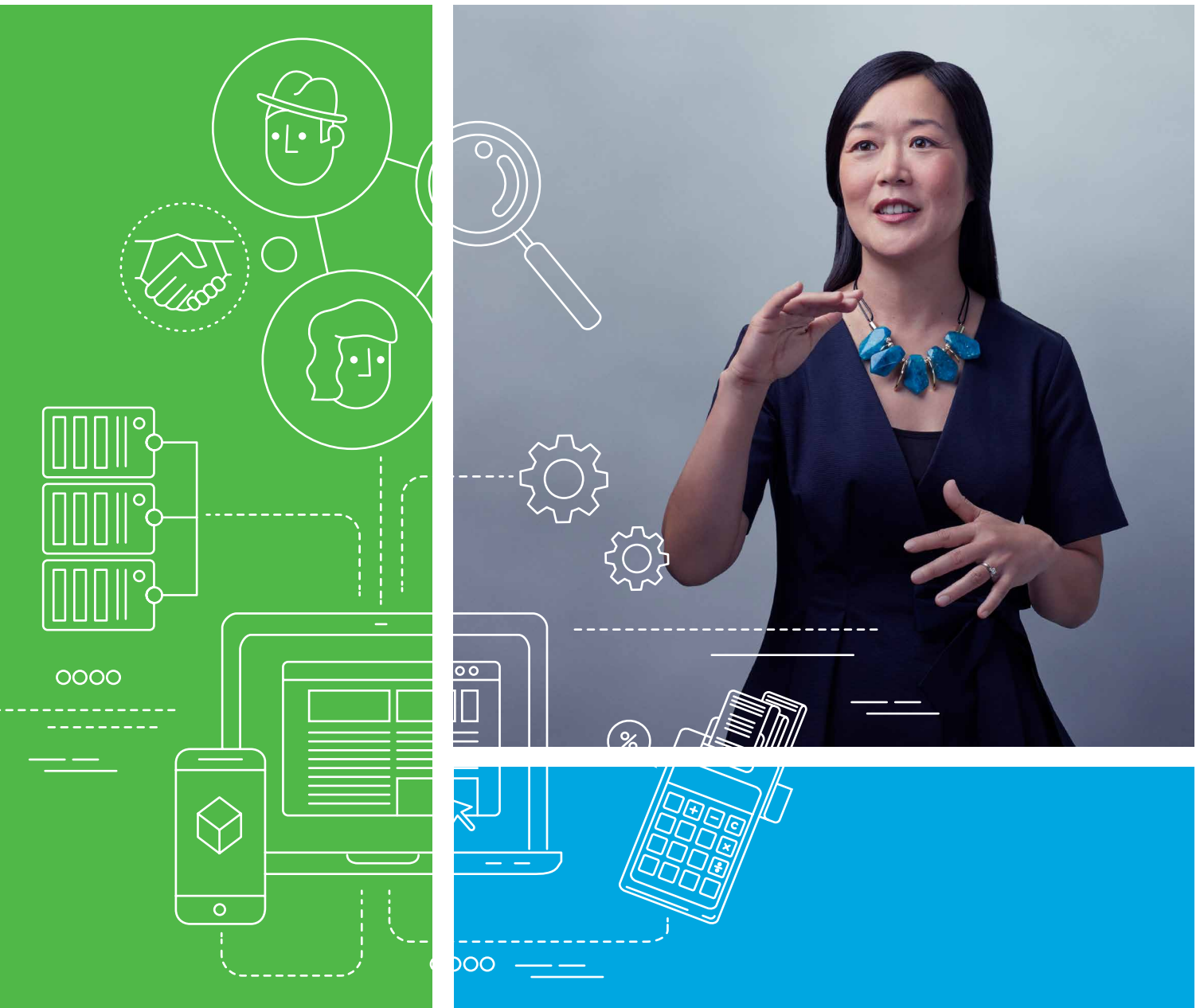


# Control Premium Study

An analysis of the implied control premiums observed in successful takeovers and schemes of arrangement



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# FOREWORD

In 2010 we released our inaugural study in which we analysed the implied control premiums observed in successful takeovers and schemes of arrangement completed in Australia between 1 July 2005 and 30 June 2010. Further updated studies with expanded data sets to the end of the most recent financial year (FY) were issued in 2013 and 2017.

