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# M&A Matters

# Counting the cost of COVID in Queenstown

*Some big picture thinking on the post-C19 world*

# The fact that the NZ Private Capital Conference was able to proceed last month in Queenstown speaks to New Zealand's relative success in containing the COVID pandemic.

But we were never going to escape some serious economic damage. The question is how much, and for how long. Because this is uncharted territory, the answers are hard to find.

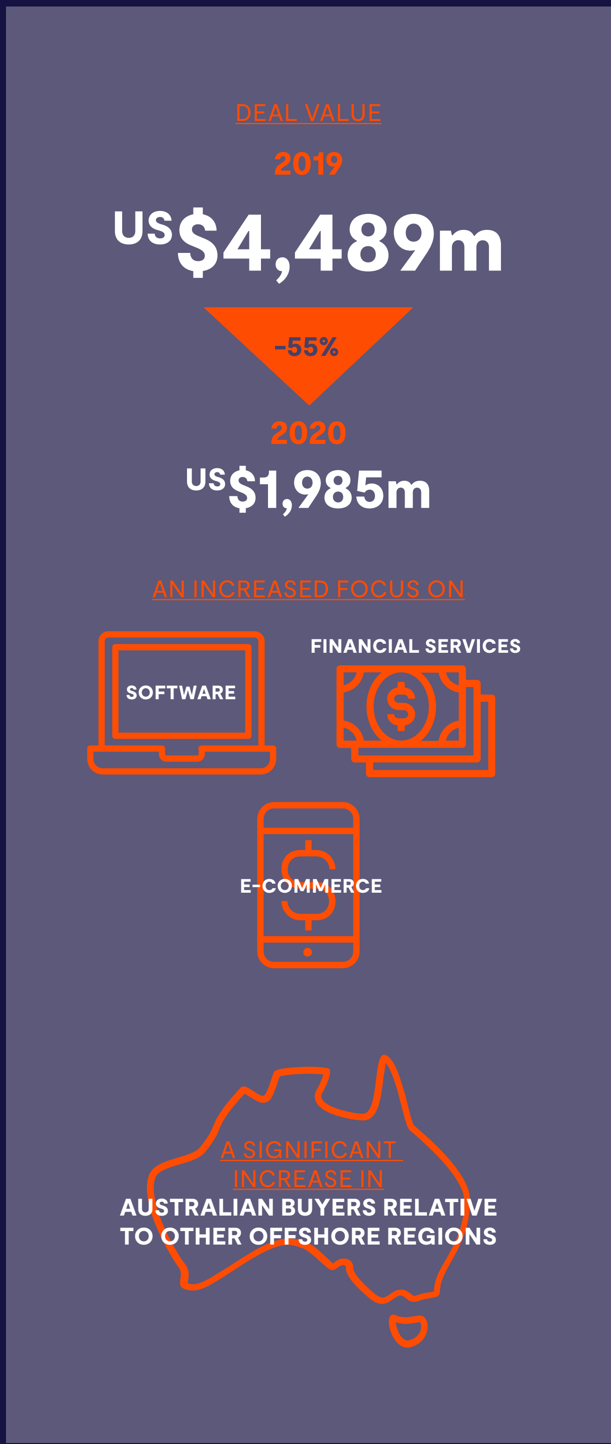
So we leapt at the opportunity in Queenstown to talk to the lead players from the private equity and venture capital sectors and to get their perspective on how the market has been tracking and what may lie ahead.

## Slump in M&A market

The feeling among the private equity (PE) firms and institutional investors we spoke with was that M&A deal volumes were down about 50% on 2019 but that transaction activity was stronger than might have been expected in the circumstances.

That sentiment is broadly consistent with Mergermarket statistics, which show:

- New Zealand announced deal value of US$1,985m for the first three quarters of 2020, compared to US$4,489m in the equivalent period last year (a 55% decrease year on year)
- a fairly similar number of deals (46 in 2020 versus 53 in 2019), implying a sharp decrease in average deal value from about $85m in 2019 to about $43m in 2020
- an increased focus on software, financial services and e-commerce businesses in 2020, all of which sectors are expected to thrive in the post-pandemic environment, and
- a significant increase in Australian buyers relative to other offshore regions, as their greater familiarity with New Zealand meant they were less unsettled by the limited ability to conduct due diligence in the time of COVID.



