THE REAL DEAL 2012

HALF-YEAR UPDATE

Welcome to *THE REAL DEAL* 2012 Half-Year Update.

This update for the first half of 2012 shows that a quiet M&A market has not prevented the emergence of some interesting trends and developments. Clayton Utz is committed to being at the forefront of developments in the M&A market and we look forward to the opportunity to share and discuss these with you.

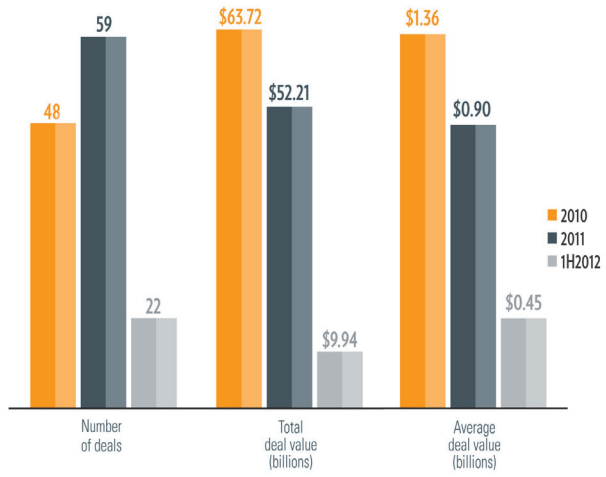
2012 TRENDS SO FAR

1. DOWNTURN IN M&A ACTIVITY

It is no secret that M&A activity has been relatively subdued in the first half of 2012. Activity is down almost 30% when compared with the same period last year: as at 30 June 2012, just 22 deals with a transaction value over $50 million had been announced[1], compared to 31 deals in the first half of 2011.

Average deal value also continues to decline, sitting at $451 million so far this year, a 50% decrease from average deal values in 2011.

M&A activity overview



[1]Deals surveyed were all deals announced between 1 January 2012 and 30 June 2012 (inclusive) which included a takeover offer, company scheme or trust scheme to acquire securities in an Australian entity to which Chapter 6 of the Corporations Act applies and where a binding announcement of a formal takeover offer or an announcement of an agreement to propose a scheme was made (as applicable) in respect of the deal.

Of course, we may be lucky and see a repeat of 2010 where there were almost four times as many deals in the second half as the first half of the year, although there doesn't as yet appear to be any particularly promising signs of that happening.

2. PRIVATE EQUITY CONTINUES TO BE ACTIVE

In *THE REAL DEAL* 2012 edition, we predicted that private equity would be increasingly active in public M&A. That prediction has been borne out by the number of bear hug approaches made by private equity firms to public companies this year. Although this has only produced one formally announced deal so far (Pacific Equity Partners' proposed acquisition of Spotless Group), we expect that target boards will show a greater willingness to engage with private equity in the second half of 2012. As with shareholder activism, a major factor driving this outcome will be the experience of a number of private equity targets now trading at significant discounts to the indicative offers that have recently been made by private equity which have not proceeded to an agreed transaction.

3. SHAREHOLDER ACTIVISM INFLUENCES TARGET BOARDS

Shareholder activism continues to grow in the Australian market, both in M&A and as a broader governance phenomenon. Shareholders have flexed their power to remove and/or appoint directors to the boards of PaperlinX, Echo Entertainment, Coalworks and Mindax. Other shareholders have used the threat of doing so to pressure boards to take particular actions.

Bidders are clearly using shareholder pressure to help them persuade the target board both to let the bidder in the door to do due diligence and to ultimately recommend a deal that the directors might not have initially supported. This is a trend set to continue while there remains a large gap between trading valuations and a target board's view of the fundamental value of the target over the medium to long term.

4. ENERGY AND RESOURCES CONTINUE TO DOMINATE

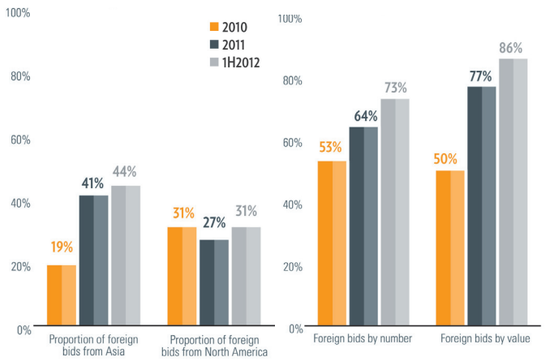
As expected, energy and resources has remained the dominant sector for M&A activity in Australia. Almost 50% of deals so far this year are in the metals & mining or oil & gas industries, which are the only stand out sectors so far.

5. FOREIGN BIDDERS CONTINUE TO INCREASE THEIR PRESENCE IN THE AUSTRALIAN M&A MARKET

Foreign bidders accounted for 73% of all deals in the first half of 2012 (compared with 53% in 2010 and 64% last year). While local bidders continue to fade away, China has finally emerged from the shadows and now eclipses the United States as home to the largest number of foreign bidders. Interestingly, Canadian bidders have become increasingly prominent in 2012.