In this study, we have updated our analysis again to include successful takeovers initiated from 1 July 2005 through to 31 December 2020 (to facilitate analysis on calendar years (CY) as well as by FY). This additional data has expanded our analysis to 605 successful control transactions in Australia covering the 15.5 year period ended 31 December 2020.

In addition the scope of the RSM 2021 Control Premium Study has been expanded to analyse the implied control premiums observed in 131 successful takeovers and schemes of arrangement completed between 1 July 2005 and 31 December 2020 in the New Zealand market.



We acknowledge the input and support we have received from Curtin University's Dr Lien Duong, Dr Baban Eulaiwi and Professor Grantley Taylor, and Victoria University of Wellington's Associate Professor Thu Phuong Truong in the completion of this study.

The results of our analysis indicate that control premiums were influenced by a number of factors including:

- Industry sector
- Consideration type
- Transaction type
- Timing within the economic cycle (including the impact of COVID 19)
- Toehold (extent of existing acquirer holding in the target)
- Size/market capitalisation

With interest rates remaining low and companies holding significant cash reserves following a capital raising spree during COVID-19, mergers and acquisitions (M&A) activity in the Australasia region is expected to be high through FY 2022 and beyond.

The control premium is a fundamental component of value and it is, therefore, critical that directors and investors consider the nature and extent of the premium when assessing equity values in the context of a potential transaction.

We hope you find the results of our study of interest and value. Should you require any further information or wish to discuss our findings in more detail, please contact the authors as follows:



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# KEY FINDINGS

The average and median control premiums observed in the Australian and New Zealand markets for companies listed on the Australian Securities Exchange (ASX) and the New Zealand Securities Exchange (NZSX) respectively on the basis of 20 days, 5 days and 2 days pre announcement for the 15.5 years from 1 July 2005 to 31 December 2020 are summarised in the table below.

CONTROL PREMIUMS	AUSTRALIA	NEW ZEALAND
Number of Transactions	605	131
<b>Average Control Premium</b>		
20 days pre announcement	34.7%	18.6%
5 days pre announcement	29.2%	15.7%
2 days pre announcement	27.1%	14.1%
<b>Median Control Premium</b>		
20 days pre announcement	27.5%	15.0%
5 days pre announcement	24.2%	9.4%
2 days pre announcement	22.2%	8.2%

*Average and median control premiums Australia and New Zealand*

## AUSTRALIA

The table above shows:

- The average implied control premium at 20 days pre-bid for the Australian market lies at 34.7% (based on transactions completed in the period 1 July 2005 to 31 December 2020).
- The median control premium offered at 20 days pre-bid in Australian transactions for the 15.5 year period was 27.5%.
- Observed premiums continue to fall in the days immediately pre-bid, which may indicate bid speculation and/or information leakage in the market.
- Median values lie consistently below the average (mean) due to the occurrence of several transactions with premiums in excess of 150% over the period.

In this study, we have explored factors relating to the target, or the transaction itself, which may exercise influence on the control premium required to be offered to shareholders of listed companies to facilitate change of control transactions. Our analysis indicates that the following factors can have an impact on the premium paid to acquire control:

- Industry sector significantly influences the control premium required to complete a successful transaction. Sectors that are traditionally priced and valued on upside potential revealed considerably higher premiums (e.g. health care and telecommunications, IT and software) than those where valuations are more typically limited to asset base (e.g. real estate and financial institutions).
- Scrip deals, which offer "relative" consideration, continue to attract lower premiums than cash only deals, where consideration is absolute.

