



# *Dealmakers:*

Mid-market M&A in Australia mid-year update



2020

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## ***About the survey***

Welcome to *Dealmakers: Mid-market M&A in Australia mid-year update*, produced in collaboration with Mergermarket, an Acuris company. Pitcher Partners has commissioned Mergermarket to again canvass the opinions of 60 M&A dealmakers in Australia (domestic and foreign investors) regarding their expectations for the market given the ongoing COVID-19 pandemic and its impact on the deal environment. For this report, 56 of the original 60 survey participants interviewed last November and December 2019 for our full-year report (launched in February 2020) took part in this research.

All dollar figures, unless otherwise stated, are in Australian dollars (AUD). Percentages may not sum to 100% due to rounding.



# Executive summary

Australia remains a market of interest among investors and will continue to provide deal opportunities even as the COVID-19 health crisis develops.

The past half year has been one of shock and awe as the COVID-19 pandemic and subsequent lockdowns spread fear and uncertainty, developments that have taken a dreadful toll on M&A. Globally, deals are down, amplifying declines that started in 2019 and reaching historic annual and quarterly drops. Australia has seen similar trends, marked by a drop off in deals as M&A is put on hold until some visibility can be established on the near-term outlook.

Amid this sudden and unprecedented jolt to the Australian M&A environment, it was important to see just how seriously investor confidence has been shaken. As such, dealmakers who participated in the research completed just prior to the spread of COVID-19 in our publication “Dealmakers: Mid-market M&A in Australia 2020” were contacted to compare and contrast their opinions with 56 of the original 60 (95%) respondents providing updated views on their intentions over the coming year.

As expected, dealmakers are planning to scale back investments in response to COVID-19. Almost half (42%) say they will complete deals in Australia, particularly into the mid-market, in the year ahead, down from 65% in January 2020. Noticeably, almost half (47%) say they are not currently considering M&A, although large numbers in this group were previously undecided on what their next move in Australia would be. It seems, then, that the pandemic has made this decision for them.

On the bright side, within this group, the majority of dealmakers (70%) say they will consider returning to the market within the next year depending on how the pandemic plays out. This is in light of expectations that the technical recession currently being experienced will further unfold in the near term, although Australia may not be hit as badly as other global markets.

Regardless of investment intentions, dealmakers recognise the current uncertainty as a short-term obstacle and many highlight Australia’s advantages as features of the deal environment that will not be shaken by the present pandemic. Indeed, a robust economy, sound fundamentals (legal certainty and political stability), low risk compared to regional markets and dynamic industries continue to be Australia’s standout features. Within the mid-market, abundant deals and new/advanced technology are creating opportunities for investors.

Our expanded research and mid-year update of the Australian market looks at these issues and others that dealmakers have on their radar, as we try to understand current attitudes and motivations among dealmakers in these unprecedented times. The interviews and insights collected provide a bounty of useful information and trends over time, creating a window through which dealmakers can see ahead as they plan out their next investment.

Pitcher Partners hopes you find this an informative read and welcomes you to join the conversation by reaching out to one of its dealmaking specialists across Australia.

# Key findings

**42%**

of dealmakers are considering M&A into the Australian mid-market, while 11% remain unsure

**90%**

say dealmaking in the TMT space will increase in the year ahead



**12%**

say PE deals will increase in the year ahead, and 48% say they will remain unchanged from current levels

**95%**

say the amount of capital to be deployed by private equity will be the top mid-market deal driver

**70%**

say foreign inbound M&A may decrease in the year ahead



**57%**

anticipate a recession in Australia, compared to 90% who say a global recession is imminent

**70%**

say they may return to the Australian market within the next 12 months depending on how the pandemic and health crisis play out

**70%**

have postponed or cancelled investments into Australia as a result of COVID-19



**75%**

say access to financing will be the top challenge facing mid-market dealmakers in the year ahead

## Australia's top mid-market advantages

Deal sourcing

**78%**

New/advanced tech

**73%**

## Challenges:

Delays in government approvals

**53%**

Regulatory change

**42%**

Difficulties conducting due diligence

**32%**

## Australia's key advantages:

- 1** Low risk compared to regional markets
- 2** Legal certainty and political stability
- 3** Favourable tax regimes



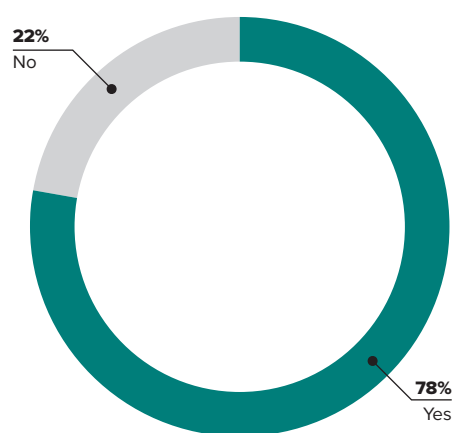
# Introduction: COVID-19 and its impact on Australian dealmaking

Dealmaker sentiment has shifted in light of the COVID-19 pandemic, however, many remain optimistic that economic conditions in Australia will be better than those in other global markets. As such, while most dealmakers have no immediate plans to invest, many are hopeful their return to the market could happen within the next year.

