NORTON ROSE FULBRIGHT

Australian private M&A outlook

2024 Edition

Contents

Introduction

Cautious optimism for a rebound in global M&A and Australian public M&A markets predicted in our 2024 Global M&A trends and risks and Australian Public M&A Outlook reports, may encourage a reticent private M&A market to pick up following a challenging year.

The headwinds to M&A activity built steadily over the course of 2023 eventually culminating in a slump, as elevated inflation, five consecutive cash rate rises and the conflict in Ukraine and later the Middle East emerged in the second half of 2022.

As a result, 2023 presented a more challenging deal making environment than we have seen in recent years, with the deal fervour we saw in 2021 now being a distant memory.

With indications that inflation may be easing, the year ahead is likely to see a response by central banks to cut lending rates.

There is substantial private equity capital available for investment domestically and in the region. We expect this combination of factors – a more stable inflationary and interest rate outlook, stronger equity capital markets and private equity capital – will see foreign buyers returning with greater confidence to the Australian M&A market and overall increase in M&A activity.

Opportunities remain open as investors look for high quality assets to acquire. Ongoing economic challenges will favour buyers on the sidelines – those who have been waiting for valuations to come off their peaks. Private equity in particular has record levels of undeployed capital and will continue to seek out businesses with strong growth potential.

Methodology

The purpose of this report is to outline our predictions for the Australian private M&A landscape for the year ahead, based on an analysis of trends that emerged in key private M&A negotiation points in 2023.

The data for this edition has been drawn from 41 completed private M&A transactions that Norton Rose Fulbright Australia worked on during the 2023 calendar year. The reviewed deals, which involved a range of target sectors and counterparties from more than 11 countries, provides a useful insight into the state of M&A activity over the year. When analysed against the Australian deal trends longitudinal study that we have undertaken since 2014, the data points provide valuable insights into where the private M&A market may go and how participants might prepare.

We hope this report continues to be a useful tool for M&A practitioners and participants in helping them understand Australian public and private M&A market practice, both as to the trends over many years and a snapshot of the current day.

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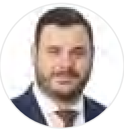

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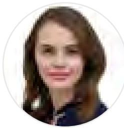

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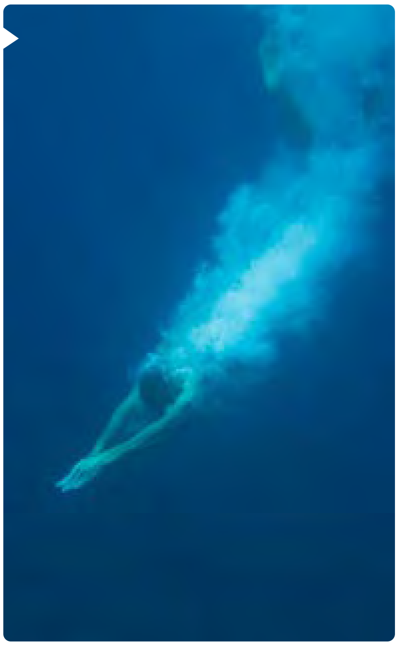
Norton Rose Fulbright's top 5 private Australian M&A deals by value, 2023:

1. **TCV's** investment into Employment Hero.
   Trade journals value the deal at A$2bn
2. **Petstock Group**, a leading Australian and New Zealand speciality pet food, accessories and services retailer, on an agreement to sell a majority equity stake to Woolworths Group.
   Deal Value A$1.7bn
3. **UniSuper, Pension Protection Fund** and **APG** on the acquisition of Forico and a 170,000-hectare plantation forestry estate in Tasmania, held by a New Forests managed fund.
   Deal Value A$1.2bn
4. **GreenFort Capital** in relation to a joint venture with private equity firm Gaw Capital Partners to acquire and develop a pipeline of land-lease community projects.
   Deal Value A$600m
5. **ESR Australia** on a partnership with Solar Bay to accelerate the deployment of renewable energy infrastructure across ESR-managed assets nationally.
   Deal Value A$500m

2023 – A year in review

Cooling deal activity through 2023



Many forecasted M&A activity in 2023 to bounce back from a downbeat 2022. These high hopes were not realised as 2023 saw a decline in both deal volume and value. Elevated inflation driven by continued labour storages and supply chain issues caused many central banks around the world to aggressively raise interest rates. In Australia, the RBA continued to hike interest rates despite the rising cost of living crisis. Although increases slowed in the back half of 2023, many commentators forecast that interest rates will keep going up, before a fall in 2025. Economic stresses resulting from the conflict in the Middle East and Russia's war in Ukraine put a further strain on an already volatile global economy.

The bullish confidence of those expecting a 2023 rebound vanished as deal values dropped significantly in 2023. Would-be buyers, once eager to deploy capital, became more cautious in their approach, opting instead to monitor the now volatile landscape. We saw many large deals grind to a halt and smaller deals slow as a result. This decline signalled a cooling of the M&A markets and a return to pre-pandemic levels – a far cry from the frenzied activity of a few years ago.

Environmental, social and governance (ESG)

As predicted in our last report, ESG played an important role in 2023 private M&A activity. ESG factors proved to be the catalyst for many major divestments, acquisitions and restructures and investors have continued to use their shareholder rights to influence corporate decisions and business behaviours. We predict that this will continue to grow in importance in the years ahead.

With ESG proving to be a major pillar in corporate strategy, we saw many companies focusing on communication strategies and engaging in effective consultation processes with stakeholders in 2023. Maximising deal value and striking the right balance between ESG considerations and other metrics were also important to many companies in 2023.

A buyer's market?

We continued to observe a surprisingly high number of aggressive buyer positions accepted by sellers (eg, 10% of deals had no knowledge qualifier on warranties and 12% of deals had no time limit on general warranties). This was combined with frequent buyer-friendly deal protections (eg. restraint periods of up to 5 years). We query whether the results reflect an expertise asymmetry among private M&A practitioners or whether the "market average" needle has moved to favour buyers.

M&A trends to look out for in 2024

Slower deal activity

Private M&A deal activity will generally be slower than in prior years given the ongoing geopolitical conflict, inflation and relatively expensive debt. M&A is expected to pick up in line with equity markets. When equity markets clearly signal their belief in the end of interest rate rises, sharply increased dealmaking is expected to follow. We expect deal activity to vary significantly between sectors, with some targets that were overvalued in 2021 and early 2022 (eg. technology) returning within reach of some bidders. The reduced value of the Australian dollar against the US dollar may also make Australian targets more attractive to US bidders. Tighter debt settings will increase the appetite for scrip deals as parties seek to minimise the impact of expensive debt markets.

Variability in performance between sectors

Energy and resources companies to remain high-priority acquisition targets

Continued pressure on global oil and gas markets is forecasted as conflicts in the Middle East and Ukraine continues. Elevated pricing levels for oil and gas will continue to make companies with exploration, extraction and processing assets high-priority acquisition targets. The gathering pace of the global transition to renewable energy will also see solar, wind, hydrogen and battery storage targets remain attractive to investors looking to benefit from the energy transition.

Technology

As technology companies return from the stratospheric valuations seen in 2021 and 2022, they will continue to attract interest as investors seek opportunities to bid for businesses that were once out of reach. Ever increasing demands for data and an accelerated remote work technology uptake in response to the COVID-19 pandemic will further ensure that these companies remain desirable targets. The trend of companies seeking bolt-on capability acquisitions to accelerate speed to market also looks set to continue in 2024.

Healthcare

The sector's stability and long-term growth prospects, particularly in pharmaceuticals and biotechnology, will remain attractive for investors. However, it may be difficult to reach an agreement on valuations as the impacts of expensive debt and inflation-impacted demand continue to be felt.