- Schemes of Arrangement, which represent almost 50% of the transactions in our data set attract lower control premiums than off market transactions. This is likely due to the hostile nature of off market bids. In addition, Schemes only have to win over 75% of the target shareholders to effect a compulsory acquisition compared to 90% in a takeover, which may enable acquirers to limit their offer.
- Size matters – there appears to be a strong negative correlation between market capitalisation and the level of control premium paid. Our analysis shows the control premium declines as target capitalisation increases and the control premium is appreciably higher in transactions involving targets with a market capitalisation of less than \$50 million.
- Our analysis shows that existing knowledge of a target (as a consequence of a toehold) can lead acquirers to pay significantly higher premiums than are otherwise observed – perhaps as a result of lower perceived business risk in the transaction.
- Underlying the specifics above is the external influence of the economic cycle, which creates the fear and optimism that fuels risk appetite, and helps drive share prices. In our opinion, the control premium is influenced by the above factors to varying degrees, at different times within the economic cycle. This can be evidenced in the period since COVID-19 was declared a global pandemic, which led to significant drops in global equity markets and a rise in observed control premiums with the average implied control premium of the analysed transactions peaking at 50.7% in FY 2020.

## NEW ZEALAND

### The table above shows:

- The average implied control premium at 20 days pre-bid for the New Zealand market lies at 18.6% (based on transactions completed in the period 1 July 2005 to 31 December 2020).
- The median control premium offered at 20 days pre-bid in New Zealand transactions for the 15.5 year period was 15.0%.
- Observed premiums follow similar trends to those observed in the Australian market with premiums declining in the days immediately pre-bid and median values consistently measuring below the average.
- However, the overall control premiums observed in the New Zealand market are significantly lower than those in the Australian market.

Analysis of the New Zealand market shows that most takeovers are uncontested. Lock-up agreements are commonly used to secure binding commitments from target shareholders in New Zealand without the same restrictions on percentage of voting rights which exist in the Australian Corporations Act 2001. This may explain the lower control premiums offered in NZSX transactions compared to the ASX, where less certainty is achievable in advance and a greater risk of competing bids exists.

Overall, the number of transactions observed in the New Zealand market is relatively low, with 45% occurring immediately prior to the GFC between FY2006 and FY2008, and an average of six per year in the period since then. This has limited the statistical reliability as individual transactions have a significant impact on the overall dataset. The detailed analysis in this study therefore refers primarily to the Australian market.

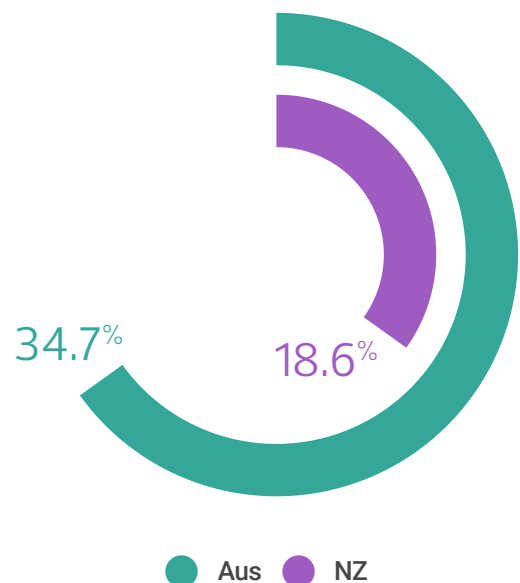
The number of **successful control transactions** covering the 15.5 year period ended 31 December 2020



The percentage of takeovers in which the **consideration type was cash**



The **average 20-day pre-bid** implied control premium for the market



The level of **existing toehold** in a target in which acquirers are prepared to **pay the highest premiums** in Australia and New Zealand

**10 < 20%**

# TIMING WITHIN THE ECONOMIC CYCLE

## AUSTRALIA

The expansion of the Australian data set to 31 December 2020 has enabled us to perform an analysis of the control premiums over 15.5 financial years from 1 July 2005 to 31 December 2020, during which time Australia experienced a mining boom (2005 – 2012), the global financial crisis (2007 – 2009), the post mining boom “hangover” (2013 – 2016) followed by a gradual expansion until the COVID-19 pandemic (2020 – current).