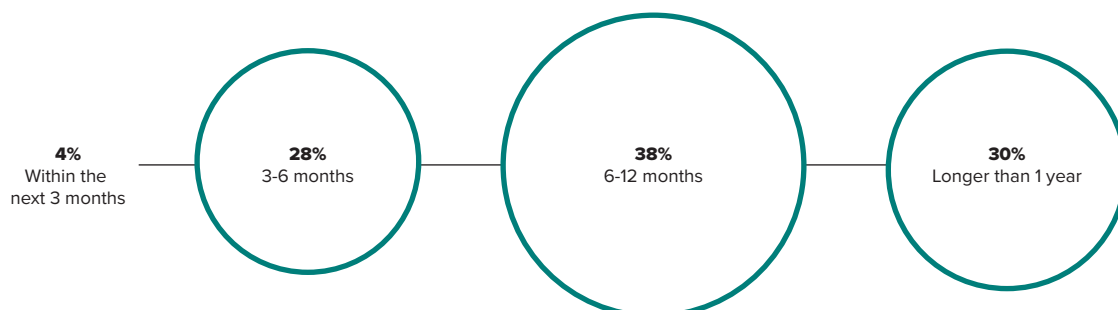
M&A remains on shaky ground, with dealmakers largely taking a wait-and-see approach to investing in Australia. Since the outbreak of the pandemic in March, 78% of dealmakers say they have postponed or cancelled investments due to COVID-19. Many cited the shroud of uncertainty behind their decisions, noting that travel restrictions and social distancing made it nearly impossible to source and vet investments. An inability to properly assess risks also contributed to this sentiment.

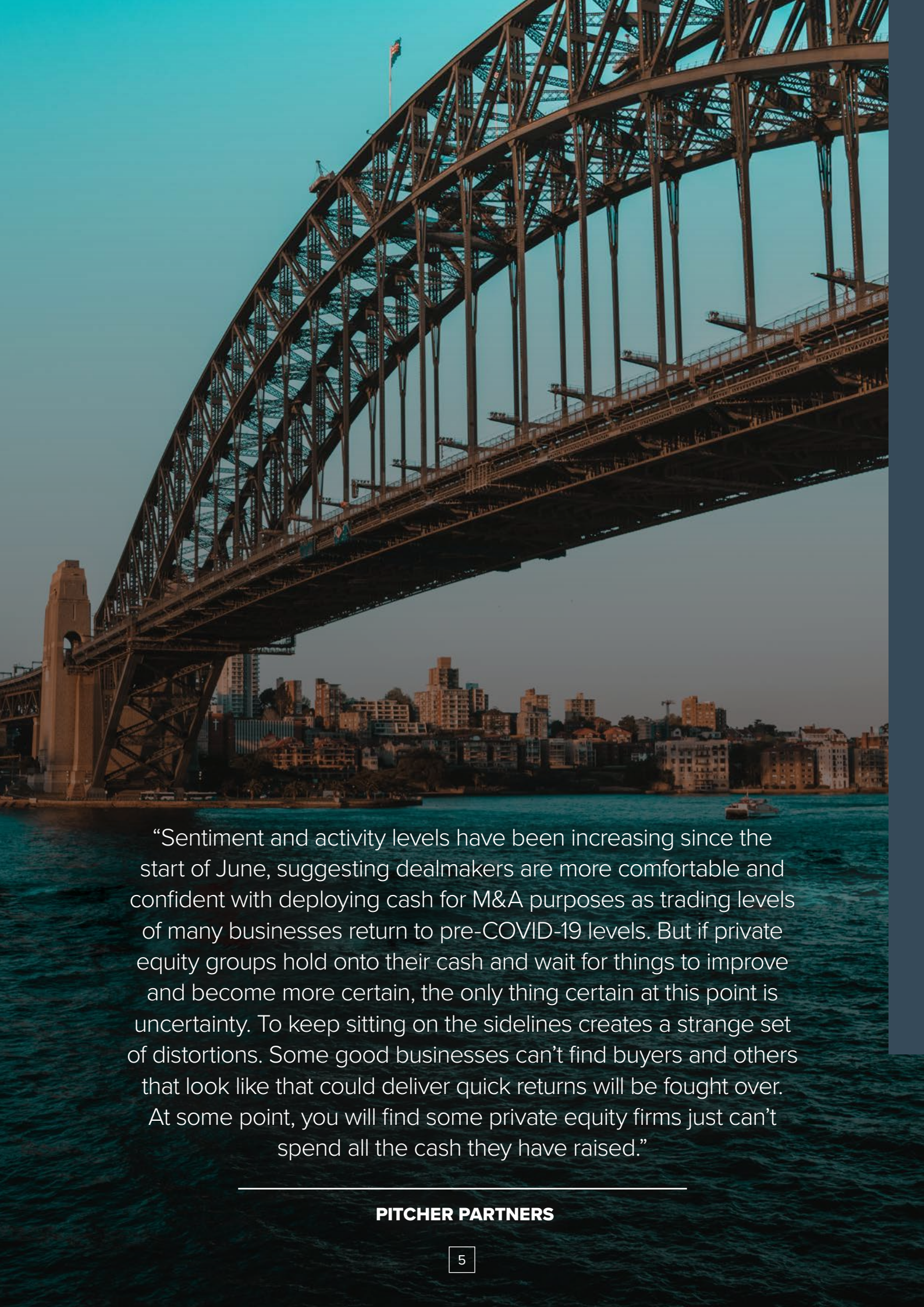
However, most dealmakers (70%) are hopeful that Australia will recover quickly, in both a public health and economic sense, and plan to return to the market within the next 12 months. One respondent says, "About 6-12 months should suffice to increase preparedness. We can ensure a careful survey of the conditions and prepare our teams and finances to cope with the changes. As it stands, there are a few uncertainties with the perceived returns, which must be clarified." This respondent, and almost all others, say that this positivity is dependent on how the next few months play out and if the spread of COVID-19 is adequately contained.