Data security

Ransomware groups are increasingly moving beyond large ASX-listed companies and are targeting midsized companies that are subject to private acquisition. Threat actors are also targeting investors and other participants in the M&A process to obtain confidential client and market sensitive information and misdirect payments. In addition to the operational and financial consequences of a cyberattack, regulators are increasingly taking enforcement action when they identify deficient post-acquisition cyber governance practices.

Buyers looking to mitigate the risk of exposure may seek greater warranty coverage in these areas or, in more drastic circumstances, seek to carve out and leave behind parts of a target's operations that pose unacceptable data and cyber security risks. We expect to see continued use of secure data rooms and encrypted document protection during due diligence, even for small deals, to guard against unauthorised access to confidential materials.

Increased underwriting scrutiny

W&I insurers are increasingly seeking fulsome due diligence around the target's key operations. Depending on the industry, insurers may refuse coverage for high risk areas, such as IT, privacy and cybersecurity. Counterparties seeking W&I coverage should engage early with potential insurers to understand the limitations of coverage and ensure that comprehensive diligence has been performed in the key warranty areas.

Environmental, social and governance (ESG) the market norm

ESG considerations are set to take centre stage this year once again as ESG cements itself as a mainstay of M&A transactions. Those companies that actively consider ESG issues as part of their comprehensive due diligence processes will be best placed to navigate this fast-evolving landscape. Global concerns ranging from addressing climate change to diversity and inclusion have attracted increased attention from investors, stakeholders, regulators and governments. The increasing push for business transparency by the public has also forced executives to place these growing concerns at the top of the corporate agenda. For this reason, even where ESG is not the central deal driver, executives should expect to spend more time on ESG due diligence when navigating the transaction process.

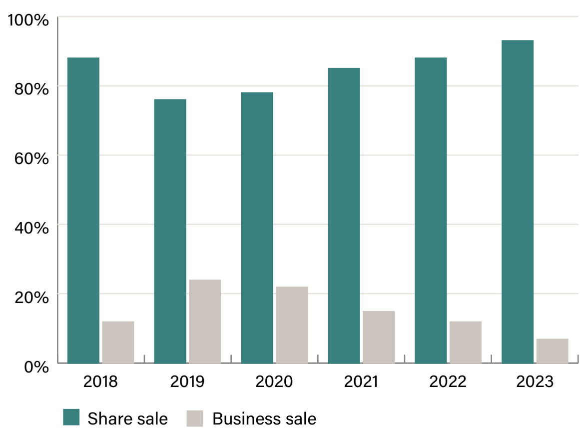
Key features

Our M&A teams had another busy and successful year representing buyers, sellers and warranty & indemnity insurers on 41 private M&A transactions that completed during the 2023 calendar year. This enabled us to perform a broad survey of the market, taking into account not only our own firm's negotiated positions but also those of many other law firms.

Business v share sale

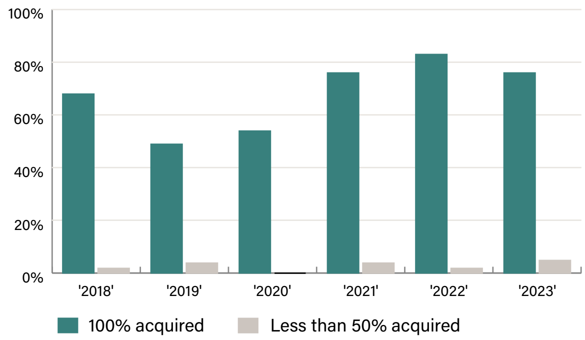
Share sales involve the acquisition of shares in a company, and along with it, control of all of the company's assets and responsibility for all of the company's historical liabilities and obligations. Extensive and careful due diligence needs to be completed before entering into these types of transactions to protect the buyer from exposure to undisclosed liabilities upon completion. In contrast, business sales typically do not involve the purchaser assuming responsibility for historical liabilities as buyers only acquire selected assets.

Despite the risk of inheriting latent liabilities, we continue to see a strong preference for share sales (93%) over business sales (7%). We expect this is primarily due to the relative simplicity of share sale structures which require only the transfer of shares as compared to the need to transfer assets one by one in business sales. Acquirers are confident that they can leverage their expertise and reputation to enable the target's business to grow after the acquisition.



More than 76% of our 2023 share sale deals involved the acquisition of 100% of the shares in the target company. In contrast, only 5% of our 2023 share sale deals involved the acquisition of less than 50% of shares in the target company. Acquirers are typically aiming to obtain control, preferring to purchase all or the majority of the shares in a target.

Share Sale % 2018 – 2023

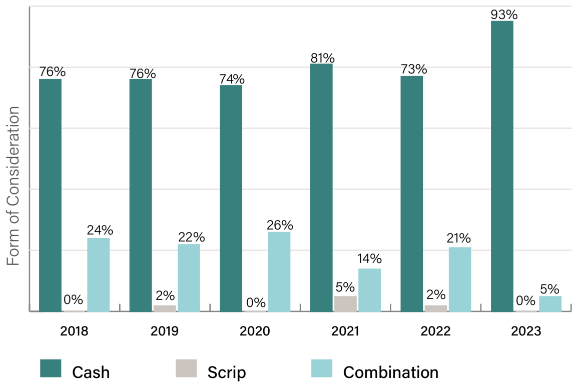


Form of consideration

As expected, cash remained the preferred form of consideration (93%) for our 2023 private M&A transactions. This figure represented an all-time high and signifies the continuing strong bias towards cash as consideration. Cash has long been the preferred type of consideration since it does not require the seller to assess the value of the buyer entity and instead provides the seller with immediate liquidity and certainty of return.

During our longitudinal study, we have usually seen at least some buyers use all scrip consideration. Although that was not the case for our 2023 deals, the idea of using a combined cash / scrip payment remains appealing for both buyers and sellers. For the buyer, using scrip consideration gives them an opportunity to preserve cash. Buyers using cash to pay 100% of the purchase price will need to use either their own cash reserves, raise capital or seek external debt financing. For a buyer looking to keep a founder seller engaged in the target business for a period post-completion, getting the seller to accept some scrip as consideration "keeps them in the game" by aligning their interests with that of the buyer and target. Sellers that are able to "cash-out" in pure cash deals may become disengaged and buyers may face difficulty in retaining any associated key talent in the business. By utilising at least some scrip, sellers are given the opportunity to share in the future growth of the business and have a greater incentive to work with the buyer to ensure the target's future success.