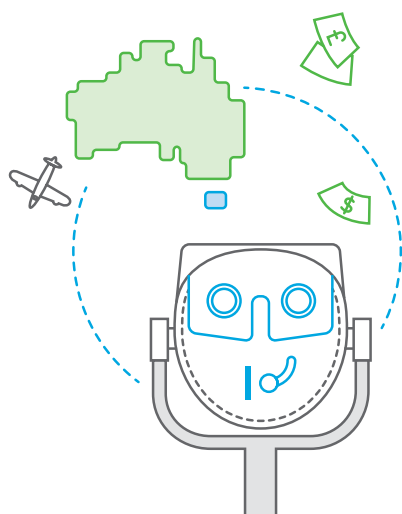
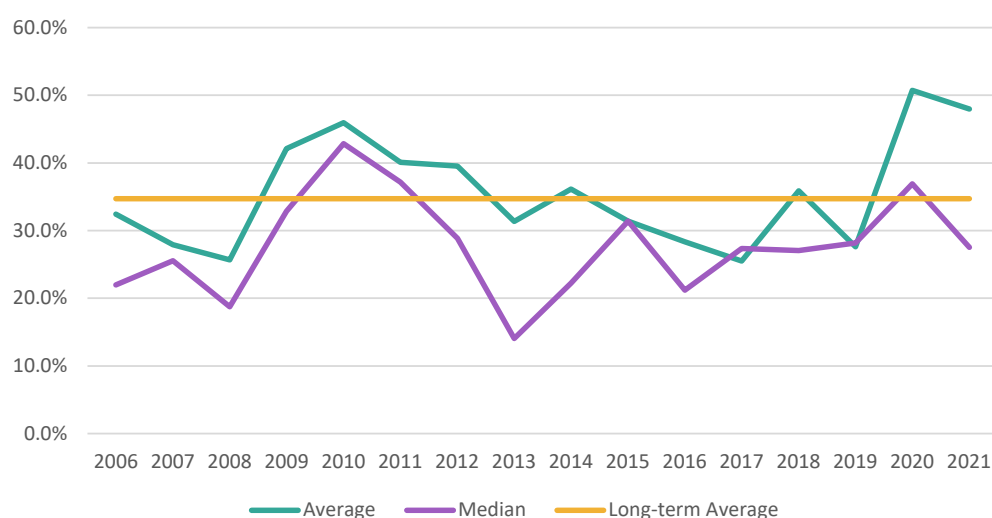
Financial Year	Number of Transactions	Average Control Premium (20 days pre)	Median Control Premium (20 days pre)
2006	35	32.4%	22.0%
2007	68	27.9%	25.5%
2008	59	25.7%	18.7%
2009	25	42.1%	32.9%
2010	45	45.9%	42.9%
2011	61	40.1%	37.2%
2012	52	39.5%	28.8%
2013	26	31.4%	14.0%
2014	37	36.1%	22.2%
2015	26	31.4%	31.4%
2016	29	28.3%	21.2%
2017	27	25.5%	27.3%
2018	31	35.9%	27.1%
2019	43	27.6%	28.2%
2020	30	50.7%	36.9%
6 months to 31 Dec 2020	11	48.0%	27.5%

Average and median control premiums Australia and New Zealand

### An analysis of the data indicates:

- The number of completed transactions peaked at 68 during FY2007 and fell to a low of 25 in FY2009 as capital markets effectively froze during the GFC. Transaction levels then rose in parallel with the mining boom through FY2010 to FY2012 before falling back to levels seen during the GFC from FY2013 onwards.
- The lowest average control premium of 25.7% was in FY2008, whilst the lowest median control premium of 14.0% was in FY2013.
- Following a period of relatively high activity and lower premiums from FY2006 – FY2008, FY2009 saw average and median control premiums both rise considerably on low transaction volumes.
- Average and median control premiums continued to rise in FY2010 to 45.9% and 42.9% respectively before beginning to contract through FY2011 and FY2012.
- From FY2013 to FY2019 a period of generally reduced transaction activity occurred while average premiums have returned closer to the 15.5 year average of 34.7%.
- For FY2020 and the six months to 31 December 2020, average control premiums rose significantly to 50.7% and 48.0% respectively reflecting the impact of COVID-19 on capital markets and equity valuations.