**Figure 1. Have you postponed or cancelled plans to make investments/M&A in Australia as a result of the pandemic and spread of COVID-19?**



**Figure 2. If you postponed or cancelled investments, when will you begin looking at investment opportunities in Australia again?**





“Sentiment and activity levels have been increasing since the start of June, suggesting dealmakers are more comfortable and confident with deploying cash for M&A purposes as trading levels of many businesses return to pre-COVID-19 levels. But if private equity groups hold onto their cash and wait for things to improve and become more certain, the only thing certain at this point is uncertainty. To keep sitting on the sidelines creates a strange set of distortions. Some good businesses can’t find buyers and others that look like that could deliver quick returns will be fought over. At some point, you will find some private equity firms just can’t spend all the cash they have raised.”

### Mid-market: Sentiment comparison

Since the launch of Pitcher Partners' full year report in February 2020, sentiment has changed regarding intentions toward mid-market investments. Today, 42% say they are currently looking at mid-market deals, a decrease from 65% earlier in the year.

The most notable shift has been sentiment among dealmakers who are not considering such investments. At present, 47% say they are not pursuing mid-market deals, a substantial increase from 5%. While COVID-19 is almost certainly to blame for this shift, the recent health crisis may also have pushed respondents who were previously undecided to abandon or delay their future investment plans. Elaborating on these decisions, one respondent says, "We are not planning on any acquisitions in Australia in the year ahead. We're thinking about our own sustainability in the current environment and even if the global panic dies down, we need to be ready for recession."

For those eager to invest, respondents point to a number of market positives that are driving their decisions. According to one respondent, "I think Australian markets have remained much more stable in comparison to others. This is the main reason for us to remain optimistic in the situation. The virus spread has impacted markets, but our expansion plans will continue at the same pace."

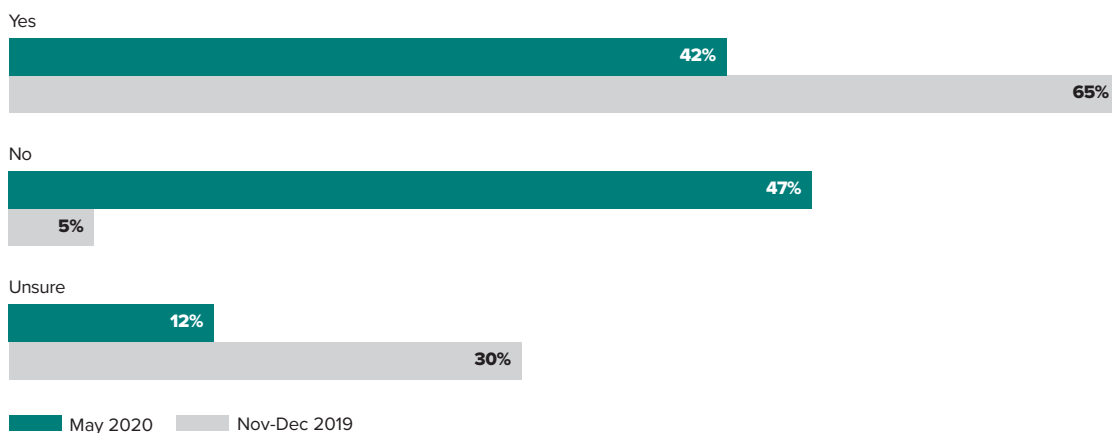
Another goes on to say that "the mid-market range is suitable for target acquisitions with good technological potential. In Australia, we can expect better sophistication and we are aware of the regulatory expectations as well, so there will be limited concerns here."

"I think Australian markets have remained much more stable in comparison to others. This is the main reason for us to remain optimistic in the situation. The virus spread has impacted markets, but our expansion plans will continue at the same pace."

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### SURVEY RESPONDENT

**Figure 3. Are you considering an acquisition into the Australian mid-market in the year ahead?**





**Recession: Global and local expectations**

Respondents are largely in agreement that a recession on a global scale will unfold, and soon. As much as 90% say a global recession is likely, with 80% convinced it is inevitable as COVID-19 takes its toll on businesses and continues to disrupt supply chains worldwide. This sentiment is reinforced as recovery measures in key markets, like the US, fail to produce results – developments that could have global ramifications.

Australia, however, may not take the economic hit that other markets are bound to bear. Far fewer (57%) say that recession in Australia is imminent, and another 38% are unconvinced that a downturn of any significance is unavoidable. Respondents point to Australia’s quick response to containing the spread of COVID-19 in addition to government stimulus measures to provide a cushion for companies in distress.

While there is a stark difference in sentiment between global and local economic outlooks, the reality is that more than half of dealmakers think there will be some economic fallout from the pandemic. The severity in Australia may not be as extreme as other global markets, which means it should bounce back quicker and see a return in dealmaking levels much sooner.

**Mid-market advantages: Deal sourcing and tech**

Regardless of the impact of the pandemic, Australia’s fundamentals continue to make it an attractive and reliable market for investment. Indeed, respondents recognise Australia’s key advantages that set it apart and make it a competitive market, notably its low risk compared to regional markets, legal certainty and political stability and favourable tax regime.

