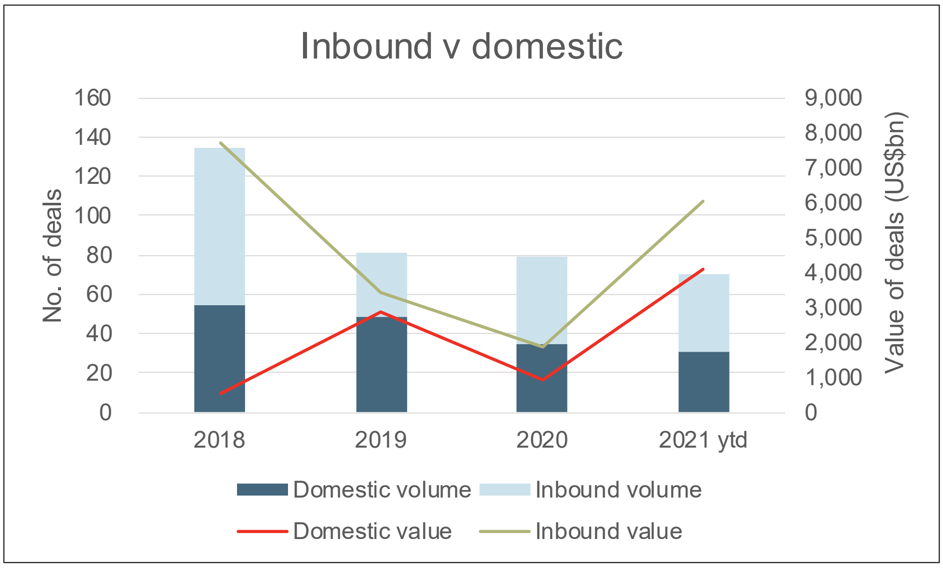
Offshore investment still dominant, but domestic activity up

2021 has seen greater domestic M&A than in previous years, driven particularly by the Tilt Renewables acquisition – the largest deal of the year-to-date.

Our closed borders have not deterred offshore buyers, with volumes and values of offshore deals up on previous years. Parties are adapting to the need to complete deals remotely.

- Offshore buyers year-to-date: 39 deals at a value of US$6bn – compared with 44 deals at a value of US$1.9bn in full-year 2020.
- Domestic buyers year-to-date: 31 deals at a value of US$4.1bn – compared with 35 deals at a value of US$0.9bn in full-year 2020.

Figure 3: Inbound v domestic deal volumes and value



Source: MergerMarket. 2021 year-to-date figures to end September. Criteria: announced deals with a New Zealand target.

Consumer and technology sectors most attractive

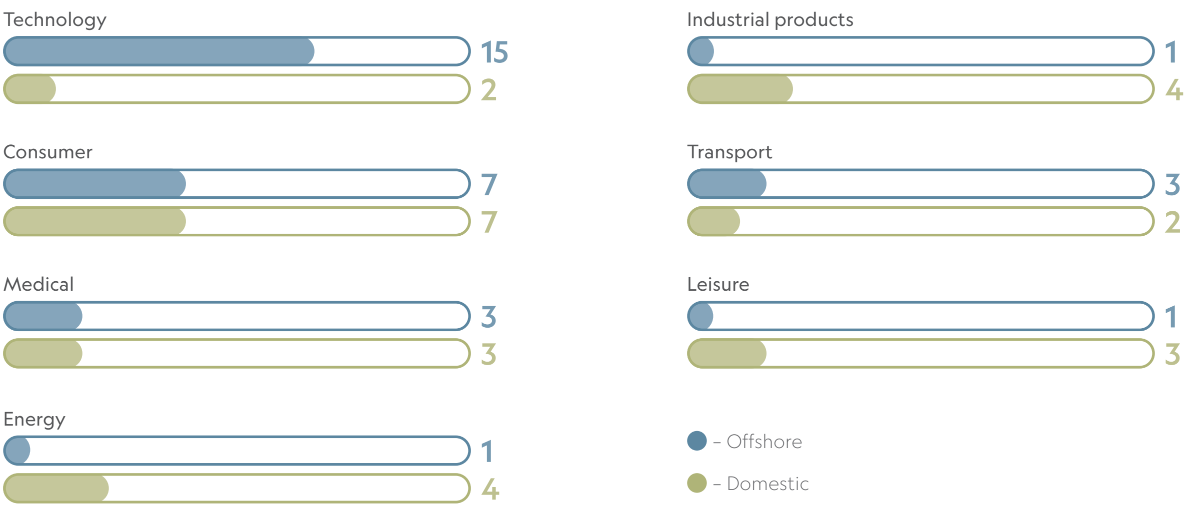
The technology and consumer sectors account for 44% of deals year-to-date.