While energy and resources remains the most attractive sector for foreign bidders, accounting for almost half the foreign deals this year, foreign bidders have again been active in a broad range of industries, including capital goods, biotechnology and real estate.

Foreign M&A activity



6. TARGET BOARD RECOMMENDATIONS HIGHLY SOUGHT AFTER

Target board recommendations continue to be highly sought after by bidders. To date in 2012, only four deals have been announced without a target board recommendation. Two of those deals have now completed successfully, but only after the target board subsequently recommended the bid. The remaining two deals are still current at the time of going to print so it remains to be seen whether the target boards might ultimately recommend those deals, and what the outcome will be.

7. PRE-BID STAKES FOR ALL TAKEOVERS

Pre-bid stakes have almost become a necessity for bidders using a takeover. So far in 2012, 70% of all deals - and 100% of all off-market takeovers - have kicked off with the bidder holding a pre-bid stake.

Pre-bid arrangements are also common in schemes, but not as prevalent as in off-market takeovers, with bidders having pre-bid arrangements in 54% of schemes.

The high level of pre-bid stakes demonstrates that, in an uncertain and volatile market environment, those bidders who choose to proceed with a deal will seek as much deal certainty as possible to increase their chances of success.

8. BEAR HUGS USED TO EXTRACT TARGET BOARD RECOMMENDATIONS

Bear hugs have continued to be a prominent feature in the M&A market in 2012. One third of all deals so far this year have commenced with a bear hug approach which was made public. This is in line with the results of our 2011 survey. There have also been a number of bear hug proposals announced this year which have not yet led to the announcement of a transaction. As we discuss on the next page, some bear hugs have given rise to renewed calls for regulatory change, or change in market practice, in the interests of market integrity.

9. INCREASED REGULATORY FOCUS ON FUNDAMENTAL PRINCIPLES

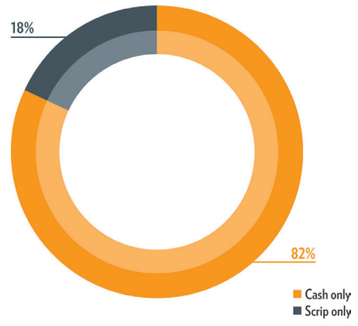
ASIC has clearly signalled to the market that it intends to scrutinise a number of Australia's existing takeovers laws and practices in order to test whether those laws and practices still meet the fundamental principles underlying those laws. ASIC is liaising with Treasury in relation to potential changes to the creep rules (under which shareholders can increase their shareholdings above 19% by 3% every six months). Also on ASIC's hitlist are measures to assist target boards in dealing with bear hug approaches: the introduction of "put up or shut up" rule, as adopted by the UK Takeovers Panel, and changes to the continuous disclosure rules. This impetus for regulatory change has grown out of a number of recent examples in the market, which we discuss further on the next page.

10. CASH IS KING

All-cash offers have become even more popular this year: 82% of deals in the first half of 2012 offered cash only consideration, a significant increase from the 61% of bidders making all-cash offers in 2011. Just 18% of 2012 deals have offered scrip only consideration and no deals have offered shareholders a combination of cash and scrip.

Two factors suggest that this trend will continue: the high number of deals by foreign bidders and the reluctance of domestic bidders to use their scrip to fund deals given current market conditions.

Type of consideration



REGULATORY DEVELOPMENTS

Market integrity has been front of mind for the Australian takeovers regulators, ASIC and the Takeovers Panel, in 2012. M&A activity this year has brought renewed focus to some of the fundamental principles underlying the regulation of the public M&A market.

Three headline-grabbing issues have been truth in takeovers, bear hugs, and the ability of foreign courts to defeat Australian takeovers.

WHAT'S THE TRUTH ABOUT TRUTH IN TAKEOVERS?

For many years, the Takeovers Panel has publicly stated its support of ASIC's Truth in Takeovers policy. The events surrounding the competition for control of Ludowici caused many commentators to question the Panel's commitment.

The furore began when FLSmidth, a proposed bidder for Ludowici by way of scheme, told a journalist on the day the transaction was announced that it would not consider raising the bid price. The media reported this as a statement by FLSmidth that its bid price was final. Despite knowing this, FLSmidth did not issue a correction until a week later.

Not unexpectedly, the Panel held that it had been unacceptable for FLSmidth to wait a week before correcting the media report even though the Panel did not consider, given the circumstances, that it was a "last and final" statement.

What caused some consternation was the Panel's remedy - an order that FLSmidth compensate anyone who had sold Ludowici shares during the week that the media report had remained uncontradicted. This appeared to run contrary to ASIC's Truth in Takeovers policy that compensation is not an adequate remedy in this sort of situation. Critics of the Panel's compensation order argued that, in this type of situation, a bidder should not be allowed to increase its bid price to match a rival bid.

