GRESHAM

M&A in an evolving ESG landscape:

A tool to achieve growth and resolve challenges

2022

Gresham's ESG capabilities

Gresham has advised clients on ESG related transactions with a value of over A$50 billion in the last five years, including some of Australia's most transformational ESG motivated M&A transactions.

Gresham has market leading ESG corporate advisory capabilities developed to meet client needs in a changing market environment.

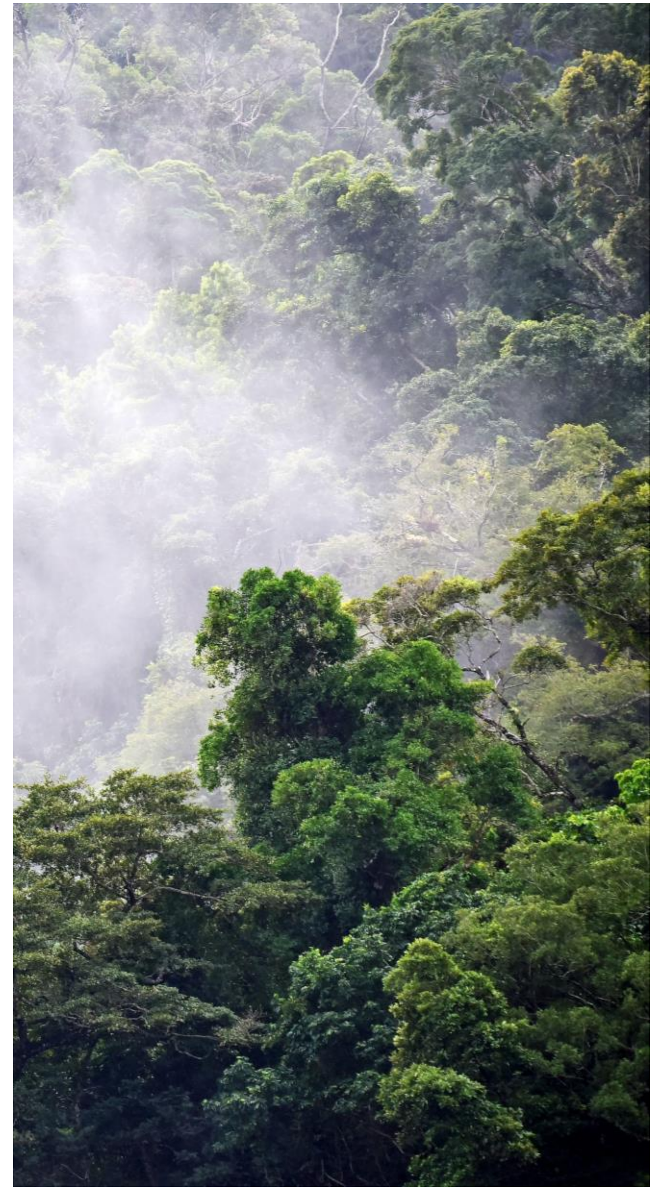
For over 30 years, Gresham has built a strong reputation for independence and innovation, as Australia's leading independent corporate advisor. Gresham has 50 professionals across three offices and offers a trusted advisor model focussed on long term relationships supported by international networks.

Mergers and acquisition team

- Offers diverse industry experience with advisory capabilities across public and private M&A, divestments, demergers and strategic advice.
- Maximises the value delivered by any transaction and ensures achievement of ESG related goals through a strong understanding of ESG related M&A trends and relevant ESG considerations across all stages of the M&A process. This approach ensures exceptional:
  - Brand and revenue outcomes.
  - Operational, expense and risk management outcomes.
  - Employee engagement, productivity and retention outcomes.

Debt Advisory team

- Offers advisory capabilities relevant to restructuring, structured asset finance, warehouse and securitisation, corporate refinance, capital market issuance and financial stress testing.
- Is able to maximise access to capital and minimise cost of capital, while also signalling relevant green and social capabilities to the market.
- Has strong sustainable finance experience, experience across all types of proceeds-based debt and behavioural based debt, and is able to guide every step of the process to ensure clients achieve their objectives.



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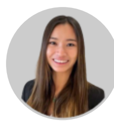

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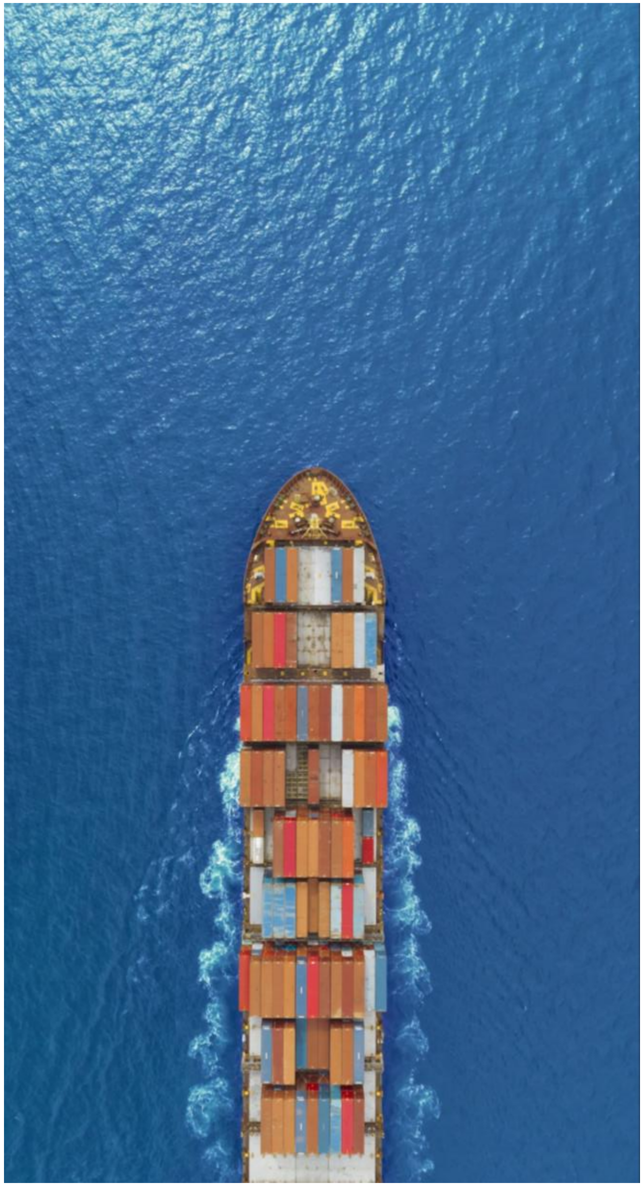


Introduction

Gresham has market leading environmental, social and governance (ESG) focused corporate advisory capabilities and is committed to working with clients to ensure M&A is effectively used to achieve ESG and broader organisational objectives.