Our 2020 Expanding Horizons Report survey showed that technology assets were the most attractive for offshore buyers (favoured by 71% of investors). That sentiment has been demonstrated this year. Offshore investors have picked up growth prospects including Vend, Seequent, and Timely. It is possible that acquisitions in this sector are easier for buyers to assess and complete remotely, with more focus on the key IT product and less on factors on the ground in New Zealand.

The demand for “lifestyle” consumer assets has been a major driver for both offshore and domestic buyers, particularly high-end food (eg honey), beverage, wellness and pet food sectors. These deals are driven by global trends, such as the growth in pet ownership in some countries as a result of Covid-19 lockdowns and a growing middle class.

There has been intense competition for quality assets in these hot sectors, reflected in record acquisition values.

Figure 4: Top sectors by deal volume in 2021

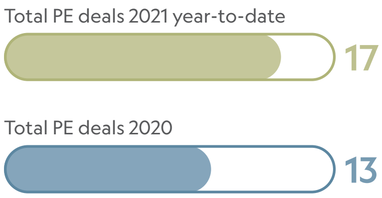


Source: MergerMarket. 2021 year-to-date figures to end September. Criteria: announced deals with a New Zealand target.

Private equity remains in pole position

Private equity remains a core player in the local market. The differences this year have been more activity from both local funds and the arrival of the global PE giants. We were expecting local PE to have an advantage in 2021 given the border closures, and there has certainly been more activity from local PE. But offshore PE has remained dominant, accounting for 15 deals, including 12 on the buy-side.

A feature of the market in 2021 was intense competition for target assets from large global funds, with inevitable consequences for acquisition values. KKR ended up with four significant acquisitions across a range of sectors, including Natural Petfood Group and Education Perfect.



Source: MergerMarket. 2021 year-to-date figures to end September. Criteria: announced deals with a primarily New Zealand target.

Capital flows reflect increasing importance of wider ESG considerations

Increased M&A volume has flowed from organisations seeking to future-proof and transform, in response to environmental, social and governance (ESG) considerations.

Examples include the sale over the past few years of Tilt Renewables, Genesis Energy’s acquisition of a stake in Ecotricity, and a range of acquisitions and investment in solar and wind energy generation assets. The sale of BNZ’s life insurance business, and AMP Life’s and Westpac’s wealth advisory businesses are other examples.

The energy sector transactions show the clear direction of travel for the sector towards renewable energy generation, in response to New Zealand’s carbon emission reduction goals. More widely, other sectors are also focused on emissions reduction – for example, Mataura Valley Milk (in which The a2 Milk Company recently acquired a large stake) has just announced its facility in Southland will be converted to be fully electrified.

The financial sector deals, while driven directly by regulatory considerations flowing from the Australian Royal Commission into the banking, superannuation and financial services industries, reflect the “S” and “G” drivers within the wider ESG phenomenon.

ESG considerations driving corporate strategy

ESG investing is now ubiquitous, and is now a driving force in capital flows and corporate decision-making. It is no longer a ‘box-ticking exercise’.

A challenge to sustainable investing is the ability to define and measure the impact outcomes, a lack of data on ESG factors, and difficulty in benchmarking non-financial goals.

New Zealand is making progress on these though.

The **Emissions Trading Scheme** provides a ‘tax’ on carbon emissions, with the price of NZUs inexorably rising, requiring carbon emitters to respond through forecasting, pricing and (ideally) absolute reduction in emissions.

Banks are marketing **sustainable lending products** – green loans and sustainability-linked loans. Each of these comes with specific sustainability-linked targets built in, with basis points at stake if borrowers do not meet them.

The **climate change financial disclosure regime** is scheduled to be ‘live’ for the 2022/2023 reporting year. Climate reporting entities will need to understand their climate-related risks (and opportunities) and identify the financial impact of those. This will inevitably require the reporting entities’ key customers to disclose their own risks, so that the reporting entity can factor those into its own business activities and outcomes.

Investors may therefore find, in a New Zealand context, that the value impact of sustainability-linked investing will become clearer, and so easier to quantify.