### Implied Control Premium: 20 Days Pre-Announcement (Financial Year)





**We consider that several factors explain the control premium volatility over the 15.5 year period analysed, namely:**

- In FY2008, the lowest average control premiums recorded coincided with the ASX reaching record levels, as acquirers appeared to balk at paying “normal” premiums over traded share price. This may have reflected a belief that a certain premium was already inherent in the share prices with the ASX at all-time highs during this time.
- Equally, while the ASX and other global markets continued to fall heavily during the GFC (circa 2009), average and median control premiums increased as buyers may have considered fair value in the context of lower traded market prices and were therefore willing to pay a higher premium.
- The ASX recovered strongly in FY2010 increasing from lows of circa 3,200 points to 5,000 points and with that came a sense of optimism that the GFC may be over. In that environment and with share prices yet to reach their FY2008 highs, buyers appeared to look beyond share prices to future cash flows and were willing to pay a higher premium in order to get deals done.
- The impact of an active metals & mining sector in FY2010, FY2011 and FY2012 (respectively 35.6%, 27.9% and 32.7% of all transactions) influenced the control premium during that period, with this sector particularly impacted by exchange rates. In essence, capital provision in mining is highly internationalised and the attractiveness of deals relates in part to the AUD/USD exchange rate. The rate rose from between \$0.77 to \$0.94 in FY2010 to between \$0.94 and \$1.10 in FY2012. In those 3 financial years the average control premium for metals & mining transactions at 20 days pre-bid fell from 48.5% to 22.4% and the median from 37.0% to 21.4%, illustrating how international competitiveness may also impact the level of premium available to acquiree shareholders. Conversely, in the period subsequent to FY2012 the AUD/USD exchange rate fell to the range of \$0.70 to \$0.77 in FY2016, which was met with a corresponding rise in control premiums in the mining sector, with both the average and median premiums at 36.8%. The movement in the premium in this sector, given the relatively high proportion of mining transactions, impacted the overall premium in the Australian market accordingly.
- In FY2013, a dramatic fall in commodity prices brought about an end to the mining boom and the lowest median control premium of 14.0% was recorded. This reflected a higher number of outliers in the sample as well as potentially, a sense of uncertainty among acquirers due to the volatility of commodity prices.
- In the period FY2013 to FY2019 median control premiums returned to normal levels while average control premiums have gravitated to around the 15.5 year average of 34.7% as Australia contemplated the post mining boom “hangover” and which industry sectors would fill the void left by resources.
- FY2020 and the six months to 31 December 2020 have been dominated by the impact of COVID-19 with control premiums rising to record levels of around 50%, significantly influenced by increased premiums in the health sector, metals & mining and diversified financials. Some acquisitions in these sectors attracted premiums of over 200% as companies sought to implement strategically beneficial Scheme of Arrangements.

# IMPACT OF COVID-19

The world started to become aware of COVID-19 in January 2020 and soon after it was recognised as a global pandemic. The impact on world trade and the world markets was dramatic.

In Australia, the All Ordinaries Index on the ASX went from a high of 7,255.17 on 14 February 2020 to a low of 4,564.13 on 23 March 2020 a fall of 2,691.04 (37%) in just 39 days. The impact on implied control premiums since the onset of COVID-19 is shown in the table below by both Calendar year and Financial Year.

	Number of Transactions	Average Control Premium (20 days pre)	Median Control Premium (20 days pre)
<b>Financial Year</b>			
2019	43	27.6%	28.2%
2020	30	50.7%	36.9%
6 months to 31 Dec 2020	11	48.0%	27.0%
<b>Calendar Year</b>			
2019	37	32.4%	34.4%
2020	23	61.1%	29.9%

*Recent average and median control premiums by financial year and calendar year*

Whilst on a financial year basis the impact of COVID-19 is spread across two financial years (FY2020 and FY2021 to date) on a calendar year basis it only impacts 2020 in our data set to 31 December 2020.