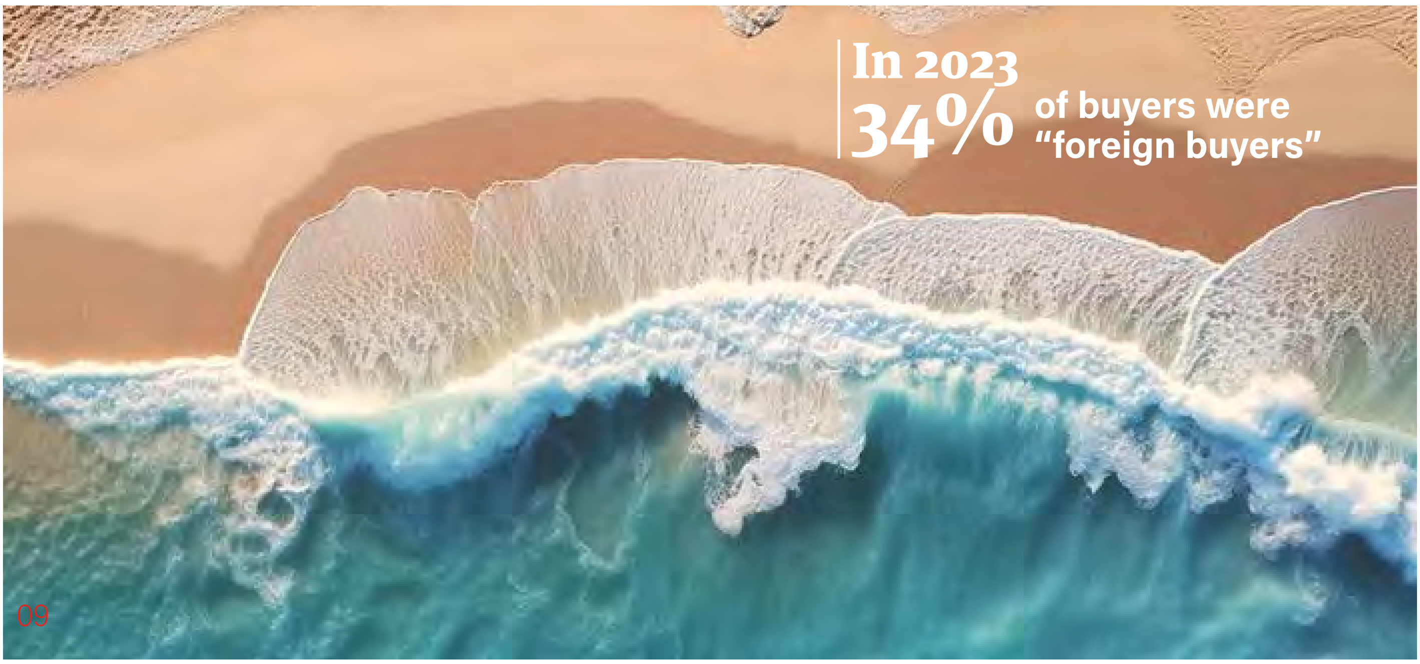
The method and form of payment is often dependent on the type of acquirer. Private equity investors and strategic buyers that operate in the same industry as the target are often inclined to use some form of scrip payment.



Foreign buyers

34% of buyers in our 2023 deals were "foreign buyers", meaning either the buyer or one of its holding companies was headquartered overseas. This figure was slightly less than what we have observed in previous years (2022: 35%, 2021: 39%, 2020: 35%, 2019: 37%). The drop appears to be reflective of a general slowdown in global M&A activity due to a combination of macroeconomic factors, such as the continuing conflict in the Middle East, Russia's war in Ukraine, supply chain pressures and elevated global inflation.

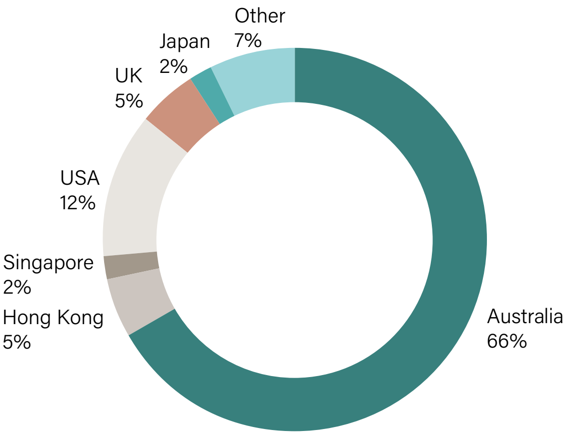
Buyers from the Asia-Pacific region continued to play a significant role in private M&A in 2023. Japan, Hong Kong, Singapore, Thailand and Indonesia were among the common countries of origin amongst buyers after Australia. Buyers from one of these countries were involved in 15% of all deals and in 43% of all deals involving a foreign buyer. China's participation in private M&A involving Australian targets has dwindled since 2019, when it was the country of origin for 12% of all buyers in the deals reviewed. This shift appears to have been brought about by a number of factors, including political tensions, the general tightening of Australia's foreign investment policy and China's general withdrawal from cross border M&A during much of the pandemic.



We continue to see investments from the United States, Canada and the United Kingdom. Foreign buyers from these countries persistently occupy a significant portion of the private M&A landscape. In 2020, for example, US or UK-based buyers were involved in nearly 20% of all deals. We expect to see buyers from these countries keep pace with their counterparts from Asia-Pacific and maintain a strong interest in Australian targets moving forward.

The global outreach of our firm has presented opportunities for us to act on transactions with a diverse group of buyers. However great the global uncertainties, the stability and quality of Australian assets remain a driving factor to entice overseas buyers to consider Australia for M&A opportunities.

2023 Buyer country of origin



Warranty & indemnity insurance

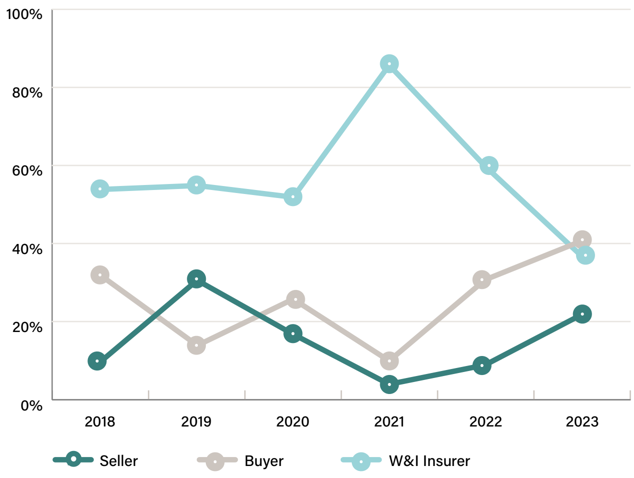
The use of warranty & indemnity insurance has been trending upwards and has become a common risk management tool used by both buyers and sellers. Prices of warranty & indemnity insurance products decreased in 2023 due to increased popularity and stiffer competition amongst insurers. In 2023, insurers began offering coverage on more favourable terms to transaction parties, including lower individual claim thresholds and longer policy periods. Insurers were also more willing to offer a broader range of bespoke products compared to the preceding years.

Warranty & indemnity insurance allows an insured party (typically the buyer) to recover amounts from an insurer in respect of claims for a breach of warranty or under an indemnity given in relation to a M&A transaction. Such policies can be helpful to both parties. On the buy-side, warranty & indemnity insurance can mitigate counterparty credit risk and allow the buyer to negotiate a more comprehensive warranty package. Sellers may also prefer the "clean break" afforded by warranty & indemnity coverage compared to the residual threat of future claims without it.

The increased use of warranty & indemnity insurance may be driven by a greater number of sellers requiring buyers to take out warranty & indemnity insurance as a condition of sale.

In 2023, our market leading insurance and corporate M&A teams continued to see interesting applications of warranty & indemnity insurance, including for public M&A transactions and distressed transactions involving insolvent sellers.

Who we represented 2018–2023



Warranty & indemnity insurance in Australia

W&I insurance is a rapidly growing area in Australia and it has become increasingly common for M&A deals to feature this risk management tool. Dealmakers have begun seeking out bespoke policies to suit their particular transactions, and it is now a common feature of auction processes. Whilst insurance of this nature is primarily designed to transfer the risk of warranty claims to an insurer, the importance of comprehensive due diligence should not be discounted and remains an important part of the process. The terms and scope of any W&I insurance policy need to be carefully considered in light of the transaction at hand.

Norton Rose Fulbright has an appreciation of the complexities and distinct features of transactions that feature W&I insurance. Where the interests of the insurers are not always aligned with the insured party, we understand how to best navigate negotiations to protect our clients' interests, whether they be the insurers or the insured. Our capability to advise on matters involving W&I insurance is backed by our sound understanding of the product, expertise in insurance law and an extensive knowledge of market practices.