Within the mid-market, respondents also say that deal sourcing opportunities (78%) and new/advanced technology (73%) make Australia an attractive market for M&A, consistent with findings from the Pitcher Partners February report. Respondents

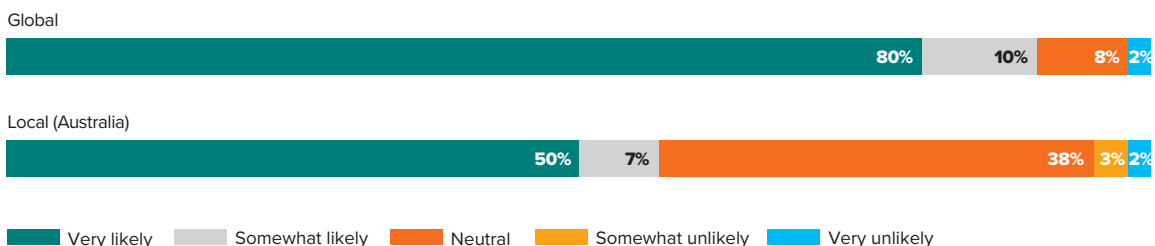
recognise the availability of mid-market deals compared to larger cap transactions, with one dealmaker saying, “Deal sourcing opportunities can be availed in an organised manner. There is consistency in good potential target availability.”

Australia’s strong culture of innovation, led by numerous dynamic industries and an enterprising, tech-focused workforce, is another advantage driving positive respondent sentiment toward Australia generally and specifically within the mid-market.

“The level of technology sophistication among Australian mid-market firms has improved significantly in recent years. Even as other countries struggled with the financial crisis years ago, Australia was in a better position with use of advanced technology, and their development has been phenomenal ever since.”

**SURVEY RESPONDENT**

**Figure 4. How likely are we to see a recession/economic slowdown either on a global or local level?**



According to one respondent, “The level of technology sophistication among Australian mid-market firms has improved significantly in recent years. Even as other countries struggled with the financial crisis years ago, Australia was in a better position with the use of advanced technology, and their development has been phenomenal ever since.”

Indeed, respondents say the uptake of new technologies and development of others has contributed not just to rapid growth in the mid-market, but within the broader economy. Generally, dealmakers see this tech-rich opportunity as ripe for investment, as innovative Australian mid-market assets can provide a significant value-add to the operations and processes of buy-side organisations. For these reasons and many others, 90% of respondents also say tech will see increases in M&A in the year ahead.

“We are considering acquisition of targets with good digital assets and IP related to advanced technology. We have been working on our expansion objectives relentlessly and an acquisition will complement these. Targeting the mid-market is the most feasible option going forward given the higher number of risks acquiring unsustainable start-ups,” says one respondent.

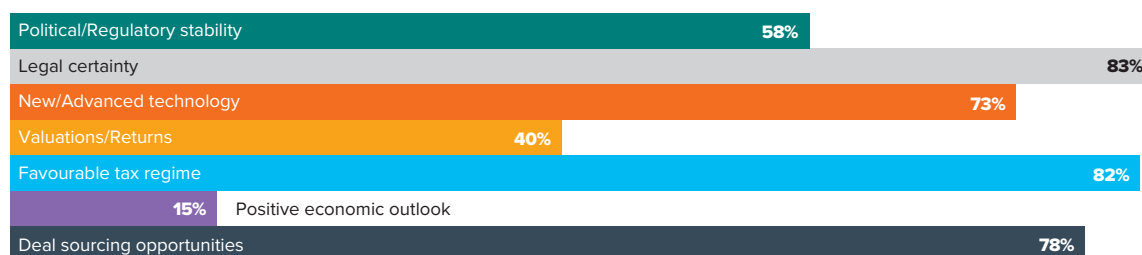
Respondents also highlight growing sector opportunities in pharmaceutical (75%) given medical advances and IP, not to mention the rising importance of the field as the world battles the pandemic. Industrials and consumer (63% each) may also see increases in mid-market M&A as

companies in both industries with digital advantages and e-commerce operations drive growth. As respondents point out, while limited in operational scope, mid-market companies in these sectors that have adopted innovative business strategies will be able to compete with larger companies or traditional industry leaders in the battle for market share.

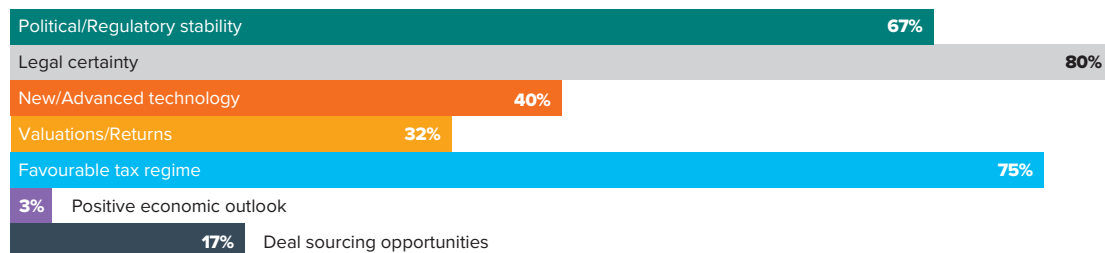
Significantly lower deal activity is now being predicted for defence and government sectors, with dealmakers suggesting activity in the sectors will be down from 43% and 35% in December to just 0% and 3% in May. The attitude to these sectors is driven by changes to foreign investment with the lowering of thresholds to zero and the more recent introduction of the Treasurer’s sign-off for transactions involving foreign acquirers of businesses with government contracts.