## Deal features

Deal trends we have observed from our own experience or were reported by conference participants include:

- much longer execution timeframes – reflecting a mix of practical reasons and a more hesitant "wait and see" attitude
- increased conservatism from financiers, resulting in lower leverage levels and smaller stakes being acquired
- continuing high investor appetite for PE as an asset class, with several successful fundraisings – driven in part by low interest rates and an investor desire to hedge against public market volatility
- relatively sensible asset pricing in New Zealand, as we have not experienced the same level of over-supply of PE "dry powder" relative to high quality assets that has characterised overseas markets
- more thorough due diligence including: an increase in the use of external consultants, greater attention to key customer robustness, and a stronger focus on reference checking and discussions with peers and customers
- warranty and indemnity insurance continuing to feature strongly in deal design, blanket COVID-19 exclusions avoided through appropriately detailed and targeted due diligence, but a hesitancy by underwriters to provide "new breach" cover for the period between signing and closing
- the emergency clearance regime of the Overseas Investment Office has been burdensome but rarely problematic, as long as the (circa) 10 business day consideration period has been properly factored into deal timeframes, and
- many deals, and most cross-border transactions, being completed remotely, from term sheet to closing. Given the importance of assessing cultural fit for PE investments, which are typically in the nature of partnerships rather than acquisitions, we are a little sceptical of the extent to which Zoom etc. can replace in-person meetings and due diligence in the longer term.

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**Jeremy Gray**

# COVID gives New Zealand a small edge for venture capital activity

The story delivered to the conference by a panel of VC experts was that investment was not as hard to secure in New Zealand as might have been expected as the pandemic has in some ways levelled the playing field. In a world where all meetings are virtual, New Zealand's remoteness is less of an impediment.

The "distributed model", as it was somewhat euphemistically termed, has also opened New Zealand VC firms up to the global market for talent – with the greater choice, but greater competition (and salary expectations) this entails.

## New Zealand investees are reportedly seen as good value in comparison to the outlandish valuations of early-stage companies in Silicon Valley.

Given New Zealand's largely COVID-free status, many within the VC and wider tech sectors have expressed a desire to physically move here, but the panellists were concerned that the Government's immigration settings will favour skilled manual labourers in the near term.

Whether a potential investee will be "COVID accelerated" or "COVID decelerated" is at the forefront of investment committees' minds. But more than anything else, a founder with strong convictions, obvious drive and ambition and a "magnetic quality" remains central to any investment thesis.

## Some big picture thinking on the post-C19 world

Bernard Salt, the renowned Australian demographer who famously attributed millennials' failure to get onto the property ladder to their penchant for overpriced smashed avo on toast, spoke to the conference by hologram.

His key messages included:

- if Australia and New Zealand can maintain their reputations as world leaders in dealing with COVID-19, we will be well placed to attract high quality investors and businesses
- China is likely to be the largest global economy by the end of the 2020s, and Australasia will have to evaluate its economic and military alignments with this in mind
- we will see a continued growth in high-tech companies - Bernard noted that New Zealand's listed company landscape is already quite dominated by tech-centric companies in terms of market capitalisation in comparison to Australia's. We are more akin to the USA in this regard
- the 2020s, far from recession, could see a period of economic and social exuberance as we emerge from the pandemic (similar to what occurred in the 1920s in the wake of World War I and the Spanish flu)
- working from home will drop back from current levels (approximately 45% in Australia) but will remain higher than historical averages, at about 10-15%
- the move away from the "fried egg" city design (with suburbs geared towards commuting to a CBD) to a "20 minute city" comprised of a series of smaller local hubs will continue, and
- the trend towards protest votes and distrust in institutions and authority figures may reverse (arguably already evident in New Zealand in the results of our recent election).

If Australia and New Zealand can maintain their reputations as world leaders in dealing with COVID-19, we will be well placed to attract high quality investors and businesses.

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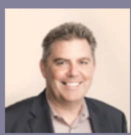

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