What is W&I insurance?

W&I insurance is a bespoke insurance product protects the insured party from financial losses arising out of a breach of warranty or claims under a tax indemnity.

Depending on the size and nature of the transaction, W&I insurance is not always appropriate, Parties are encouraged to consider if it is suitable at the term sheets stage, as it can impact both the due diligence undertaken and the negotiation of key terms of the transaction documents. W&I insurance facilitates a clean exit for sellers, or at least a way to mitigate potential financial losses, and buyers are able to more easily secure debt financing as having insurance provides financiers a measure of comfort.

W&I insurance policies available to Australian dealmakers include both buy-side and sell-side policies, but sell-side policies are quite rare. Buy-side policies are more common as they enable the buyer to make claims for breach of warranty or under the tax indemnity directly against the insurer. Under a sell-side policy, the buyer needs to pursue the seller for the claim, and the seller subsequently seeks to recover financial losses from the insurer.

In both instances, the insurer may control the defence and settlement of any claims.

How can Norton Rose Fulbright help?

We have an intimate knowledge of W&I insurance, and how to structure a transaction and due diligence process to maximise the potential coverage. We understand what drives insurers and the process they undertake in order to determine the level of risk they are willing to accept. We are able to ensure that any due diligence process is appropriately designed to meet the expectations of insurers to avoid a W&I policy being filled with exclusions and other unfavourable terms. The team at Norton Rose Fulbright leverage our experience and market insights to assist tour clients to structure the best insurance solutions possible.

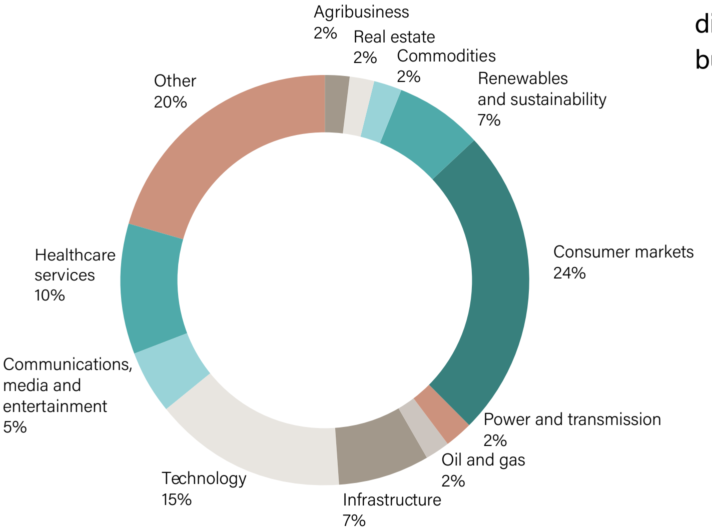
Alternatively, should you be an insurer, our service offering includes assisting insurers with the underwriting process, advising on key deal risks and leading W&I policy negotiations. We have represented a significant number of W&I insurers and are well placed to ensure the risk being insured is appropriate.

Target industries

Technology, consumer markets and healthcare services emerged as the most popular target industries in 2023. A summary of the trends is set out below:

- Following a surge in M&A activity in 2021, technology M&A has slowed down considerably in the past two years. Only 15% of our 2023 deals involved the technology sector. The second half of the year saw many technology deals take longer than usual to complete as buyers conducted due diligence with greater rigour than in previous years. We also saw many divestments postponed in 2023 given the volatility of the markets.
- Consumer market deals remained steady at 24% in 2023. With the rising costs of living, it is likely that many consumers have continued to prioritise saving instead of spending in uncertain market conditions. Increased interest rates paired with rising inflation and raised concerns of a recession in Australia are likely to continue impacting this industry.
- The healthcare sector continued to attract M&A deals, representing 10% of our 2023 transactions. The pandemic brought a renewed focus on this industry. Although societal interest in COVID-19 has dissipated, buyers remain interested in acquiring businesses relating to healthcare.

2023 Industry break-down

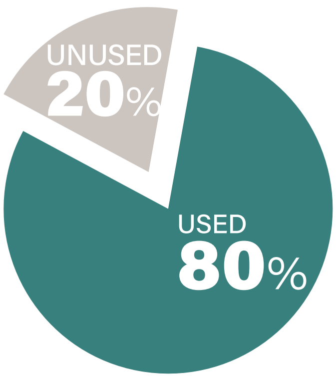


Post-completion adjustments

Post-completion adjustments are changes to the purchase price after a transaction has been completed. By using actual financial metrics and comparing it against the target value for that metric, parties may choose to rely on adjustment mechanisms referring to completion date balance-sheet, working capital or net debt. Our study shows that a majority of transactions relied on working capital as an adjustment metric, with 61% utilising this in 2023 and net debt coming in second at 39%. In fact, most commonly these two metrics were used together. This was the case for 34% of the deals surveyed.

Overall, post-completion adjustments remained a common feature in the majority of the deals surveyed in 2023. 80% of deals included post-completion adjustments while only 20% went without this mechanism. This trend is in line with what we saw in 2022.

2023 Post-completion adjustment mechanism



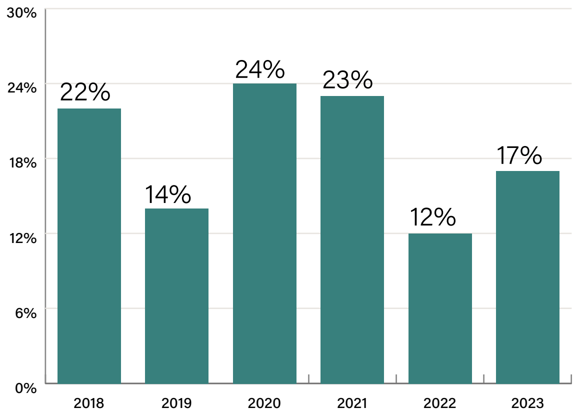
A few explanations as to why some parties may not have used a post-completion adjustment include:

- a locked box was used instead;
- the parties were related and the buyer was familiar with the asset;
- the acquisition was for a minority stake of the target; and
- the valuation was a condition to the completion of the sale.

Locked box

A locked-box mechanism involves the parties to a transaction agreeing on a fixed price for the target at a specific date prior to completion. This method is an alternative to a post-completion adjustment and has the benefit of providing greater certainty over the purchase price and avoids potential disputes that may arise in relation to the target's financial position between signing and completion. A high degree of care when conducting due diligence and negotiations is required to ensure that the agreed locked box figure is well informed and takes into account any risks and uncertainties as well as possible.

Locked box used 2018 – 2023



The use of locked boxes in 2023 was recorded at 17%, which is a slight increase from the 12% recorded in 2022. However, parties have been more reluctant to include a locked-box mechanism in the past few years compared with the preceding years (2021: 23%, 2020: 24%). There are a few reasons for this. Locked box dates are often agreed well in advance of completion which opens the floodgates for potential large discrepancies in the target's ultimate financial position. These large discrepancies may result in prices being much lower or higher than is fair to either party. This mechanism also places a higher degree of risk on buyers. Favouring the seller, this mechanism gives the seller greater price certainty, whilst the buyer must accept the risks of changes in the performance of the business between the locked box date and completion – a factor that the buyer has no control over but one that the seller has a large degree of influence over. While adopting a locked box is a useful pricing mechanism, its potential drawbacks continue to see more than 4 out of 5 deals in Australia opting for post-completion adjustments instead.