**Figure 5. What makes Australia an attractive market for M&A? (Select all that apply for each row)**

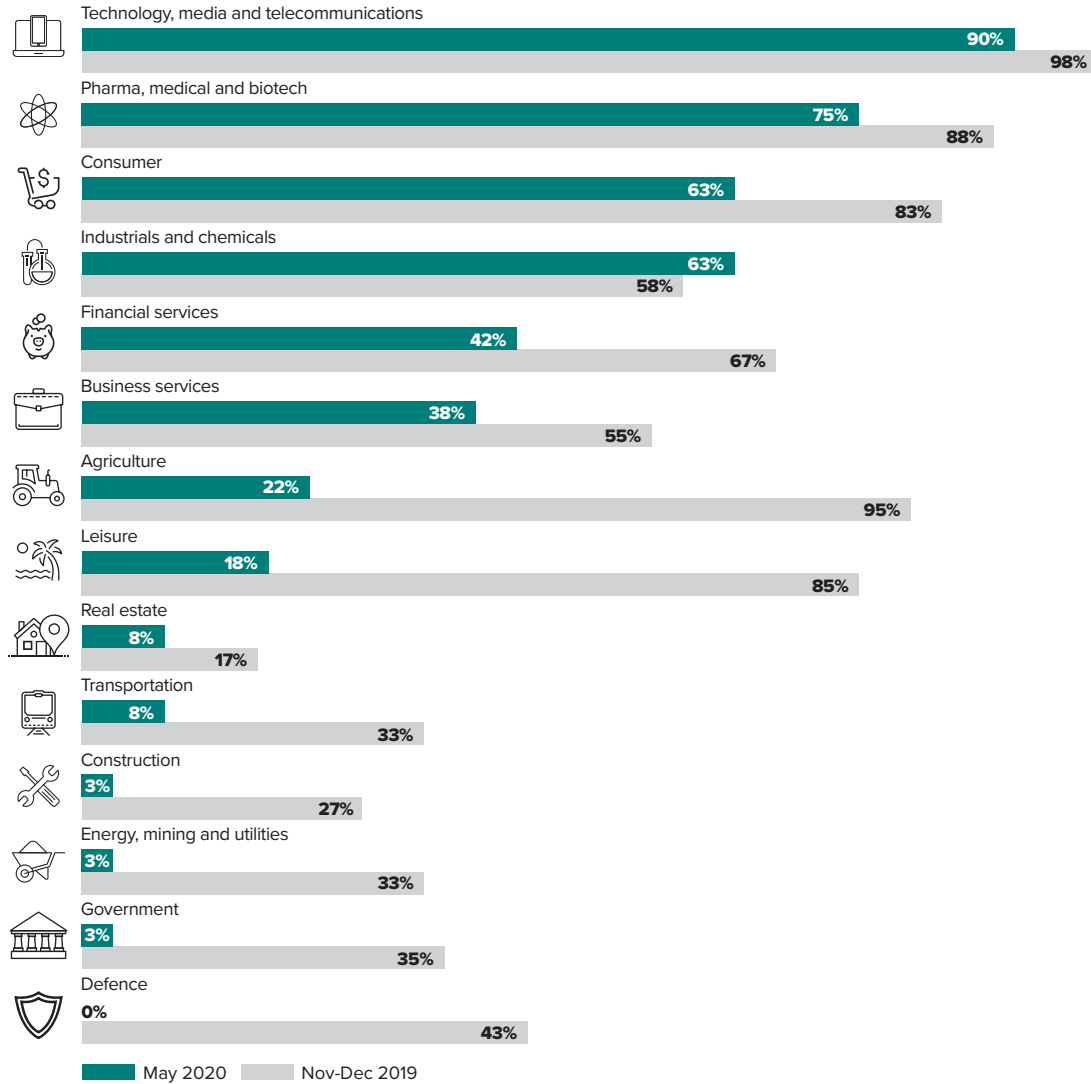
**Mid-market M&A**



**Overall M&A**



**Figure 6. Which of the following sectors will see increases in mid-market M&A in the next 12 months? (Select all that apply)**



“Appetite for tech businesses has two key drivers; tech businesses have the advantage of being able to conduct due diligence in a locked-down environment and while borders are closed, as the technology can be inspected remotely, unlike other businesses where site visits and inspections are critical.

Tech has been one of the key differentiators of how businesses have survived COVID-19, with those embracing technology faring better than those that haven’t.”

# Mid-market deal drivers and challenges

Changes to the bidder universe are likely in the year ahead as offshore investors stick closer to home, leaving opportunity for private capital. Respondents also see new challenges as the deal environment and Australian market adjusts to the pandemic.

Overwhelmingly, 95% of respondents say private equity will be a key participant driving mid-market dealmaking in 2020. Private equity deals are also one of the few transaction types where M&A levels are expected to rise in the year ahead (12% expect increases) or at least remain unchanged from current levels (48%).

Expanding on overall sentiments, one respondent says, “The amount of dry powder available with private equity firms will drive M&A activity in the year ahead.” Indeed, private capital investors in Australia continue to have an unprecedented level of undeployed funds at their disposal – Australian private capital investors have AU\$22bn to deploy, according to the Australian Investment Council – so availability of capital is unlikely to be a problem.