15 largest announced New Zealand deals year-to-date

	Transaction	Size (US$)	Sector	Domestic or offshore buyer
1	Mercury / Powering Australian Renewable consortium buying Tilt Renewables Ltd	$2.553bn	Energy	Domestic
2	Ampol’s proposed acquisition of Z Energy	$1.769bn	Energy	Offshore
3	FountainVest Partners' acquisition of Ziwi Peak	$1.057bn	Consumer	Offshore
4	Bentley Systems' acquisition of Seequent	$1.05bn	Technology	Offshore
5	Infratil’s acquisition of Pacific Radiology Group	$416m	Medical	Domestic
6	Amplifon’s acquisition of Bay Audiology	$411m	Medical	Offshore
7	Lightspeed’s acquisition of Vend	$362m	Technology	Offshore
8	Mercury’s acquisition of TrustPower	$306m	Energy	Domestic
9	Platinum Equity’s acquisition of Hexagon Holdings	$287m	Manufacturing	Offshore
10	Fidelity Life’s acquisition of Westpac Life NZ	$281m	Financial services	Domestic
11	KKR’s acquisition of Education Perfect	$293m	Technology	Offshore
12	Sixth Street Partners’ acquisition of 15% of Pushpay Holdings	$230m	Technology	Offshore
13	Idexx Laboratories’ acquisition of EzyVet	$157m	Technology	Offshore
14	Modern Times Group’s acquisition of Ninja Kiwi	$141m	Technology	Offshore
15	Eroad’s acquisition of Coretex	$131m	Technology	Domestic

Source: MergerMarket. 2021 year-to-date figures to end September. Criteria: announced deals with a New Zealand target and a disclosed value.

Section 2
Market to remain strong in 2022

The robust M&A market is set to continue

There is no sign that the offshore capital pool will reduce suddenly, or that desire among corporates to complete strategic acquisitions will drop.

The big question is how long it can all last. Inflation is rising, central banks have either already started to raise interest rates or are signalling an intention to do so, and – with locked down economies starting to re-open – fiscal policies are tightening.

A number of factors nonetheless point to a continued strong M&A market.

- PE funds and other private investors still have money to spend (with fundraising continuing), and so still need to find a good home for it.
- Borrowing rates are still at an all-time low, although central banks are now starting to raise interest rates and tighten monetary policies.
- Businesses, now as much as ever, still need to progress strategic agendas: strengthening balance sheets, bolstering sustainability drivers, taking steps to manage climate change risks, responding to consumer or market requirements.
- Covid-19 vaccination responses are allowing economies to re-open, and there is a general recognition that the world must adapt to living with Covid-19.

Most importantly, New Zealand's investment fundamentals are good. We have good assets which people want, at fair values. Our economy and political environment are generally stable, with a well-managed Covid-19 response. Our population is good at adopting technological solutions, and we are in a growth region.

Macro international trends will drive New Zealand activity

New Zealand M&A activity down the line will simply reflect that value lies in investing in things that New Zealand has, and that other people want.

Response to Covid-19 and adaption to post-pandemic conditions

- Pharmaceuticals
- Further investment in digital infrastructure
- IT solutions created or refined in response to the remote working revolution
- Food delivery solutions
- Solutions to ease transport bottlenecks and bolster supply chain resilience.

Premium consumer products demanded by expanding global middle class

- Food and beverages
- Dairy
- Pet food.

Response to environmental drivers

- Renewable energy generation
- Solutions to boost energy efficiency
- Battery storage technology
- Commercial opportunities arising from net zero carbon transition
- Waste reduction
- Circular production
- Sustainable food sourcing.

New Zealand has yielded investment targets in all three areas, and we expect investors to keep looking for more.

Good quality targets still driving premium values

Big players with capital to invest have had to compete for high quality targets, inevitably driving premium values for vendors.

This was the story in 2021, and basic economics suggests the same will be true in 2022: there is still a vast capital pool, which needs to be invested in quality assets – which buyers are willing to compete for.

The global trend for high valuations and low interest rates allows investors to modify overall investment return expectations, allowing capacity to keep paying what is needed. High pricing nonetheless demands clear-eyed due diligence and a thorough understanding of the operating environment.

Closed and restricted borders are mattering less to investors

New Zealand's closed borders have not slowed activity in 2021. Local players may have enjoyed an edge in 2021, but offshore buyers are adapting to the "new normal" and the need to originate, assess and negotiate deals remotely.