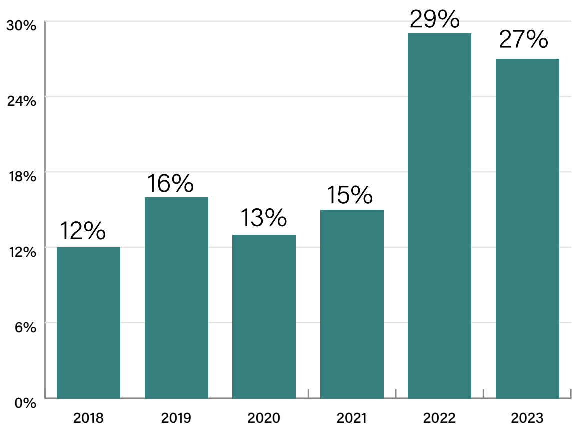
Earn out

Earn outs are a portion of the purchase price that is only payable to the seller if the target business achieves agreed milestones after the transaction is completed. These milestones may be non-financial in nature, such as regulatory approval being successfully obtained, or financial in nature, for example, requiring the target to achieve a set revenue goal. Earn outs are most commonly seen in transactions where a seller's involvement with the target continues beyond completion. This strategy incentivises the seller to continue positively contributing to the target's operations since the maximum purchase price it may earn is tied to the successful performance of the target business.

Continuing on from the 2022 study results (29%), our data set showed that 27% of deals in 2023 used earn outs. In the last two years, there has been a large spike in the number of deals that utilise earn outs. Between 2015 – 2021, the percentage of deals which had an earn out remained steady at between 11% – 16% in each year. A number of factors can explain this jump in recent years:

- Uncertainty over future performance: in uncertain market conditions, using an earn out enables the buyer to defer a portion of the purchase price to future performance, thus, closing the gap between the buyer's and the seller's valuations.
- Financial hardship: in some instances, a buyer may not have immediately available funds to pay for the transaction upfront. As such, an earn out allows the buyer to pay a portion of the purchase price at a later date, making financing the transaction more manageable.
- Alignment of interests: an earn out aligns the interests of both parties by directing their joint focus on seeing the target business strive for success. This may have benefits such as smoother integration periods and better long term performance.

Earn out used 2018 – 2023



Conditionality

Material adverse change

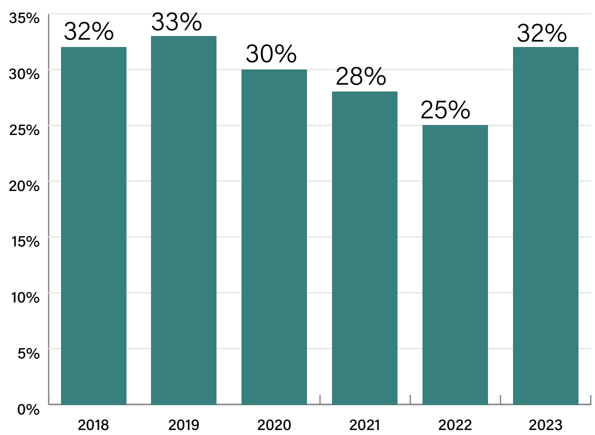
Generally, the inclusion of a no material adverse change (**MAC**) condition will mean the buyer has the right to pull out of the transaction if there are events that negatively impact the target's business or assets between signing and completion of the sale. MAC conditions allow the parties to allocate the risks of adverse developments in the period between signing and closing a transaction. MAC conditions typically exclude adverse developments in general business or economic conditions that do not have a disproportionate effect on the target business.

The longitudinal data indicates that MACs are used in 25%-33% of Australian deals surveyed, with most years featuring MAC use in a narrower 28%-32% range.

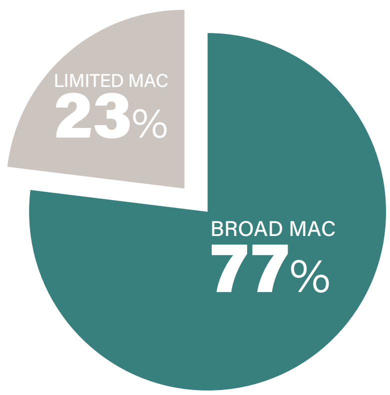
2023 saw a moderate increase in the usage of MAC conditions, with 32% of Australian deals including a MAC condition. This sat within expectations and at the usual 28%-32% range.

When a MAC clause was included as a condition, a "broad MAC" (i.e. where material adverse change was defined very broadly as an event which had a materially adverse impact on the target) was used 77% of the time whereas a "limited MAC" (i.e. a MAC which referred to specific indicators, such as the percentage impact on EBITDA) was used 23% of the time. The usage of broad MACs is a noteworthy increase from 2022 (used only 42% of the time) and shows that in 2023 buyers had the upper hand in negotiating the coverage of MAC clauses.

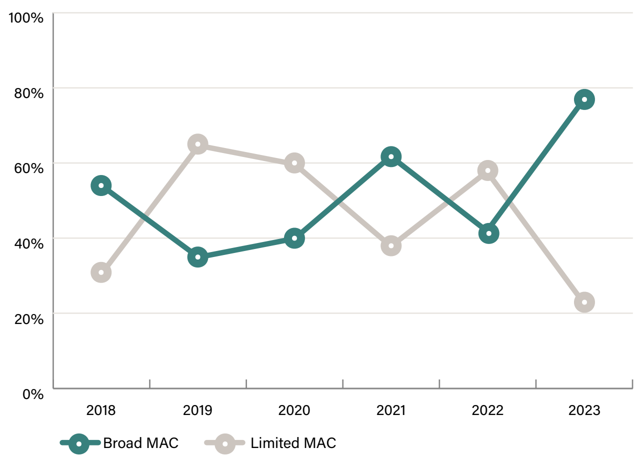
MAC used (% of deals) 2018 – 2023



MAC 2023



MAC 2018–2023



Regulatory approval condition

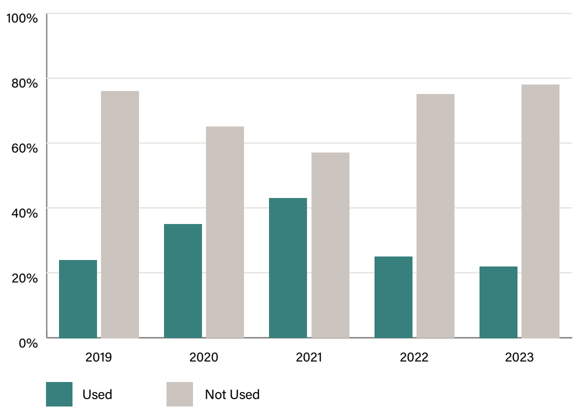
In 2023, 22% of our Australian deals included a regulatory approval condition. That is, the deal was conditional on receipt of approval from a regulator such as the Foreign Investment Review Board (**FIRB**) or the Australian Competition and Consumer Commission (**ACCC**). This represents a minor decrease from 2022 (25%) and a marked decrease from 2021 in which 43% of deals included a regulatory approval condition. Nonetheless, with regulators sharpening their focus on data security, there has been increased regulatory scrutiny over more deals. As a result, bidders and their advisors need to remain agile and efficient to navigate the regulatory approval process. The focus for foreign bidders will be to proactively engage FIRB to ensure that they are addressing issues that may put them at a disadvantage to local bidders.

The increase that we saw over the use of regulatory approval conditions in 2020 and 2021 may be attributable to changes in Australia's foreign investment regime during that period, which included a $0 review threshold for all investments by foreign persons. The $0 review threshold has been abandoned, but the capture of transactions for foreign investment review remains significantly greater than before the pandemic. A number of new requirements have been introduced over the past few years, meaning that we expect to see continuing high usage of FIRB conditions.

We have seen FIRB continue to experience delays in processing applications due to the need for a case-by-case review and the need to engage with various consult partners. The sheer volume of applications that required processing also had an impact on FIRB's processing times and foreign buyers should bear this in mind when considering their strategy. It is not unusual for FIRB approval to impact transaction closing dates as sales cannot be closed if the FIRB process is not completed.