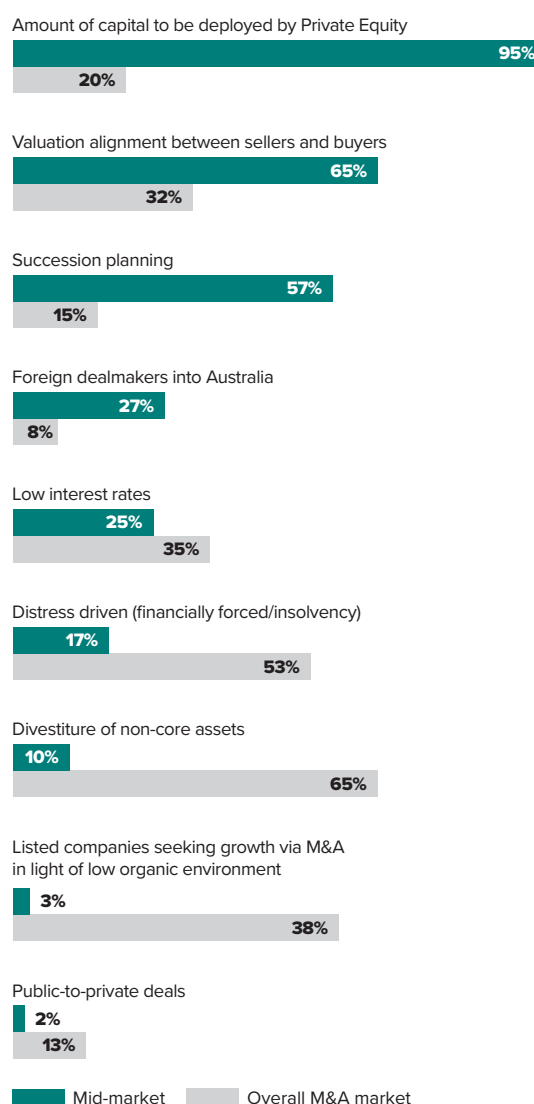
Likewise, there was also AU\$24bn of capital raised by corporations between February and May. While half of this was raised to strengthen balance sheets, the level of government support that has also arrived in response to the pandemic means that many corporations now find themselves with excess cash that will need to be put to work to generate returns for their shareholders.


Among Australian private equity firms, many view the COVID-19 pandemic as a crisis, not a market failure as presented during the global financial crisis. As such, they may be in a better position to respond to investment opportunities, according to Mergermarket intelligence. Already, private equity firms have been active in looking at assets and seeking to execute deals despite the pandemic – KKR’s AU\$1.7bn acquisition of a 55% stake in Colonial First State, and the private equity interest in Virgin Australia are good examples.

Valuation alignment between sellers and buyers will be another deal driver within the mid-market, according to 65% of respondents – continuing the trend outlined in the Pitcher Partners’ February report, although at slightly reduced levels (73%). Dealmakers say that valuations are declining due to insolvency issues and a lack of financing for some businesses. While distress may not be an issue facing the Australian mid-market at present, it could become a reality later in the year amid rising financial constraints and a deepening recession.

Within the broader M&A market, respondents highlight several other factors emerging as likely to drive deals in the year ahead. Most respondents think divestitures of non-core assets (65%) will create the most deal

**Figure 7. What will be the main drivers of M&A activity in 2020? (Select 3 most likely for each category)**





“The level of undeployed funds seeking investment, combined with the need to invest funds and generate returns during a rapidly declining fund period are likely to drive PE’s M&A activity over the coming years. In the absence of a flood of M&A activity from PE firms, it is possible some will not have the opportunity to deploy the funds raised.”

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## PITCHER PARTNERS

opportunities as larger corporations restructure operations and offload financially strained divisions or businesses. In that vein, distress-driven M&A (53%) will also be a key driver as some businesses become insolvent, recession strengthens and stimulus packages and rental relief cease and bank holidays are extended. A large number of respondents (38%) point to listed companies seeking growth as a driver of M&A in the current year. Organic growth is likely to be low for many listed companies in the current environment and with over \$24bn raised by listed companies between February and May, listed companies are expected to be active in the year ahead.

### **Changing deal flows: Offshore capital in decline**

Foreign inbound M&A is expected to show a steep decline in the year ahead, due to a combination of border closures limiting access to Australia and the reduced threshold for Foreign Investment Review Board (FIRB) approval. Once a key buyer group in

the Australian mid-market, today the vast majority (70%) say offshore investment will decline, with only 30% expecting it to remain unchanged from current levels. Likewise, only 27% of respondents said foreign dealmakers would be one of the main deal drivers of mid-market activity.

Much of this sentiment derives from general concern regarding COVID-19’s impact on cross-border M&A and the associated risks. Such transactions are already challenging, and adding the complexities of doing deals during an ongoing pandemic and spectre of recession may be more trouble than many offshore dealmakers will tolerate.

Regulatory changes are another issue offshore dealmakers must consider. In response to COVID-19, the Australian Government implemented several measures to safeguard Australian businesses amid rising financial and operational stress levels. This has so far included increased scrutiny from

FIRB, which now reviews all foreign investments of any amount. More recently, deals involving foreign buyers require Treasury approval, adding another obstacle for offshore capital and measures that could potentially keep foreign investors from playing through 2020 and early 2021.

### Key deal challenges

Perceptions of deal challenges have also shifted since the beginning of the year. While the valuation gap was the dominant issue facing dealmakers earlier in 2020, today most (75%) feel that access to capital or financing will be the main obstacle to doing deals. This is a significant rise from only 25% when the survey was conducted in Nov-Dec 2019. Echoing the sentiments of dealmakers, one respondent says, “Access to capital and financing will be limited as financial institutions become more conservative with lending.”

While this is a very valid and common fear among respondents, it is important to keep in mind that the current challenging environment is one dominated by a health crisis rather than a financial crisis. While the pandemic is causing uncertainty, credit is still widely available and banks still have resources and ability to lend, although for the time being they may be more selective on which businesses they lend to.