The degree to which ESG is both impacting and being embraced by organisations has accelerated in recent years. Individual environmental, social and governance considerations and requirements are increasingly becoming interdependent and climate risk has become a global priority. In Australia, the Climate Change Bill 2022 will enshrine into law an emissions reduction target of 43 per cent from 2005 levels by 2030, and net zero emissions by 2050.

As a result the M&A landscape is changing. The successful origination and execution of transactions now requires consideration of ESG forces and trends, which are changing the business environment, in addition to sector and company specific factors.

M&A is becoming a key tool to achieve ESG related goals, in addition to broader organisational targets. Businesses are increasingly employing a combination of approaches to achieve their ESG objectives including:

- organic business and operational initiatives;
- financial tools, including sustainable finance and carbon credits; and
- M&A solutions to strategically position for success in a changing environment.

In response to the growing need to understand the relationship between ESG and M&A, Gresham has conducted a detailed review of the ESG characteristics of 793 transactions (>A$100 million), completed during the five years to 30 June 2022, involving an Australian target or acquirer.

This report shares the findings of this review. The report:

- identifies trends in ESG related transaction frequency, characteristics and objectives;
- articulates the emerging forces motivating ESG related transactions;
- considers acquirer and target trends; and
- outlines requirements for success for corporates and investors when originating ESG motivated transactions.

This document is the first of several that will consider a range of topics related to ESG.

Charles Graham

Charles Graham

Managing Director, Gresham Partners

ESG related transaction data considerations

In an environment of changing ESG norms and expectations there is no accepted approach to classifying and analysing transaction data. As a result, the Gresham team has drawn on ESG terminology and methodology used by corporates, asset managers and banks and adapted these for M&A purposes. It is recognised that different individuals and organisations will hold different views regarding the best way to classify transactions and that as ESG related norms further developed, so too will classification approaches.

With that in mind, in order to identify the trends shared in this report the Gresham team has classified the 793 transactions based on:

- Target: ESG related sector or activity linkages.
- Seller & acquirer: ESG related transaction motivations.

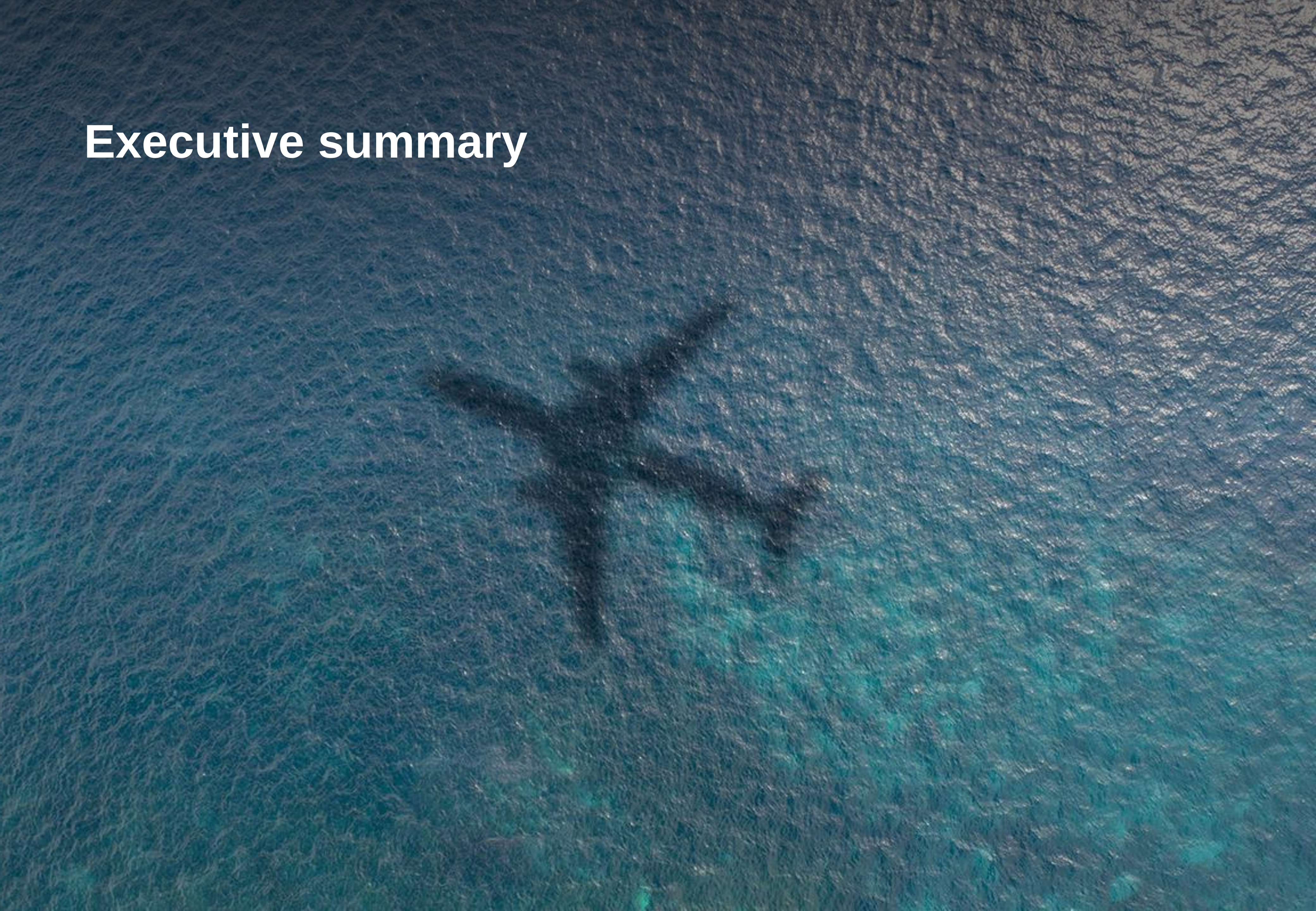
ESG motivated transactions are linked to ESG beneficial or ESG sensitive targets.