The data shows a significant increase in control premiums from an average of 27.6% in FY2019 to 50.7% in FY2020 and by calendar year from 32.4% in CY2019 to 61.1% in CY2020. Transactions with the highest observed control premiums were announced during April and May 2020, when economic uncertainty was at its peak and acquirers took advantage of the distressed capital markets.





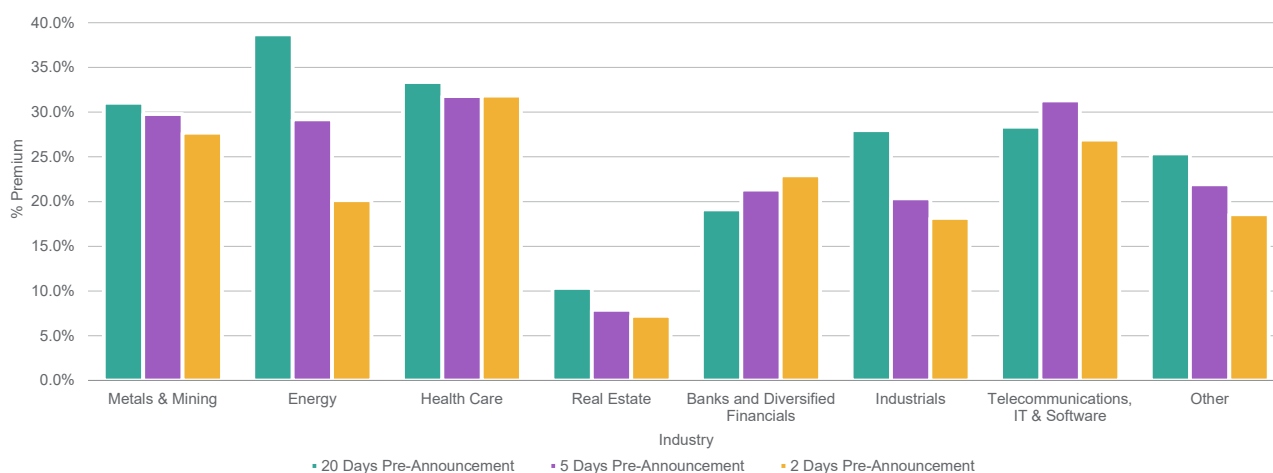
# DIFFERENT INDUSTRIES DEMAND DIFFERENT CONTROL PREMIUMS

Our analysis confirms that different industry sectors command different control premiums. The table below highlights the considerable variability in average pre-bid control premiums across different industry sectors for the period of our study.

Industry	Number of Transactions	20 day pre-bid	5 day pre-bid	2 day pre-bid
Metals & Mining	161	36.6%	32.5%	29.8%
Energy	68	39.6%	32.5%	27.2%
Health Care	37	48.6%	49.9%	42.5%
Real Estate	39	14.4%	13.7%	12.6%
Banks and Diversified Financials	47	26.4%	24.8%	25.4%
Industrials	60	36.1%	27.3%	24.7%
Telecommunications, IT & Software	64	44.1%	31.8%	34.8%
Other	125	29.6%	23.4%	21.7%

Average control premium segmented by Industry

## Median Control Premium by Industry



Sectors such as metals and mining, healthcare and telecommunications, IT and software exhibit above average control premiums (30% to 50%) whereas average control premiums in the real estate and banks and diversified financials sectors exhibit a tight range around 15% to 25%.

Healthcare in particular exhibits the highest average control premiums. Average control premiums in this sector have increased markedly in recent years as acquirers search for growth.

The higher premiums in the metals and mining, energy, health care and telecommunications, IT and software sectors may suggest that bidders in these sectors are focusing on the future cash flow potential of businesses. However, buyers of financial and property assets are generally paying only for the assets in place. These conclusions are broadly supported by the typical valuation methods used in

these sectors and a comparison of control premium to price-to-book ratios where assets tend to be "marked-to-market". In this study pre-bid real estate stocks were trading at a price-to-book ratio of 1.0x and attracting an average control premium of 14.4%, a reduction from the 2017 Study average control premium of 16.9%.