Delays in government approvals for foreign investment (53%) and regulatory change (42%) are also top of mind among dealmakers. The previously mentioned FIRB and Treasury approval process will be a burden for all offshore investors looking to enter the market, although it will be particularly challenging for first-time investors as opposed to those who have been active in the market previously.

Difficulties conducting due diligence will also be a challenge, although again one that will be even

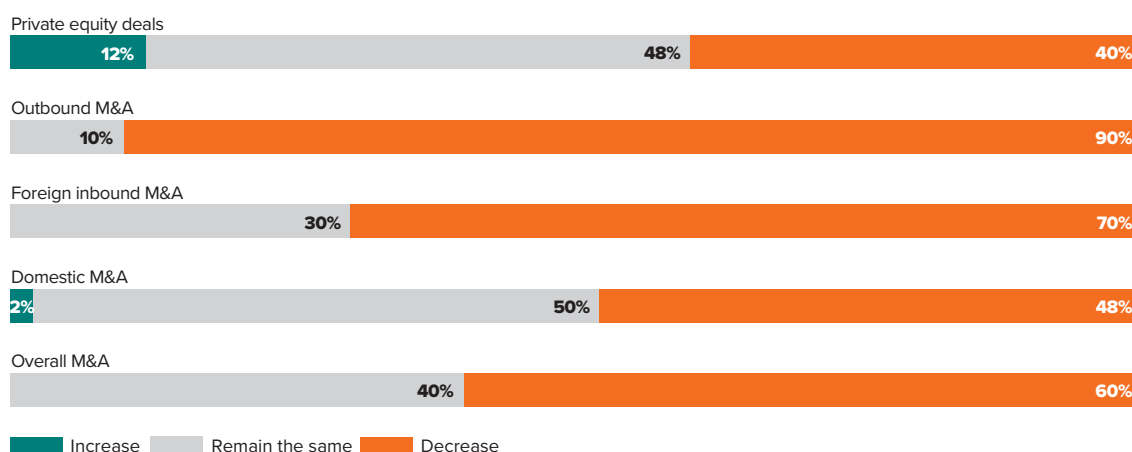
tougher for foreign buyers. With limited ability to enter the country and transportation still limited, foreign investors will not have access to the market to complete due diligence and site visits that could inhibit investigations. According to one respondent, “Completion of deals will take longer and a prolonged due diligence phase can be expected.”

Social and environmental activism and unrest was another field where sentiments have shifted, although perhaps in de-emphasising the overall challenges or importance in the current environment. While still a significant issue, the threat of the pandemic seems to have overshadowed the rise of social and environmental activism, which has seen increasing protests against companies in all industries to become more environmentally conscious in the battle against climate change. Such pressure was expected to increase in the wake of the Australian brushfires, although with the risk of COVID-19 on business and public health – transmission of the virus has seen rising use of single-use cups as opposed to reusables – focus may remain on economic and health matters before returning.

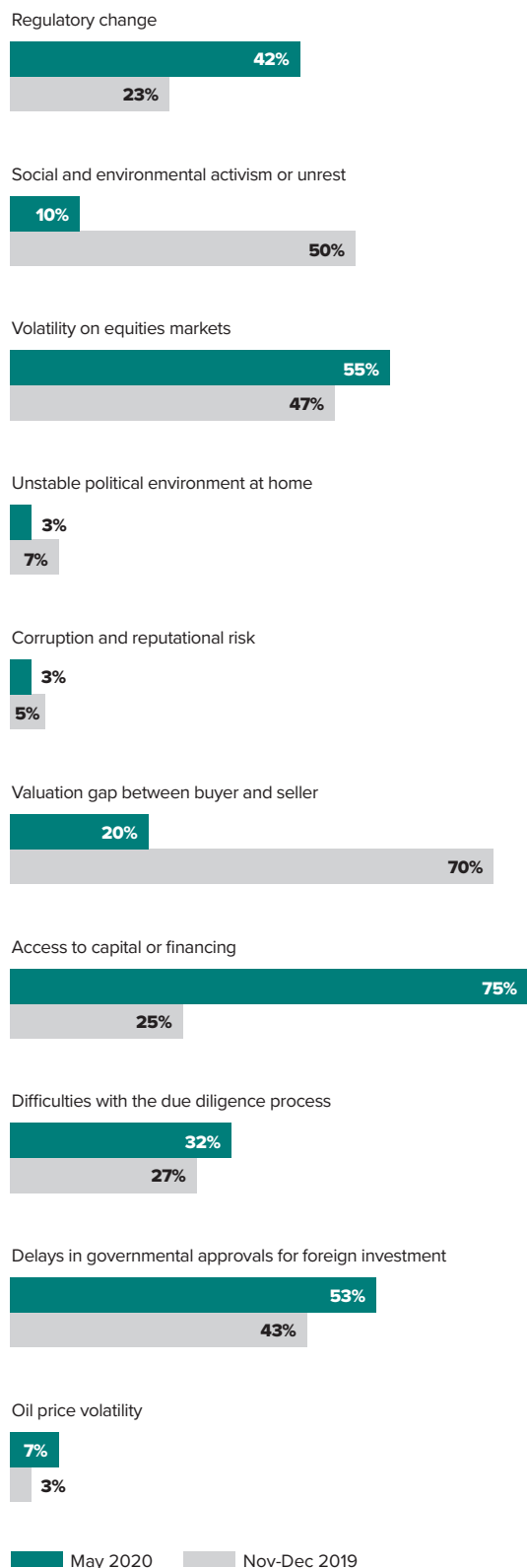
“Completion of deals will take longer and a prolonged due diligence phase can be expected.”