- Targets within ESG beneficial sectors or undertaking ESG beneficial activities have been identified with broad reference to UN Sustainable Development Goals (SDGs). Within the data set, ESG beneficial targets are commonly linked to emissions avoidance activities, carbon sequestration activities, health care, aged care, early learning & care and education.[1] The point at which an organisation delivers sufficient benefits to society to be classified as ESG beneficial has required judgement. In many instances the way in which a company describes itself and its sources of revenue have been used for guidance.
- Targets within ESG sensitive sectors or undertaking ESG sensitive activities have been identified with reference to common investor screens and bank prohibitions. Within the data set, ESG sensitive targets have been frequently linked to gambling, alcohol, tobacco and fossil fuels.[1] Again, where sensitive activities are undertaken by a company the point at which an organisation is recognised as ESG sensitive has required judgement.

In addition, Gresham has assessed all transactions, included in the data set, against announced seller and acquirer motivations. These motivations have been used to identify ESG motivated transactions and types of ESG beneficial and ESG sensitive transactions. However, as above, judgement has necessarily been applied to determine the materiality of motivators shared by sellers and acquirers.

Notes: 1. Targets are not been limited to these sectors. Any target that delivers material positive or negative environmental or social impacts to the community may be associated with an ESG motivated transaction.

Executive summary



Organisations are responding to ESG opportunities and pressures via M&A

Historically, ESG motivated transactions were predominantly driven by environmentally and socially linked growth opportunities. However, M&A is now increasingly being used as a tool to resolve ESG related challenges.

ESG motivated transactions are undertaken to achieve normal economic business benefits, but they also have a material ESG linked motivation. They may be:

- **ESG beneficial target (Beneficial Target) transactions** usually involve targets linked to emissions avoidance activities, carbon sequestration activities, health care, aged care; early learning & care and education.
- **ESG sensitive target (Sensitive Target) transactions** usually involve targets linked to gambling, alcohol, tobacco, defence and fossil fuels, or supply chains at risk of modern slavery.

46%

of all AU transactions were ESG motivated in FY22
↑ from **21%** in FY18

A$120 bn

in transactions ESG motivated in FY22
↑ from **A$35bn** in FY18

Average ESG motivated transaction reached

A$1.7 bn

in size in FY22 ↑ from **A$0.8bn** in FY18

ESG motivated transaction have grown at a

CAGR of 36%

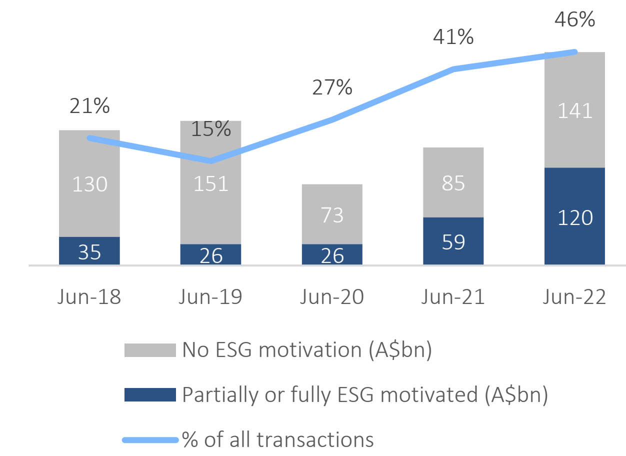
over the past five years

Transactions without an ESG motivation have grown at

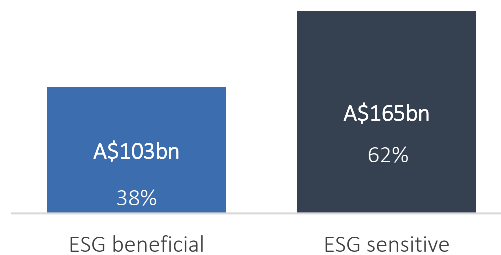
CAGR of 2%

over the same period

Australian ESG vs. non-ESG motivated transactions, by value (A$bn), 5 years to 30 June 2022[1]



Beneficial Target vs. Sensitive Target transactions (A$bn), FY18-22, by value[1]



	ESG beneficial	ESG sensitive
5 yr. CAGR (val.)	23%	41%
# transactions	162	59
Average size	A$637 m	A$2,774 m

Sources: 1. Mergermarket, Gresham analysis.

There are several types of ESG motivated transactions

Three transaction types have Beneficial Target linkages, while four transaction types have Sensitive Target linkages

Beneficial Target transactions:

1. **Corporate growth:** accelerate the growth of a business that operates in an ESG beneficial sector. They involve a corporate acquirer with existing capabilities in the relevant sector, or an adjacent sector.

   Platform for growth into the beneficial global clinical trials sector

2. **Business mix:** involve a change the underlying business mix of an acquirer, in order to better position to achieve and ESG related growth. They involve a corporate acquirer with no, or limited, capabilities in the relevant sector.

   Investment in an ESG commodities exchange

3. **Investor demand:** grow the ESG beneficial investments of an asset manager, in response to asset owner demand. They involve an investor acquirer.

   25 per cent interest in Group's Retirement Living business.

   Supporting the needs of Australia's ageing population

Sensitive Target transactions:

1. **Sector specialist:** are a response to changing environmental or social expectations, opportunities or threats. They involve an acquirer that intends to improve some aspect of the new entities ESG performance.

   QIC placed significant emphasis on tilting offering to renewables

2. **Risk transfer:** involve the divestment of sensitive sector operations or assets to achieve risk management benefits. Relevant acquirers may, or may not, seek to improve some aspect of the new entities ESG performance.

   Petroleum Division

   BHP exit of oil and gas

3. **Transition:** involve the acquisition of heavy emitting operations or assets. They involve an acquirer who intends to reduce target emissions to net zero, in-line with science based targets and/or materially support broader economy transition through the activities of the target.

   AustralianSuper's 16.8 per cent stake

   Heavy emitter with path to net zero

4. **Governance and risk management:** are caused by changes to, or breaches of, regulatory, compliance, legal, operational or societal requirements; that have had negative consequences for the community.

   Continue to operate at the highest standards of compliance, governance, and integrity

ESG Beneficial Target transactions are growing because of four key trends

These trends also influence Sensitive Target transactions.