This criticism misunderstands the basis for the Panel's decision. As is usually the case, the Panel here focused on the unique circumstances of the case before it. This was not a case where the bidder had voluntarily made a statement with the intention, or which in the Panel's view had the effect, of attracting the Truth in Takeovers policy. Rather, this was a case of a bidder failing to correct a statement made by a third party, and for that reason, a compensation order rather than an order preventing the bidder from proceeding with a higher offer, was appropriate.

It should be remembered that the purpose of the Truth in Takeovers policy is to protect market integrity, not to deprive shareholders of the opportunity to receive a higher bid. What this decision does highlight however is that the application of the policy involves inevitable tension between the interests of market integrity and the principle that shareholders should have the opportunity to participate in offers for control of the company. Just where the line is to be drawn in any particular case between these competing principles will be dependent on the particular circumstances of that case.

BEAR HUGS - BEWARE THE SHEEP IN BEAR'S CLOTHING

There was great debate in the market place when David Jones recently announced that it had received an unsolicited takeover approach from an entity that it did not initially identify. Despite the company recommending that shareholders act cautiously,

its share price immediately increased by 14%. A later announcement on the same day identified the entity and the terms of its proposal.

Following these announcements, there was extensive media speculation about the purported bidder, its identity and its wherewithal to make a bid for the company, leading some to describe it as a "hoax" bid. This publicity led to the purported bidder then withdrawing its proposal. On receiving notice of this withdrawal, David Jones sought a trading halt, then advised the market of the withdrawal. Once trading recommenced, the company's share price rapidly fell to pre-announcement levels.

The unfortunate position that David Jones found itself in demonstrates that a considerable degree of caution is required before announcing approaches which appear purely speculative. This is despite the fact that, in the past few years, it has become almost standard practice for companies to announce the receipt of indicative non-binding proposals for control of the company regardless of the level of conditionality and uncertainty surrounding the proposal. This practice has allowed bear hugs to become a prominent feature of the M&A market - providing a way for would be hostile bidders to force a target board out into the open to defend its rejection of such an approach.

The practice has developed as a result of Australia's strict continuous disclosure rules for listed companies. While those rules do not require disclosure of confidential and incomplete takeover approaches which a reasonable person would not expect to be disclosed, there are two major qualifications. If there is sufficient and credible market speculation about a takeover approach such that the company can no longer claim that it is confidential, then the company has to make an announcement, even if the proposal remains incomplete. Similarly, if a reasonable person would expect the company to disclose the takeover approach, disclosure also needs to be made.

What these events demonstrate is that, before engaging in a bear hug by making a takeover approach public, companies need to be sure that they really are dealing with a bear, not just a sheep in bear's clothing. In other words, great care needs to be taken to ensure that the market is clearly informed about the uncertainty that surrounds such an approach, particularly where that uncertainty goes to the identity and credibility of the purported bidder.

WHEN WILL BREACH OF A CONDITION NOT GIVE THE BIDDER THE RIGHT TO WALK?

As we predicted in *THE REAL DEAL* 2012 edition, regulators are starting to take a stronger stance against bidders and targets seeking to rely on broadly drafted conditions in order to walk away from announced deals.

The Takeovers Panel allowed Magnitogorsk Iron and Steel Works and Flinders Mines to walk away from their proposed scheme merger after it was injuncted by a regional court in Russia. However, the Panel took the opportunity to fire a warning shot in the direction of bid conditions that are too broadly drafted. The Panel was particularly concerned that the standard condition relating to injunctions ordered by any courts of competent jurisdiction could be unacceptably broad if it allowed a deal to be killed by a foreign court on grounds that would not be recognised as appropriate in Australia.

It is not clear just how far the Panel would choose to extend this concept. We do not believe that the Panel is saying that any condition triggered by laws different to those which apply in Australia could be considered to be unacceptably broad. However, it is not clear exactly where the line of unacceptability will be drawn between this position and the unusual fact situation considered by the Panel in this case.

The decision does emphasise the current concern of the regulators to administer the takeover laws in a manner which promotes market efficiency and integrity. There is no doubt that in certain cases the Panel will prevent bidders and targets from relying on conditions to walk away from a deal in circumstances which would adversely affect market integrity.

THE REAL DEAL is Clayton Utz's detailed analysis of public company M&A in Australia. Using our unique database, we provide unrivalled insight into the trends and developments shaping the Australian M&A market. For further information on *THE REAL DEAL* or any information contained within this update please contact authors Karen Evans-Cullen (+61 2 9353 4838 or kevans-cullen@claytonutz.com) or Jonathan Algar (+61 2 9353 4632 or jalgar@claytonutz.com).

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