**SURVEY RESPONDENT**

**Figure 8. What do you expect will happen to the level of mid-market deal activity for the following types of deals over the next 12 months?**



**Figure 9. What are the top challenges facing mid-market dealmakers in Australia in the next 12 months? (Please choose three)**



"When things are going well, secondary items like social and environmental considerations come to the fore in the dealmaking equation. But when circumstances take a downturn, there is a refocus on core fundamentals and these secondary items expectedly fall behind. What is encouraging is that once the market settles, we anticipate there will be a returned emphasis on these important factors such as ethical and sustainable sourcing, wage theft, governance and other social responsibility policies as indicated in the February report."

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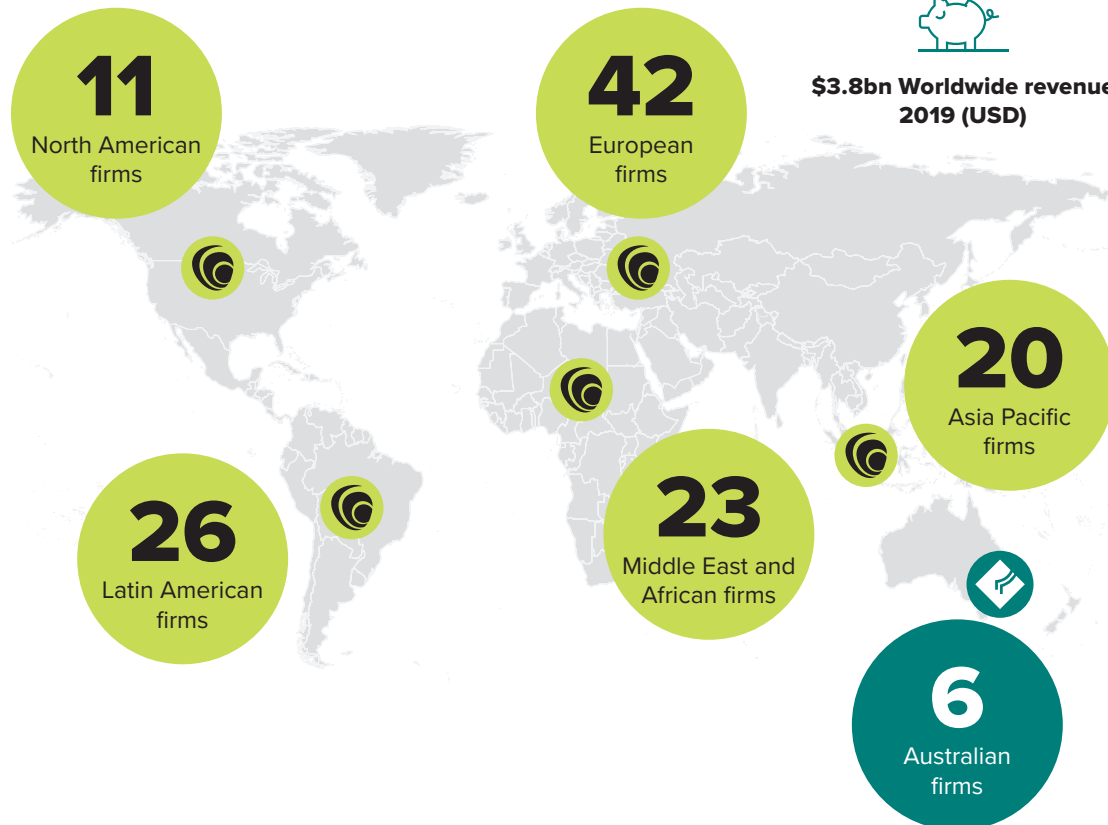
## Global statistics



**36,200+** experienced professionals



**\$3.8bn** Worldwide revenue 2019 (USD)



**Michael Sonogo** | Partner  
 p. +61 3 8610 5485  
 e. michael.sonogo@pitcher.com.au



**Kieran Wallis** | Partner  
 p. +61 7 3222 8383  
 e. kwallis@pitcherpartners.com.au



**James Beaumont** | Partner  
 p. +61 3 8610 5568  
 e. james.beaumont@pitcher.com.au



**Alan Max** | Partner  
 p. +61 2 8236 7882  
 e. alan.max@pitcher.com.au



**Warwick Face** | Partner  
 p. +61 7 3222 8302  
 e. wface@pitcherpartners.com.au



**Bryan Hughes** | Perth Chairman  
 p. +61 8 9322 2022  
 e. hughesb@pitcher-wa.com.au



**Andrew Faulkner** | Principal  
 p. +61 8 8179 2800  
 e. andrew.faulkner@pitcher-sa.com.au



**Scott Edden** | Partner  
 p. +61 2 4911 2000  
 e. scott.edden@pitcher.com.au

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Please contact:

Simon Elliott

Managing Director, Acuris Studios

Tel: +44 20 3741 1060

16/F  
Grand Millennium Plaza  
181 Queen's Road, Central  
Hong Kong

t: +852 2158 9700  
f: +852 2158 9701

10 Queen Street Place  
London  
EC4R 1BE  
United Kingdom

t: +44 (0)20 7059 6100  
f: +44 (0)20 7059 6101

1501 Broadway, 8th Floor  
New York  
NY 10036  
USA

t: +1 212 686 5606  
f: +1 212 686 2664

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