Decarbonisation targets and carbon credit price influences

For most organisations, internal projects will not be sufficient to achieve net zero.

Other options are:

1) **Financial solutions:** purchase carbon credits; or
2) **Strategic solutions:** divesting heavy emitting / acquiring low or negative emitting assets

Carbon credits forecasts by 2035[1]

Demand: will need to grow by **c.30-40x current levels** to achieve Paris Agreement obligations

Prices: are expected to rise **3-6x current levels**

Environmental sector economics

Ten high-potential emissions focused sectors will by 2030, generate revenue of:

US$9 - 12tn globally and **US$150 – 200bn** in AU,

representing a **10 to 15 per cent real increase** in total global and AU revenue pools.[2]

Green transport	Green fuels/ minerals
Green buildings	Green power & infra.
Water	Green Consumer
Green agri & land	Recycling & waste mgmt
Green industrials	Green carbon mgmt

Social sector trends

Social sector transactions are not experiencing the same growth as environmental sector transactions, as these sectors are not experiencing equivalent business model shifts or growth opportunities.

Transaction economics are being driven by **individual sector trends and conditions.**

Investor objectives

Institutional managers charge a fee on assets under management (AuM). Fees have been under pressure so profitability is maximised by attracting and investing new funds.

High **AuM inflows are driving asset manager demand**, and subsequently corporate demand, **for ESG motivated transactions.**

Sustainably invested funds, prioritising ESG beneficial investment processes, **are growing >10 per cent p.a.**[3,4]

ESG themed funds, that seek to support defined ESG themes and outcomes, are **growing >30 per cent p.a.**[3,4]

Sources: 1. EY, "How can carbon offsets create new value in a rapidly changing world?", Apr 2022; 2. McKinsey, "Playing offensive to create value in the net zero transition", May 2022; and 3. Global Sustainability Investment Alliance, "Global Sustainability Investment Review 2020", Mar 2021; and Think Ahead Institute, "The world's largest 500 asset managers", Oct 2021. Notes: 4. Sustainably invested AUM are invested using techniques such as ESG integration and screening. Thematically invested AUM seek to generate positive environmental and social improvements alongside a financial return.

ESG Sensitive Target transactions are growing because of six key trends

These trends also influence Beneficial Target transactions.

Sensitive sector outlook

The long term growth outlook and economics of many sensitive sectors are:

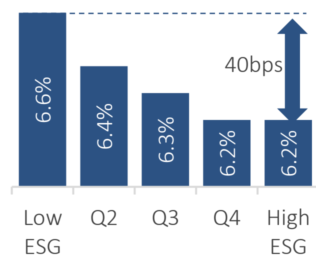
- **Limited by demand (e.g. tobacco), or**
- **Significantly challenged by regulations (e.g. heavy emitting sectors).[1]**

However, in the short to medium term some sensitive sectors (e.g. fossil fuel-linked sectors) will at times benefit from high prices.

General ESG and cost of capital

A study by MSCI found a **40bps difference** in the cost of capital between companies with high and low total ESG scores.[2]

ESG scores vs. cost of capital, globally



Net zero, cost and availability of capital

Net zero commitments require financial institutions to decarbonise in line with science based portfolio decarbonisation targets.[4]

Portfolio companies are not decarbonising fast enough to support these commitments.

Emissions related penalties of >300bps are being seen in select sectors.

They are expected to **progress to other sectors**

Divestment vs. acquisition of heavy emitters

Financial institutions' net zero commitments **encourage the divestment and discourage the acquisition of heavy emitting operations or assets.**

- A primary objective of net zero commitments is to ensure capital is directed towards **green sectors** offering decarbonisation solutions.
- Sectors associated with the highest emissions are often associated with **greenwashing concerns,** because they do not have well accepted pathways to net zero.

Litigation

Australia is subject to the **second highest level of ESG related litigation globally.[5]**

ESG related litigation risks are most evident in relation to climate risk.

Climate targets or commitments to limit warming may expose organisations to misleading and deceptive conduct related litigation risk, if greenwashing is demonstrated.

Governance & risk management considerations

Poor corporate governance and risk management may motivate a deal.

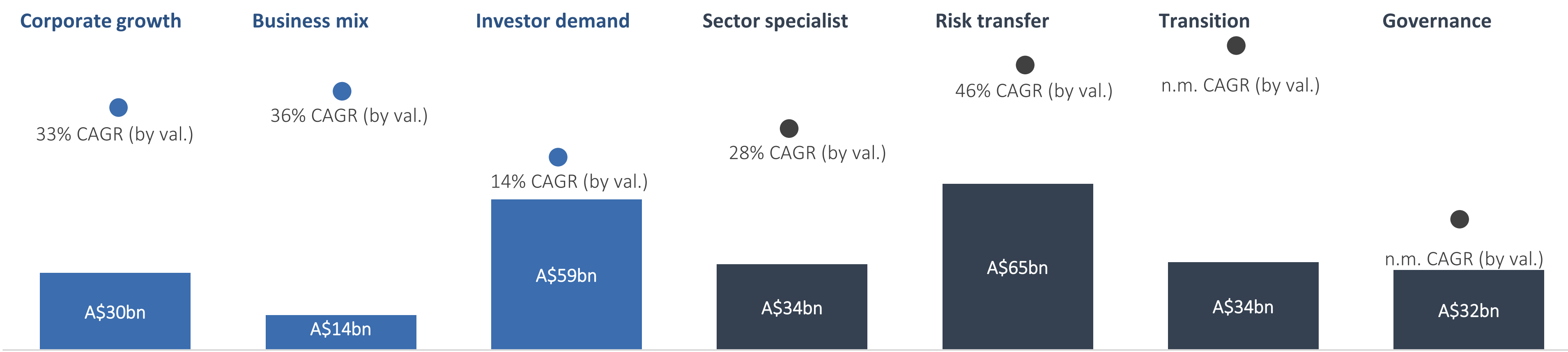
Even if a company has strong corporate governance and risk management practices, **a transaction may be prompted by changes** to legal, compliance, regulatory and operational risk management requirements **that cannot be satisfied without material investment.**

Sources: 1. McKinsey, "Playing offensive to create value in the net zero transition", Apr 2022; 2. MSCI, "ESG and the cost of capital", Feb 2020; 3. Nature Energy, "The cost of debt of renewable and non-renewable energy firms", Feb 2021; and NAB, "ESG and Capital: Part 1 Equity, Oct 2021; 4. unepfi.org/net-zero-alliance, unepfi.org/net-zero-banking, and netzeroassetmanagers.org; 5. Norton Rose Fulbright, "Climate Change Litigation Update", Feb 2022.