The variability in control premium between industry sectors means the relative proportion of transactions from different industries has a major bearing on the overall average control premium observed. Cyclical/volatile sectors such as metals and mining (26.6%), energy (11.2%) and technology (10.6%) combine to represent 48.4% of transactions. It could be argued that such a high proportion of transactions from these sectors may lead to control premiums in the Australian market having greater variability over time.

## DOES TRANSACTION TYPE MATTER?

We have considered whether the type of transaction has an impact on both the average control premium and the median control premium as shown in the table below.

Document Type	Number of Transactions	Average Control Premium (20 days pre)	Median Control Premium (20 days pre)
Scheme of Arrangement	300	32.1%	25.2%
Off-market bids	282	37.3%	30.1%
On-market bids	23	36.4%	22.0%

*Average and median control premium by Transaction Type*

Schemes of Arrangement (Schemes) account for almost half (49.6%) the transactions in the data set over the 15 year period from FY2006 to FY2020. There has been an increasing use of Schemes over the period with only 41.2% of transactions being Schemes over the 15.5 year period to 31 December 2020 and 62.3% of transactions being Schemes in the period FY2015 to FY2020.

As shown in the table above Schemes have both lower average control premiums (32.1%) and median control premiums (25.2%) compared to the other common takeover structure (an off-market bid) which shows average and median control premiums of 37.3% and 30.1%, respectively.

One of the key differences between Schemes and takeovers is that to achieve compulsory acquisition in a Scheme, acquirers have to win over a lower proportion (75%) of target shareholders than in a takeover (90%). In addition, unlike takeover transactions (off-market bids and on-market bids) which are covered by the provisions of Chapter 6 of the Corporations Act 2001, including safeguards for target shareholders which are known collectively as the Eggleston principles (Section 602), Schemes are subject to the provisions in Part 5.1 of the Corporations Act and therefore not subject to the Eggleston principles.

## DOES CONSIDERATION TYPE MATTER?

Cash is the most popular form of consideration accounting for 420 (69.4%) of the transactions in the data set. Scrip consideration accounts for 140 transactions (23.1%) and the remaining 45 transactions (7.5%) comprise both cash and scrip. The average and median control premiums for each of these consideration types for 20 day, 5 day and 2 day pre bid are shown in the table below.

	CASH	SCRIP	SCRIP/CASH
<b>Average Control Premium</b>			
20 days pre-announcement	36.2%	32.3%	28.1%
5 days pre-announcement	30.9%	26.5%	22.2%
2 days pre-announcement	28.1%	25.6%	22.8%
<b>Median Control Premium</b>			
20 days pre-announcement	28.6%	20.7%	27.4%
5 days pre-announcement	26.3%	20.1%	18.7%
2 days pre-announcement	22.6%	22.8%	18.4%

*Average and median control premium by consideration type*

Our current study reinforces the findings of our previous studies that control premiums in cash transactions are higher than scrip transactions. The average control premium at 20 days pre-bid in cash transactions was 36.2%, considerably higher than scrip and scrip/cash transactions, where the observed premiums were 32.3% and 28.1% respectively.

Cash is an absolute measure of consideration whereas scrip is relative. This may explain why control premiums in scrip transactions appear to be lower than cash transactions as:

- From a business specific perspective, target shareholders can expect to participate in synergistic benefits in the combined entity; and
- From a general market risk perspective, target shareholders effectively receive an option to benefit from market risk volatility

## THE TOEHOLD

Our most recent study confirms our findings in the previous studies that control premiums vary based on the level of existing shareholding in the target, with higher premiums generally being paid when acquirers have a material stake in the target as shown in the table below.

Toehold	Number of Transactions	Average Control Premium (20 days pre)	Median Control Premium (20 days pre)
0%	278	33.2%	25.0%
>0%<=10%	48	30.7%	30.5%
>10%<=20%	162	37.8%	31.4%
>20%<=50%	69	35.3%	30.0%
>50%	48	36.1%	28.2%

Average and Median control premium segmented by toehold

Our findings are consistent with the view that, when considering a change of control, an existing shareholder, who may well have board representation, is likely to be better informed and more committed to the target.