Deal structures and processes are adapting.

- Various strategies are being employed to help bridge valuation gaps: earn-outs, contingent payments, retention of vendor interest.
- There is more focus on due diligence and a greater willingness to rely on local advisers.
- W&I insured deals are now the norm.
- Technological solutions are adapting also.

Section 3

Plenty of opportunities for savvy investors – five sectors to watch

Health

M&A activity in the health sector is seeing real growth, and there is more to come.

There has been significant historical underinvestment in the New Zealand health sector. Investment to date has been largely driven by practitioners rather than by governments or the private sector. Private equity, and offshore corporates, see this opportunity and the potential for consolidation.

The proliferation of small healthcare providers (spanning testing and diagnostics, general practice, specialists and allied care) present opportunities for investors to find scale and synergies.

New Zealand's universal public health system, the role of Pharmac, the Accident Compensation regime and good levels of private health insurance present opportunities for stable returns. The Government response to the Covid-19 pandemic provides opportunities also, with funding of testing and vaccination programmes. The plans to streamline the existing network of DHBs provides further opportunities for significant long term supply agreements.

The lack of private investment in this sector to date also means that there is not the proliferation of corporate intermediaries involved in providing health services, all requiring a profit margin. Overall operating costs are therefore relatively low.

Carbon farming: forestry's new asset

With the growing presence of the ETS and its carbon pricing function, carbon farming is developing into a new asset class which we expect to develop further in 2022.

As the price of carbon rises in New Zealand (reflected in the price of NZUs), and the cost of operating in a high emissions environment, reliable sources of NZUs, at a known and stable price will become more and more valuable.

The ETS enables eligible forest owners to be awarded NZUs based on the estimated carbon dioxide emissions absorbed by the forest. The more the forest grows, the more NZUs are awarded, and the owner of the forest is then able to sell those NZUs. Forest blocks need to be permanent stands, and indigenous forests yield significantly more NZUs than 'planted' pine or other rotational forests. Land owners can therefore release financial value from forestry planted on land that is otherwise unproductive or inaccessible.

Value opportunities will come through investment in relevant forestry blocks and the entities needed to manage the forests, and commercialisation of NZUs as they arise (on the spot market, or under longer term arrangements). Development of secondary market activity in this sub-sector is inevitable as the price of NZUs rises and while there is still high demand for them.

Technology

Big players fought hard over technology assets in 2021, resulting in record multiples. Given wider market dynamics, there appears to be little reason why this trend won't continue in 2022.

Three drivers stand out to us.

- Habits adopted after the world has largely worked from home since April 2020 seem here to stay – driving massive amounts of digital data across platforms, as consumers do more and more daily activities digitally, from home.
- Effective digital responses are required to issues posed by ESG and sustainability drivers.
- The need for ever-increasing efficiencies in agriculture and farming systems.

New Zealand has shown itself to be good at producing proven and scaleable software solutions. Border closures were of little importance. This is perhaps because the code is what matters most, and code can be assessed from anywhere.

Energy infrastructure

We expect energy assets – both renewables and thermal-based – to drive further M&A (and other investment) next year and for years to come. Clear regulatory direction will assist investors in both spheres.

2021 disclosed gaps in New Zealand's current energy ecosystem (spanning generation, transmission and distribution). The need for more renewable energy generation assets will only increase as the nation's vehicles are decarbonised, and carbon emitting industries adapt to a low carbon environment. The operation of the ETS and introduction of the climate-change financial disclosure regime are intended to force the New Zealand economy to start that shift.

The renewable energy requirement needs significant investment to solve. The solution will need to be multi-faceted, in terms of where the investment comes from and where it is directed. 2021 proved that the market is not waiting for the Government to solve the problem, and that a variety of renewable generation assets are expected to drive value. Significantly more investment in energy infrastructure will be needed, however, if the currently proposed emissions reductions targets are to be met.

We also expect to see activity among owners of existing thermal assets, as they determine how best to deal with those assets - against a backdrop of both rising costs of carbon emissions (deliberately aimed at forcing a rapid decarbonisation), and a foreseeable gap in renewable energy supply.

Investors will welcome clear policy settings that support the end objectives. Obvious areas where regulatory direction is needed are the proposed reforms of NZ's local authority environment and the RMA, and certainty of regulatory direction for the electricity industry, including a clear pathway for transition from hydro-carbon to renewables-based energy sources.