Nearly all types of ESG motivated transactions experiencing strong growth

Beneficial Target transactions, five years to 30 June 2022[1,2]

Sensitive Target transactions five years to 30 June 2022[1,2]



	Corporate growth	Business mix	Investor demand	Sector specialist	Risk transfer	Transition	Governance
Key take-outs	*Have grown significantly off a low base, as acquirers pursue ESG related growth*	*Green minerals targets are 5x more common than any other target type*	*Most common type of Beneficial Target transaction*	*Emerging transaction type, driven by consolidation and specialisation*	*Huge growth driven by organisations exiting sensitive*	*Fastest growing transaction type. Category did not exist 5 years ago.*	*An intermittent part of the M&A landscape, currently commonly linked to financial services.*
Target sectors	Healthcare, green minerals, green power and infrastructure and education	Green minerals	Health care and green power & infrastructure	Oil and gas and fossil fuel based power & utilities	Thermal & met coal, oil & gas and gambling and alcohol	Power generation and infrastructure related targets with path to net zero	Financial services
Example transactions	Orocobre, Galaxy. Created top 5 lithium player globally	South32, Sierra Gorda. Large with portfolio reshaping objective	Healthscope, Brookfield. Largest Beneficial Target transaction over 5 years	EnergyAustralia, Ecogen Energy. Complement to existing generation	Woolworths Group, endeavour group. Demerger due to differing ESG needs	KKR, Ontario Teachers' Pension Plan, sparkinfrastructure, PSP. Heavy emitter with path to net zero	Australian Ethical, Christian Super. Improved scale to benefit members

Sources: 1. Mergermarket, Gresham analysis. Notes: 2. The three largest Beneficial Target transactions over the period influencing the data were the Brookfield Asset Management acquisition of Healthscope Ltd for A$6.1 billion (May 2019), the Powering Australian Renewables and Mercury Energy acquisition of Tilt Renewables Ltd for A$3.3 billion (Aug 2021) and the First Sentier acquisition of Wheelabrator for A$3billion (Feb 2021). 3. The five largest Sensitive Target transactions over the period influencing the data were the Woodside Energy Group Ltd merger with BHP Petroleum for A$27.1 billion (Jun 2022), the Brookfield Infrastructure Group consortium acquisition of Ausnet Services for A$18.4 billion (Feb 2022), the Spin-off of Endeavour Group Ltd. From Woolworths Group for A$12.8 billion (Jun 2021), the acquisition of Oil Search Ltd. by Santos Ltd for A$12.2 billion and the demerger of the Lottery Corporation by Tabcorp Holdings Ltd for A$10.5bn.

ESG Beneficial Target and Sensitive Target transactions requirements for success often differ

This is due to the differing characteristics of these transactions.

Beneficial Target vs. Sensitive Target transaction

Beneficial Target transactions requirements for success often include the ability to leverage in-depth industry and ESG knowledge to identify, assess, value and execute transactions in fast evolving and incredibly competitive landscape.

Key drivers of these requirement are a need to understand fast changing business and operating models and successfully identify and execute on areas of opportunity in an environment of intense competition for high quality operations and assets.

In contrast Sensitive Target transaction requirement for success are often linked to risk and stakeholder management. These transactions usually require identification of key risks and exceptional engaging with all concerned stakeholders from an early stage.

Key drivers of these requirements are the societal issues associated with relevant transactions; large number of stakeholders involved; significant regulatory and governance requirements; and social scrutiny associated with these transactions.

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Section I:
Introduction to ESG motivated transactions

ESG as we know it today is the result of decades of evolution

This evolution is continuing and has significant implications for M&A activity

History has demonstrated that the three components of ESG are intertwined and continuously support and influence each other. That being said, the 1980s, 1990s and 2000s are each associated with major developments in environmental, social or governance concepts.

During the 1980s the environment became an area of focus as a consequence of multiple man-made natural disasters and as scientists identified the risks that emissions posed to the climate. This focus on the environment has gradually increased.

The 1990s was a decade that delivered significant improvements in Governance. Governance related awareness and standards have been improving over several decades. However, several of the key governance mechanisms that support businesses and the economy today were established in the 1990s.

During the 2000s social concerns and goals become more prominent and were gradually added to equivalent environmental concepts.

Finally, during the 2010s and early 2020s governance concepts combined with environment and social concepts to accelerate change and climate risk was recognised as perhaps the greatest threat facing the world today.

Select examples of trends are outlined to the right.

1980s

Pre-1980s: The oil crisis of the 1970's encouraged the development of renewable power sector. As environmental concerns emerged the UN Environmental Program was formed.[1,2]

1983: UN created the World Commission on Environment & Development.[3]

1984: The Bhopal gas tragedy unfolded at the Union Carbide Ltd pesticide plant in India with over 500,000 killed or injured.[4]

1987: The Brundtland Report was published by the UN, it placed environmental issues firmly on the political agenda and introduced the concept of 'sustainable development' and described how it could be achieved[5]

1988: UN formed the International Panel on Climate Change (IPCC) to provide policy makers scientific assessments.[6]

1989: Exxon Valdez oil spill disaster in Alaska led to Coalition of Environmentally Responsible Economies (CERES).[7]

1990s

1992: The Cadbury Report contained a number of recommendations to raise standards in corporate governance, it laid the foundations of current corporate governance systems, in response to the actions of Robert Maxwell.[8]

1997: Kyoto Protocol and Global Reporting Initiative (GRI) established.[9,10]

1998: Australian Securities and Investments Commission (ASIC) formed to protect Australian consumers, investors and creditors[11]

1999: G7 established the Financial Stability Forum (FSF), comprised of Central Banks to promote international financial stability through information exchange and international co-operation in financial supervision and surveillance.[12]

2000s

2002: Extractive Industries Transparency Initiative (EITI) launched to deal with corruption and payments made to Governments [13]

2003: Equator Principles was formally launched.[14]