The *Competition and Consumer Act* prohibits mergers that are considered anti-competitive as they can substantially lessen competition in a market. As a result, many large transactions are conditional upon receiving ACCC approval. There have been no significant changes to the merger approval requirements or process in the past 2 years and we have not observed any market practices that have significantly changed on the use of ACCC approval conditions.

Regulatory Approvals 2018–2023



Foreign Investment Review Board (FIRB)

Increase to FIRB monetary thresholds

The monetary screening thresholds under the foreign investment framework were indexed on 1 January 2024. Because of the indexation, the increased thresholds include:

- A$330 million (previously A$310 million) for acquisitions of Australian businesses by foreign persons, unless the higher A$1,427 million threshold below applies;
- A$1,427 million (previously A$1,339 million) for acquisitions of Australian businesses by foreign persons who are FTA country investors acquiring non-sensitive businesses; and
- A$71 million (previously A$67 million) for acquisitions of Australian agribusinesses by foreign persons other than certain FTA country investors who are entitled to the higher A$1.427 million threshold.

Maximum financial penalties for contraventions relating to residential land doubled

On 1 January 2023, the maximum financial penalties for contraventions of provisions in the *Foreign Acquisitions and Takeovers Act 1975* that relate solely to residential land were doubled.

This measure was introduced as part of the Labor Government's election commitment to address housing affordability.

Register of foreign ownership of Australian assets

With effect from 1 July 2023, the *Treasury Laws Amendment (Measures for Future Instruments) Instrument 2023* inserted a new Part 5B into the *Foreign Acquisitions and Takeovers Regulation 2015* (Cth) (**Regulations**). The new provisions support the operation of Australia's Register of Foreign Ownership of Australian Assets (**Register**) by prescribing circumstances in which foreign investors must notify certain information to be included on the Register. The Register records foreign interests in land, water, entities, businesses and other assets in Australia.

Together with the *Foreign Acquisitions and Takeovers Act 1975* (Cth), it is intended that the Regulations will enhance Government visibility of foreign ownership of Australian assets to aid policy consideration and assist efficient case processing by making more information available to decision makers.

Other common conditions

Retention of key employees

This condition was seen in 37% of our Australian deals in 2023 which represents a significant increase over recent years (*2022: 21%, 2021: 18%, 2020: 15%, 2019: 14%, 2018: 12%*). Retention of key employees is often important to acquirers and is commonly achieved through entering into a new employment agreement with the employees.

Due diligence

This condition precedent enables the buyer to complete upon the satisfaction of the due diligence it has conducted. This condition was rarely seen in our 2023 private M&A deals (5%). Sellers typically resist due diligence conditions since they are often seen as amounting to giving the buyer an option to proceed with or exit the sales process.

Competition authority clearance

Competition authority clearance was required in 20% of our Australian deals in 2023, a continued decrease from the 21% in 2022. We were not surprised by this result given the lacklustre M&A activity in 2023 and the rarity of large-scale transactions that required competition clearance from the ACCC.

Pre-completion restructuring

Pre-completion restructuring was required in 22% of deals in 2023. The amount of deals requiring a pre-completion restructure has varied significantly throughout the years and 2023 was no exception (2022: 6%, *2021: 12%, 2020: 13%, 2019: 6%, 2018: 7%*). The nature of the condition is such that we would not expect any obvious trend to emerge in the future. There are also no clear links between the inclusion of this condition and the value of the deal.

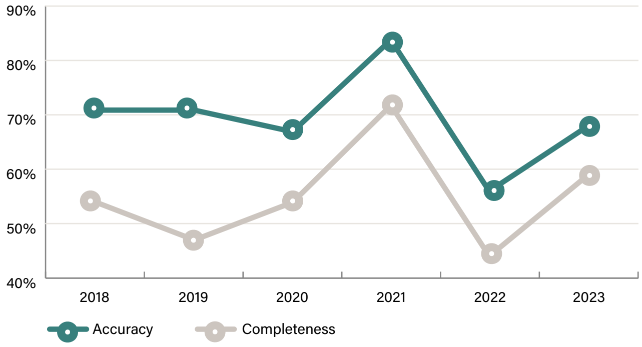
Warranties and liability limitations

Buyers and sellers in the Australian market are usually more flexible and willing to negotiate on warranties and limitations in order to reach a commercial arrangement. This is in contrast to other jurisdictions, such as in other parts of the Asia-Pacific, where parties typically insist on a more standard position.

Accuracy of disclosure materials

An accuracy warranty involves the seller warranting to the buyer that the information given in the disclosure materials is accurate. In 2023, we saw accuracy warranties used in 68% of transactions, a figure that is well within the average range in the context of our longitudinal data (*2022: 56%, 2021: 84%, 2020: 67%, 2019: 71%*). This suggests that the far higher 84% figure we saw in 2021 may have simply been an anomaly. Only 49% of our 2023 private M&A deals contained a seller warranty that the disclosure material is "complete". Sellers have been reluctant to include this warranty, leaving the onus on buyers to ensure that they leave no stone unturned.

Warranties – Accuracy and completeness of disclosure materials 2018–2023



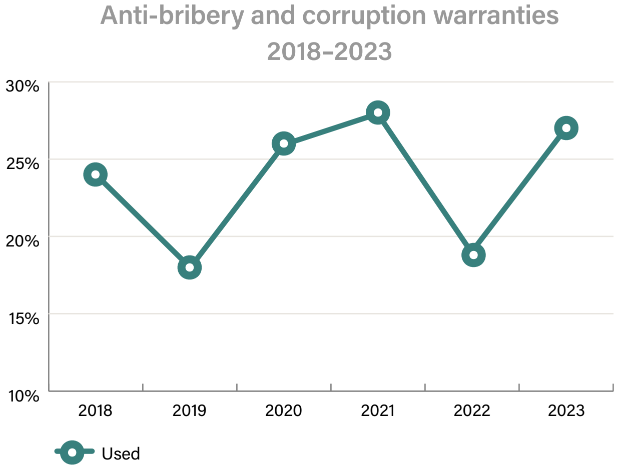
Anti-bribery and corruption (ABC) warranties

An ABC warranty is a warranty (usually by the seller) that the target and its related entities have not breached any of the anti-money laundering (or similar) laws.

ABC warranties were used in 27% of our deals in 2023. We have seen enough of a trend (*2022: 19%, 2021: 28%, 2020: 26%, 2019: 18%*) to conclude that ABC warranties now have a firmly cemented presence in many of our Australian deals. We expect their usage to continue to increase over the medium term.

Australia's ABC laws have become more stringent in recent years, driven by international, high-profile prosecutions of corruption around the world. As with conditions for FIRB approval, we expect to see more deals including ABC warranties to give the buyer comfort that they are not inheriting unwanted future liabilities.

With the increasing spotlight on ABC and AUSTRAC's growing presence in the M&A environment, we expect this upwards trend to continue.



> *"With the increasing spotlight on ABC and AUSTRAC's growing presence in the M&A environment, we expect this upwards trend to continue."*

Average monetary liability cap on warranty claims

The capping of maximum liability and general warranties as a percentage of the purchase price has returned to the levels we saw in 2020 and 2021 after a momentary drop in 2022. It appears that the results from the 2022 dataset were an anomaly and the 2023 data suggests that maximum liability caps on warranty claims are here to stay. A large majority of deals included a maximum cap on loss recoverable for a breach of title and tax warranties (88% and 80% respectively). More often than not, we saw this cap set at 100% of the final purchase price.