Agri-tech

New Zealand's agri-tech sector combines high-tech manufacturing, biotech and ICT (in order of revenue). All players are using technology to solve problems for the agricultural sector.

Markets are global, but solutions can start out in New Zealand with our strong agricultural economy and producers keen to adopt new technology. These solutions can provide that all time investment prize: a proven, scalable solution to a problem faced by farmers everywhere.

We see New Zealand agri-tech as well placed to provide solutions to the many challenges presented by both climate change and the drive for sustainability, including:

- lowering of carbon emissions
- herd management
- soil testing and analysis
- maximisation of water resources
- microbial crop solutions
- on-farm efficiencies at all stages of the farming process
- organic agricultural systems
- developments in "gate to plate" technologies in response to consumer demand for identifiable food sources
- development of plant-based proteins.

Section 4
Offshore investors unphased by overseas investment reform

A reform process undertaken over the last two years is nearing its end. The end result is a process that is improved in some areas, but more complex in others.

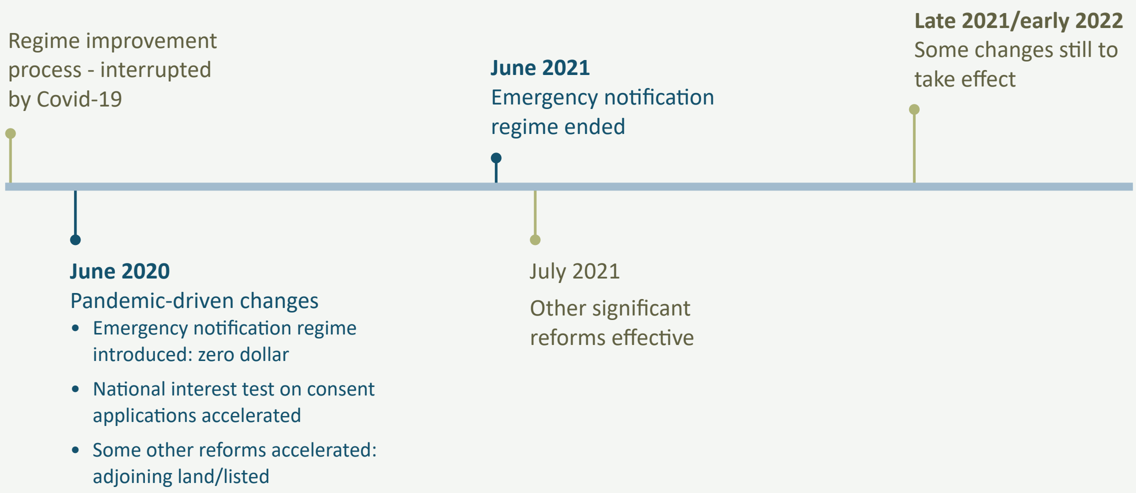
However, a clear theme reflected in our 2020 Expanding Horizons report was that New Zealand's overseas investment regime does not stop buyers coming to New Zealand (although many surveyed expressed frustration over the lengths of time involved in getting approvals, and the uncertainty as to both timing and likely outcome).

The number and value of transactions undertaken by offshore buyers this year suggests that this sentiment still applies.

Further clarity on approval time frames, due in November 2021, will be welcomed however – and perhaps expected given recent fee increases.

Key impacts of reform, and timetable

- Fewer transactions require consent (more targeted 'sensitive land', changes to control triggers for 'overseas persons').
- Streamlined consenting process: More sensible investor and benefit to New Zealand tests, faster timeframes for decisions.
- Further due diligence: Call-in power adds 'strategically important business' DD requirement to almost every transaction.
- Consent applications more complicated: National interest test makes consent applications more complex.
- More expensive: Fee increases mean consent applications now cost more; new OIO application process does not permit efficiencies between applicant and its advisors.



About Simpson Grierson and contacts

We are one of New Zealand's largest law firms, but that's not what sets us apart.

It's our team of experts, market-leading reputation, and absolute commitment to achieving the right outcome for each client that makes us different.

By involving us early on, our clients and their advisers benefit from access to unsurpassed understanding of New Zealand's business and regulatory environments, plus insight into how local conditions are responding to Covid-19 recovery measures.

You'll have the advantage of leading specialists delivering timely advice, solving problems and anticipating issues. Having us in your corner means making decisions with confidence.

Please contact any of our experts for advice on the New Zealand market and investment opportunities, or to discuss any aspect of this report.

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