The knowledge of operational strengths and potential of the business, together with the associated ability to quantify the risks and rewards of ownership are likely to be amongst the factors which lead the informed buyer to pay more for perceived benefits of synergy. In addition, behavioural finance research has shown that greater commitment to a target does lead to a greater degree of "optimism bias" often leading managers to overestimate their capabilities and to overpay for acquisitions.

The table above indicates that the highest average and median premiums are paid when the existing shareholder's toehold is between 10% and 20%; being 37.8% and 31.4% respectively. This could indicate a strategy to buy the toehold (19.9%) on market with no premium attached, before aggressively acquiring.

## SIZE DOES MATTER

Size does matter when it comes to control premiums. In order to explore the relationship between control premium and the size of the target, we have classified targets based on their market capitalisation, and then analysed average and median control premiums for each band at 2, 5 and 20 days pre-bid. Market capitalisation was determined 20 days before bid announcement to mitigate any bid effects on value. Band sizes of less than \$25m, \$25m to \$50m, \$50m to \$100m, \$100m to \$500m and greater than \$500m were used to achieve statistically reasonable sample sizes. In addition, breakdowns of less than \$12.5m and greater than \$1b were analysed to explore the effects at the top and bottom of the spectrum.

A summary of the results of our analysis are set out in the table below.

Market capitalisation	No. of transactions	20 day pre-bid	5 day pre-bid	2 day pre-bid
\$0 to \$25M	119	50.8%	40.1%	40.6%
\$25 to \$50M	67	41.0%	37.1%	31.8%
\$50 to \$100M	102	36.7%	32.6%	28.6%
\$100 to \$500M	185	30.9%	26.1%	23.9%
\$500M +	132	20.8%	17.2%	16.0%

Average Control Premium by Market Capitalisation

Confirming our findings in previous studies, as the target's size increases, the size of the average control premium decreases across all bands at 20, 5 and 2 days pre-bid. Our analysis shows that the starting values and the degree of change for the bands is significant: for entities of less than \$25m market capitalisation the average control premium at 20 days pre-bid is above 50% whereas, for entities of greater than \$500m market capitalisation this value is just above 20%.

Factors that may explain the relationship between market capitalisation and control premium include:

- The industry and nature of companies within those size bands, with small Metals & Mining and Software deals influencing the lower bands
- Larger companies are likely to be more heavily traded and closely scrutinised by analysts and market participants, than their smaller counterparts, which could lead to share prices more accurately reflecting intrinsic value; and
- Smaller companies, by contrast, are less well followed by analysts and often less understood by market participants and may be subject to discounts relating to lower liquidity. Micro-cap entities may also be targeted for the value of their existing listing – effectively as "shell" companies.

# APPENDIX

## Methodology

RSM has analysed successful takeover offers and schemes of arrangement completed between 1 July 2005 and 31 December 2020 for companies listed on the Australian Securities Exchange (ASX) and on the New Zealand Securities Exchange (NZSX).

We have calculated the implied control premium as (offer price – share price) / share price, based on the closing share price of the target company at 20, 5 and 2 days pre and post the announcement of the offer. Our analysis and commentary is, however, primarily focused on 20 day pre-bid premiums, which, in our view, are less likely to be influenced by bid speculation. Accordingly, we consider the 20 day pre-bid data as providing the most reliable observation of any control premium implicit in the transaction.

In the period of our review, we observed a total of 784 transactions in Australia and 211 in New Zealand. Of these, 179 transactions in Australia and 80 transactions in New Zealand were excluded due to insufficient available data to calculate control premiums based on pre-bid share prices.

Where the offer included scrip of the acquiring entity, the closing share price of the acquirer on the day of the offer has been used to calculate the value of the offer.

## Acknowledgements

We acknowledge the input and support we have received from Curtin University's Dr Lien Duong, Dr Baban Eulaiwi and Professor Grantley Taylor, and Victoria University of Wellington's Associate Professor Thu Phuong Truong in the completion of this study.