	Maximum aggregate liability	Title warranties	General warranties	Tax Warranties
2019	67%	62%	49%	60%
2020	81%	89%	72%	86%
2021	80%	83%	62%	63%
2022	67%	76%	50%	67%
2023	**88%**	**88%**	**73%**	**80%**

Limitation of liability – time limits (general)

M&A lawyers pay close attention to limitation of liability clauses. These clauses are a safety net that clearly defines what each party is liable for in the event things go wrong. Used correctly, limitation of liability clauses can balance the interests of buyer and sellers, providing the buyer a reasonable path of recourse if there are warranty breaches without exposing the seller to undue liability.

Time limits specify the period in which a claim for a breach of warranty must be brought. Claims are barred after these periods have expired giving sellers peace of mind that they will not be held liable for anything after this cut-off date. The table below illustrates time limits belonging to three categories of warranties being general warranties, title warranties and tax warranties.

In line with previous years, we have seen a low proportion of Australian deals imposing no caps on general warranties (12%), title warranties (12%) and tax warranties (15%). Title and tax warranties are typically called out and treated separately from general warranties given the foundational basis for these warranties. Given the importance of these warranties, it is no surprise that the most common time limit on title and tax warranties sit at a lengthy 84 and 60 months respectively as compared to 24 months for general warranties. Our data also tells us that the average period of time for title and tax warranties is 47 months and 64 months respectively. This is more than double the average of 26 months for general warranties.

The 2023 data has demonstrated a widespread move towards longer warranty periods. With the many uncertainties of 2023 creating unpredictable market conditions, this could be a plausible explanation behind a party's preference for a longer protection period.

		General warranties (months)	Title warranties (months)	Tax warranties (months)
Uncapped		12% of deals had uncapped time limits for general warranties	12% of deals had uncapped time limits for title warranties	15% of deals had uncapped time limits for tax warranties
Capped deals	Mode	24 months	84 months	60 months
	Average	26 months	47 months	64 months
	High	36 months	84 months	84 months
	Low	3 months	3 months	3 months

Is the seller's liability limited by knowledge of the buyer?

As a general principle, a buyer may not bring a claim for a breach of warranty if it had knowledge of the breach before the transaction was signed. This position can be contracted out of entirely or, in some instances, a buyer's prior knowledge of the breach can be used to reduce the amount of damages owed.

In a sale agreement, "knowledge" should be carefully defined. Without properly defining this scope, parties run the risk that knowledge could later be imputed which could broaden their liability or limit their ability to make claims. For the purposes of our study, we categorise the limitations of liability regarding knowledge into limited by actual knowledge, limited by constructive knowledge or not limited.

Actual knowledge is where the party has direct knowledge of an event, matter or circumstance.

Constructive knowledge goes one step further by including matters which a party ought to have known had they made reasonable enquiries, regardless of whether they actually knew about them. Constructive knowledge definitions are designed to encourage parties to make reasonable enquiries of matters before relying on or giving an assurance about them (eg. by undertaking searches or making enquiries of direct reports).

80% of deals limited the seller's liability in respect of matters within the buyer's actual knowledge. Proving actual knowledge may be difficult for a seller seeking to limit its liability for a claim made by a buyer however, this definition is preferred over constructive knowledge.

Our data demonstrated that only 10% of deals limited the seller's liability in respect of matters within the buyer's (or its key personnel's) constructive knowledge.

Warranties qualified by information

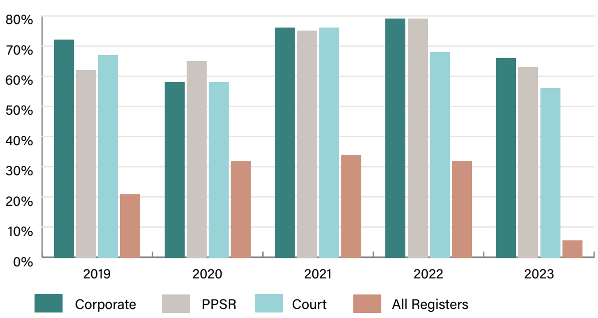
Having a warranty qualified by information available through public searches puts the onus on a buyer to ensure it has conducted a reasonable level of due diligence on the target business. A qualification of this nature typically prevents a buyer from making a claim for a breach of warranty where the facts, events or circumstances underlying the breach would have been known to the buyer had it done a search of the seller or the target business in specified public registers.

73% of the deals reviewed in 2023 contained a clause limiting the seller's liability in respect of matters identifiable in public searches. Of the deals which had a public search qualifier, we found that the seller's liability was limited by matters disclosed in one or more of the following searches:

- Corporate searches (in 66% of the 2023 deals with a public search warranty qualifier)
- PPSR searches (in 63% of the 2023 deals with a public search warranty qualifier)
- Litigation searches (in 51% of the 2023 deals with a public search warranty qualifier)
- "All registers open to the public" (in 5% of the 2023 deals with a public search warranty qualifier).

As a whole, these figures are generally lower than what we have seen in previous years. This is mainly attributable to the fact that a larger proportion of our 2023 deals were drafted by foreign counsel. Of the deals that were originally drafted by Australian lawyers, we often saw that a seller's liability was limited by the matters disclosed in one of those searches above. Corporate, PPSR and litigation searches remain a common qualifier and we expect to see this limitation in the first iteration of Australian sale transaction documents.

Searches qualifying warranties 2019–2023



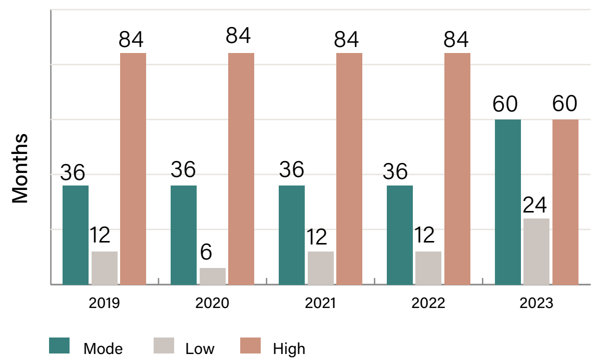
Is the seller restrained from competing?

Another protective mechanism for the benefit of the buyer is a restraint clause. This typically prevents the seller from setting up a similar business to, or competing with, the target business for a specified period of time. A restraint clause can give a buyer comfort that the target is not going to decline in value due to existing customers following the seller to a reincarnation of the business.

Restraint clauses were present in 68% of the deals surveyed in 2023, a similar figure to the number of deals in 2022 (67%). Restraint periods typically varied between 24 months to 60 months after completion. Restraint clauses are often presented as cascading clauses, meaning if a court is inclined to find the highest level of restraint unenforceable, there are several lower restraint options the court may choose to give effect to. Buyers have had the upper hand on negotiating the length of the restraint period over the past year. The most frequent restraint period in our 2023 data set was a 60-month restraint (compared with a 36-month restraint in 2022). Parties have been more willing to set a higher starting point on the restraint period and are choosing to leave it to the courts to determine what level is enforceable if there is a dispute.

Restraints should only be employed where they are reasonably necessary in the circumstances to protect the buyer's legitimate interests. Excessively long or otherwise onerous restraints are in danger of being severed from a contract if they are challenged in court. Deal makers should be aware of this limitation in negotiations and only advocate for what is in their genuine business interests.

Restraint period 2019–2023



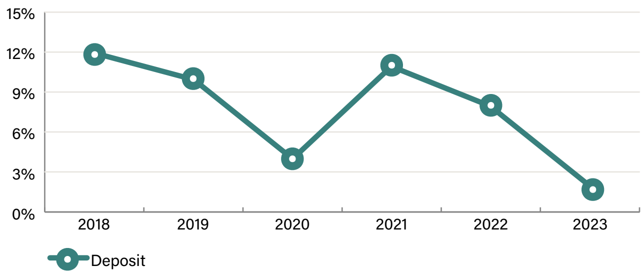
Deal protection

Was the buyer required to pay a deposit?