2005/06: UN Secretary General convened largest institutional investors to join a process to develop principles for responsible investing. The Principles for Responsible Investing (PRI) launched in 2006.[15]

2009: Financial Stability Board (FSB) established[16]

2010s

2015/16: Paris Agreement signed by 196 parties. UN Sustainable Development Goals (SDGs) were set by the UN General Assembly. G20 identified climate change as systematic risk.[17,18]

2017: Climate Action 100+ formed (largest investor engagement initiative) and TCFD established voluntary guidance on disclosures.[19,20]

2019-21: Australian Royal Commissions conducted into financial services, gambling and aged care; Special IPCC Report which shows global warming must be limited to 1.5C degree; US withdrew / re-enters Paris Agreement; various UN convened Net Zero Commitment groups launched and climate activism and litigation becomes common.[21,22,23,24]

2020s

2022: Nearly 90 per cent of greenhouse gas (GHG) emissions are now targeted under a government or corporate net-zero commitment.[25]

Sources: 1. Karsten Neumeister, "A brief History of Solar Energy", Apr 2022; 2. UNEP, "Environmental Moments: A UNEP @50 timeline", Sep 2022; 3. United Nations, "Report of the World Commission on Environment and Development: Our Common Future", Aug 1987; 4. The Atlantic,"Bhopal: The World's Worst Industrial Disaster, 30 Years Later", Dec 2014; 5. Jarvie, Michelle E.. "Brundtland Report". Encyclopedia Britannica, May 2016; 6. IPCC, ""ipcc.ch/about/history/" Aug 2022; 7. Ceres, "ceres.org/about-us", n.d.; 8. ECGI, "Cadbury Report (The Financial Aspects of Corporate Governance), Dec 1992; 9. Wikipedia, "Kyoto Protocol", Aug 2022; 10. Betsy Atkins, "Demystifying ESG: Its History & Current Status", Jun 2020; 11. Federal Register of Legislation, "Australian Securities and Investments Commission Act 2001",n.d; 12. FSB, "Financial Stability Forum re-established as the Financial Stability Board", Apr 2009; 13. Ibeth L. Elissaios P. Lorenzo P., "The Extractive Industries Transparency Initiative (EITI) and corruption in Latin America: Evidence from Colombia, Guatemala, Honduras, Peru, and Trinidad and Tobago", Mar 2021; 14.UNEP, "The Equator Principles Do They Make Banks More Sustainable?", Feb 2016; 15. PRI, "About the PRI", n.d.; 16. FSB, "History of the FSB", Dec 2021; 17. UN, "The Paris Agreement", n.d.; 18. UN, "The Sustainable Development Agenda", n.d.; 19. Climate Action 100+, "About Climate Action 100+", n.d.; 20. TCFD, "Recommendations of the Task Force on Climate-related Financial Disclosures", Jun 2017; 21. IPCC, "Global Warming of 1.5 ºC", Oct 2018; 22. US Department of State "The United States Officially Rejoins the Paris Agreement", Feb 2021; 23. Net zero asset managers, "The Net Zero Asset Managers initiative", n.d.; 24.GFANZ, " Glasgow Financial Alliance for Net Zero", n.d.; 25. McKinsey, "Playing offensive to create value in the net zero transition", Apr 2022;

ESG considerations have for a very long time influence M&A activity

ESG motivated transactions are undertaken to achieve normal economic business benefits, but they also have a material environmental, social or governance linked motivation.

ESG is not a concept that is traditionally associated with M&A. However, an examination of history shows that environmental, governance, and social considerations have had a significant impact on the M&A landscape for many decades.

As ESG is increasingly impacting and being embraced by organisations the scale and number of ESG related transactions is increasing. M&A is becoming a key tool to achieve ESG related goals in addition to broader organisational targets. Businesses are increasingly employing a combination of approaches to achieve their ESG objectives including organic initiatives, financial options (e.g. carbon credits) and M&A solutions that are linked to organisational strategy.

1 **Growth focused renewable and environmental transactions appeared early** and have grown in size and scope

Globally, environmental sector transactions have increased in size and scope over the last four decades.

- Over the past four decades, the global growth in breadth and depth of all types of renewable and environmental transactions has been enormous. Renewable transactions started in the 1980's with the Solarex acquisition of Solar Power Corporation from Exxon (1984). The largest renewables transaction in the Asia Pacific reached a value of US$5 billion when Global Infrastructure Partners (GIP) acquired Equis Energy for US$5 billion (2017).[1,2]
- Traditional growth focused environmental sector transactions accounted for up to 10 per cent of Australian transactions each year by value, during the five years to 30 June 2022.[3]

2 **Poor governance has long driven** high profile governance **transactions**

Governance transactions can be seen in every decade. They tend to be high profile and can have significant community implications.

- Global examples include Standard Oil's (1910s) anti-competitive and monopolistic actions that eventually led it into dissolution and Texaco's (1980s) illegal interference with Pennzoil's acquisition of Getty oil that resulted in a US$11 billion fine (the largest in the history of US civil justice system at the time) and ultimate acquisition by Chevron. [4,5]
- Governance transactions have on average accounted for less than 5 per cent of Australian transactions each year by value, during the five years to 30 June 2022.[3]

3 **Social sector transactions** to drive sector specific growth have been **consistently in demand** for over four decades

A broad range of social transactions are common.

- Globally, pharmaceutical transactions rank in the top ten by value most decades. Key transactions include Bristol-Myers acquisition Squibb (1990s), Zeneca acquisition Astra AB (1990s), Glaxo Wellcome acquisition SmithKline Beecham (2000s), Bristol-Myers Squibb acquisition Celgene (2010s), AstraZeneca acquisition Alexion Pharmaceuticals (2020s).[6]
- Traditional social sector transactions accounted for around 5 per cent of all Australian transactions each year by value, over the five years to 30 June 2022. Health care transactions are the most common type of social sector transactions.[3]

4 **M&A has emerged as a tool to achieve ESG targets,** as organisations employ organic, financial and strategic solutions to achieve their goals

It is becoming common to see heavy emitters and organisations associated with a range of sensitive activities or challenging situations undertake transactions with clear ESG objectives.