Deposits were recorded in 2% of the deals surveyed in 2023. This is below the 4% - 12% range that has been recorded over the past 5 years. These relatively low figures suggest that deposits in Australian deals are not commonplace. Deposits are more frequently seen when a buyer originates from an emerging market and no other form of security has been provided (such as a buyer guarantee). In these instances, a seller may require a deposit to cover the risk of a transaction not completing due to the buyer's default. Deposits are typically paid upon execution of a sale agreement and are non-refundable if the sale does not complete in certain circumstances (such as where the agreement is terminated due to buyer default) and so can be a powerful incentive for a buyer to complete the transaction.

Deals exceeding $50 million in value rarely use deposits. Plausible explanations for this include the fact that providing deposits is not market practice and many buyers like to assert their bona fide intent to complete the transaction without putting down a large deposit.

Number of deals where deposit was paid 2018–2023

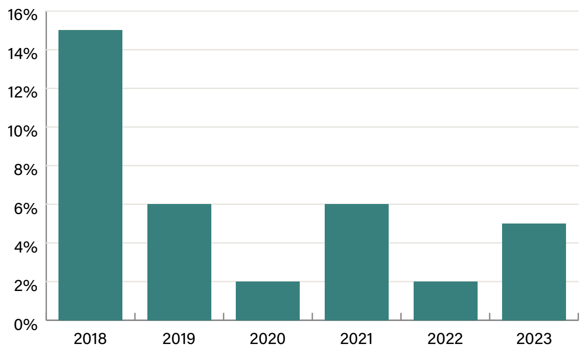


Break fees

Break fees remain uncommon in private M&A deals and are more often a feature of public M&A deals. Where they do appear in private M&A, they tend to be used as a protective mechanism in transactions arising from a competitive bid process or larger

transactions. In 2023, we saw break fees employed in 5% of the deals surveyed. As seen from the graph below, the percentage of deals with a break fee fluctuate on a year-to-year basis but have often remained in the 2% - 7% range.

Number of deals with a break fee 2018–2023

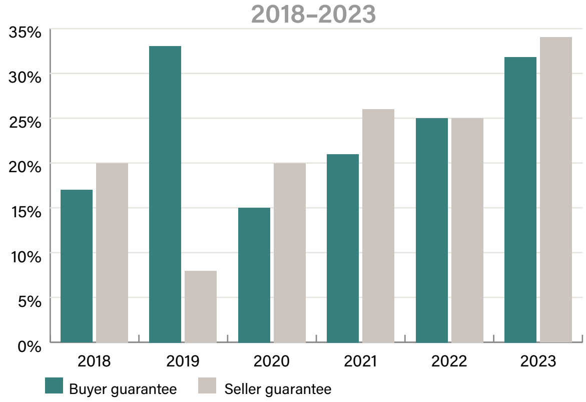


Guarantees

Guarantees can be used when one party has doubts that the other has the ability or financial capacity to fulfil its obligations in a transaction. They are often used to mitigate counterparty risk by providing recourse against the guarantor in the event the relevant party does not perform the guaranteed obligations. Guarantees can be used to protect buyers (ie. where a guarantor guarantees performance of the sellers obligations such as payment for warranty claims), sellers (ie. where a guarantor guarantees performance of a buyer's obligations such as to pay the purchase price) or both (ie. where mutual guarantees are provided in respect of both parties' obligations).

In 2023, buyer guarantees and seller guarantees appeared in 32% and 34% of deals respectively. These figures are similar to those recorded in 2022. The results indicate that while not overly common, guarantees are seen in around one out of three private M&A deals and where they do appear, they tend to be mutual.

Buyer and Seller Guarantees 2018–2023



Contract Law – Indemnities

A contractual indemnity has been defined by the Australian courts in various ways as follows:

1. *An indemnity is a promise by the promisor that he will keep the promisee harmless against loss as a result of entering into a transaction with a third party… (Mason CJ in Sunbird Plaza Pty Ltd v Maloney (1987) 166 CLR 245).*
2. *Indemnity clauses are provisions that purport to exempt one party from civil liability which the law would otherwise impose upon it. They are provisions that shift to another party the civil liability otherwise attached by law to the first-party. (Kirby J in Andar Transport Pty Ltd v Brambles Ltd (2004) 317 CLR 424, at 437).*

Distinction between guarantees and indemnities

A guarantee is a binding promise of one person to be answerable for the debt or obligation of another if the other defaults (*Sunbird Plaza Pty Ltd v Maloney* [1988] HCA 11). The distinctive feature of a contract of guarantee is the secondary nature of the obligation which is assumed by the guarantor. There must be another person who is primarily liable (*Turner Manufacturing Co Pty Ltd v Senes* [1964] NSWR 692). In contrast, under an indemnity, a person assumes a primary liability. A contract of indemnity is "a contract by one party to keep the other harmless against loss" and is not dependent on the continuing liability of the principal debtor (*Yeoman Credit Ltd v Latter [1961] 1 WLR 828*). An indemnity is an independent obligation to make good a loss.

Drafting mechanisms for controlling the exposure of an indemnifying party

1. The indemnity should be fault based. The indemnifying party should only be liable for its negligent, wilfully wrongful or unlawful acts or omissions.
2. The indemnity should be expressed to be proportionately reduced to the extent that the indemnified party caused or contributed to the loss or claim.
3. An appropriate causal nexus should be selected. The expressions "caused by" or "directly resulting from" provide the best protection for the indemnifying party.
4. Avoid, if possible, giving an indemnity for a breach of contract. However, the risk associated with providing such an indemnity will very much depend upon the specific transaction and limitations agreed between the parties as to loss caveats.
5. Consider whether there are any types or categories of loss or liability which should not be the subject of indemnification, eg. loss of profit, loss of revenue, loss of anticipated savings or loss of reputation. Again, this is a transaction-based exercise and may involve some vigorous negotiation with the counter party.
6. Consider the introduction of a provision that the indemnity is not to survive termination of the relevant contract.
7. Consider the possibility of introducing an overall financial cap on liability under the indemnity.

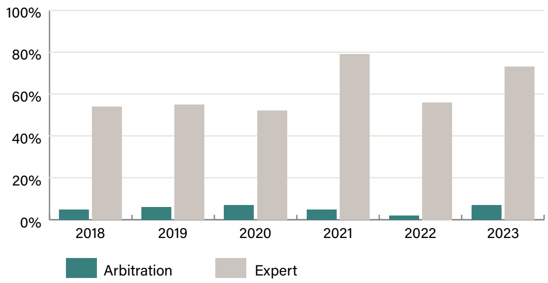
Dispute Resolution

Once again, expert determination was the most popular dispute resolution mechanism and was used in 73% of deals in 2023. Although it did not reach the 2021 high of 79%, 2023's figure suggests the increasing willingness to appoint an independent expert to resolve disputes.

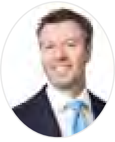
Expert determination is popular because it offers transaction counterparties a degree of certainty as to the process (and associated costs) for future disputes that may arise. Expert determination is commonly used as the mechanism to resolve disputes with respect to factual matters that need to be determined by the parties such as the calculation of adjustment payments or valuations. It is rarely used to resolve warranty claim disputes where parties tend to resort to litigation if the claim cannot be resolved by agreement.

The use of arbitration as a dispute resolution mechanism remains out of favour – only 7% of our 2023 deals elected to use this method.

Dispute Resolution
2018–2023



About the authors



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