- Globally, M&A is increasingly being used as a tool to achieve organisational ESG policy objectives.
- Examples of recent transactions for this purpose include the Fortescue Metals Group acquisition of Williams Advanced Engineering Ltd (2020s), Visy acquisition O-I Glass Aust. & NZ (2020s), South32 Ltd acquisition of 45 per cent Sierra Gorda copper mine (2020s), Shell Australia's acquisition of 49 per cent of WestWind Energy wind farm (2020s).[3]
- This emerging type of M&A has been increasing and is estimated to now account for up to 20 per cent of all transactions.[3]

Sources: 1. Karsten Neumeister, "A brief History of Solar Energy", Apr 2022; 2. Vena Energy, "GIP acquires Equis Energy", Oct 2017; 3. Mergermarket and Gresham analysis, 2022; 4. US Supreme Court, "Standard Oil Co. of New Jersey v. United States, 221 U.S. 1", May 1911; 5. Steven E. Prokesch, "A case study, Texaco Inc: Is there a way out of McKinley's nightmare", Dec 1985; 6. Wikipedia, "List of largest mergers and acquisitions", Aug 2022;

ESG motivated transactions are material

Within Australia, ESG motivated transactions now account for c.46 per cent of transactions.

ESG motivated transactions may be partially, or completely ESG motivated and may deliver positive, neutral or negative benefits to society.

A recent global survey of companies and investors found that ESG motivated transactions represent up to 40 per cent of transactions, and that environmental risks and opportunities are the most common motivator for ESG motivated transactions.[1]

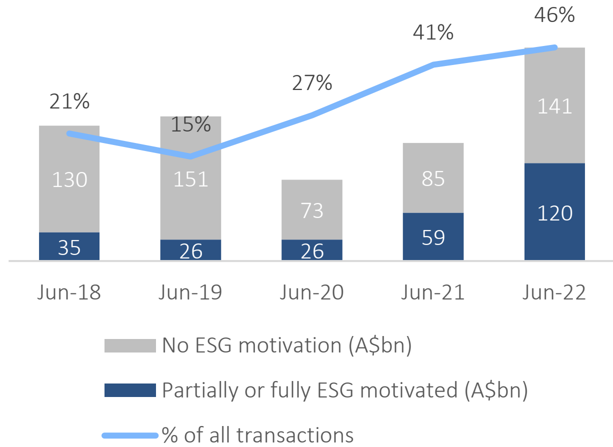
In Australia, transactions with material ESG motivations have increased from:

- 43 transactions worth A$35 billion (or 21 per cent of transactions) in 2018; to
- 71 transactions worth A$120 billion (or 46 per cent of transactions) in 2022.

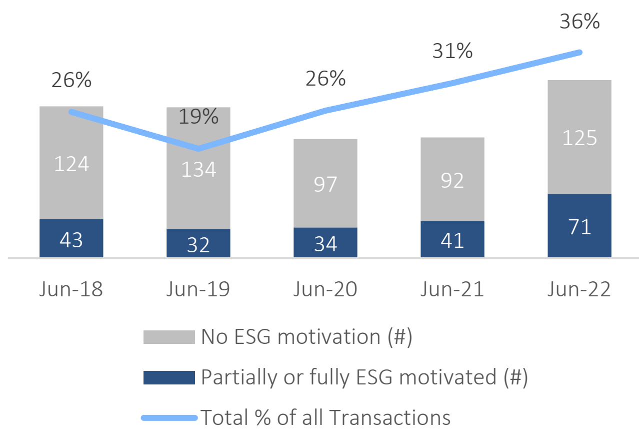
ESG motivated transactions achieved a cumulative value of A$267 billion in the five years to June 2022. They have experienced a CAGR of 36 per cent over the past four years.

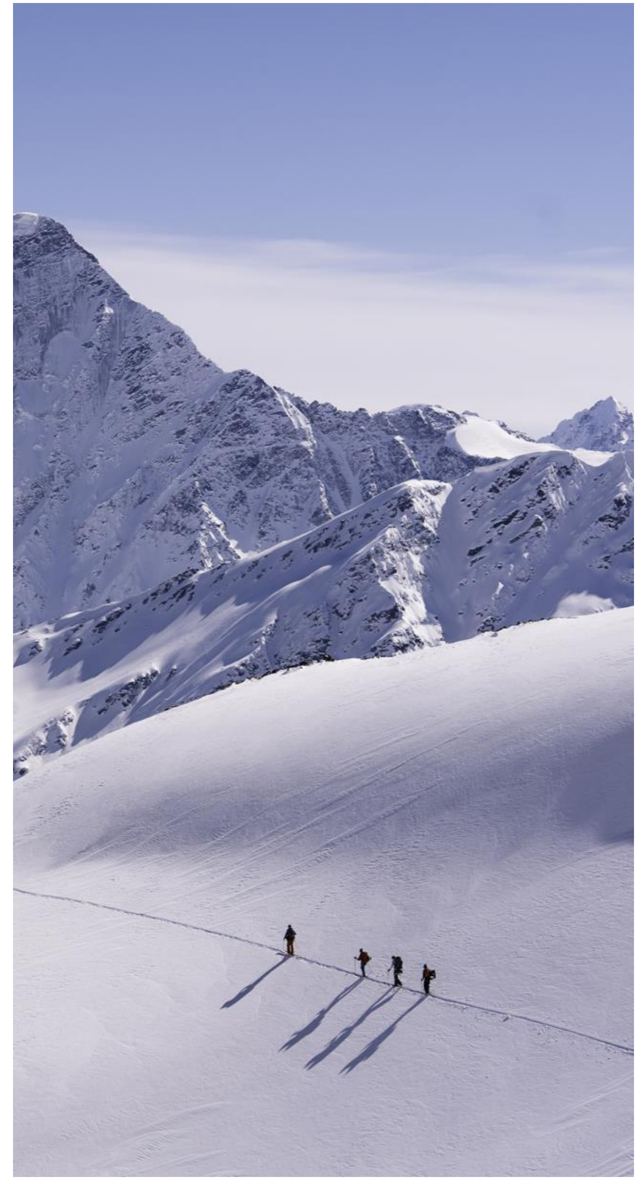
This increase in volume, without an equivalent increase in value reflects a reduction in average transaction values.

Australian ESG vs. non-ESG motivated transactions, by value (A$bn), 5 years to 30 June 2022[2]



Australian ESG vs non-ESG motivated transactions, by volume (#), 5 years to 30 June 2022[2]





Sources: 1. Bain and Company, "Global M&A Report, Jul 2022. 2. Mergermarket, Gresham analysis

ESG motivated transactions may be linked to Beneficial Targets or Sensitive Targets

Three transaction types have Beneficial Target linkages, while four transaction types have Sensitive Target linkages

ESG Beneficial Target transactions

Beneficial Target transactions involve a change in ownership of operation or asset that offers environmental or social benefits to the community. These are usually linked to emissions avoidance activities, carbon sequestration activities, health care, aged care; early learning & care and education.

Three transaction types involve targets with ESG beneficial sector and activity linkages:

1. **Corporate growth:** transactions accelerate the growth of a business that operates in an ESG beneficial sector. They involve a corporate acquirer with existing capabilities in the relevant sector, or an adjacent sector.
2. **Business mix:** transactions involve a change in underlying business mix, in order to better position an organisation (particularly if exposed to material ESG risks). Business mix transactions involve a corporate acquirer with no, or limited, capabilities in the relevant sector.
3. **Investor demand:** transactions are undertaken to grow portfolio investments in ESG beneficial sectors, in response to strong asset owner demand for Beneficial Target transactions. Investor demand transactions involve an investor acquirer.

ESG Sensitive Target transactions

Sensitive Target transactions involve a change in the ownership of operation or asset with material sensitive sector operations or assets. These are usually linked to gambling, alcohol, tobacco, defence and fossil fuels, or supply chains at risk of modern slavery.

Four transaction types involve targets with ESG sensitive sector and activity linkages:

1. **Sector specialist:** transactions are undertaken in response to changing environmental or social expectations, opportunities or threats. This type of transaction involves an acquirer that intends to improve some aspect of the new entities ESG performance to deliver benefits to the community.
2. **Risk transfer**: transactions involve the divestment of sensitive sector operations or assets. They are undertaken by a seller to achieve risk management benefits. Relevant acquirers may, or may not, seek to improve some aspect of the new entities ESG performance.
3. **Transition:** transactions involve the acquisition of heavy emitting operations or assets. They involve an acquirer who intends to reduce targets emissions to net zero, in-line with science based targets and/or materially support the transition of the broader economy through the activities of the target.
4. **Governance and risk management:** transactions are caused by changes to, or breaches of, regulatory, compliance, legal, operational or societal requirements; that have negative consequences for the community. Governance and risk management transactions are related by a loss of customer and broader stakeholder support which impacts a seller's revenues, expenses and/or ability to operate on an ongoing basis. The loss of support may be the result of either the specific actions of the seller, or a seller's peers.

ESG impact specific considerations

Benefits to society delivered by any Beneficial Target or sensitive transactions may vary depending on the approach taken to a transaction. A shared value approach to transactions prioritises both economic business benefits and the delivery of positive environmental and/or social benefits to the community.[1] A business benefit approach to transactions prioritises the delivery of economic, risk management, or other sources of value, with no incremental environmental and social benefits to the community.[2]

This report does not seek to define ESG related transactions by how effectively they deliver shared value, as assessment of shared value can be highly subjective process.

Notes: 1. An example of a shared-value related transaction would be the acquisition of a renewable energy company, with reinvestment of some or all transaction synergies into growth initiatives in order to reduce global greenhouse gas (GHG) emissions, and 2. An example of a business benefit related transaction would be the sale of a heavy-emitting fossil fuel asset to an acquirer that does not intend to reduce emissions, in order for the seller to achieve financial and risk management objectives.
Sources:

ESG Beneficial Target and Sensitive Target transactions have different growth profiles

Beneficial Target transactions have increased significantly in volume, but not value, due to a reduction in average transaction values. Sensitive Target transactions have increased significantly in value, but not volume, due to an increase in average transaction values.

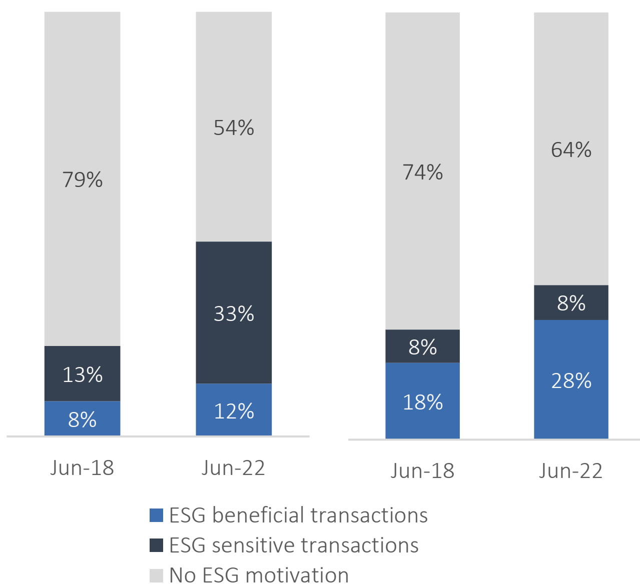
162 **Beneficial Target** transactions with
A$103bn cumulative value
Over the five years to 2022

59 **Sensitive Target** transactions with
A$164bn cumulative value
Over the five years to 2022

Beneficial Target transactions have increased significantly in value from a total value of A$14 billion in 2018 (representing 8 per cent of all transactions) to A$32 billion in 2022 (representing 12 per cent of all transactions).

They have also grown substantially in volume with the number of Beneficial Target transactions increasing from 30 (representing 18 per cent of all transactions) to 55 (representing 28 per cent of all transactions) over five years.

ESG motivated as % of all Australian transactions[1]
by value (A$bn) FY18-22 by volume(#) FY18-22

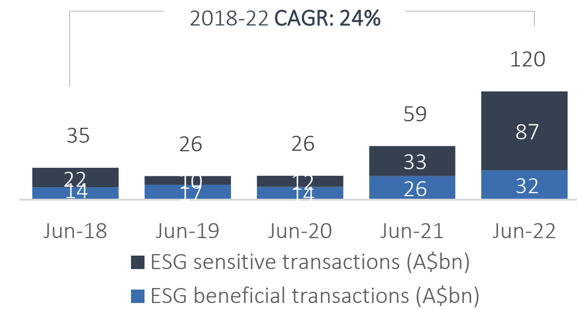


Sensitive Target transactions have increased significantly in value, from A$22 billion in FY18 (representing 13 per cent of all transactions) to A$87 billion in FY22 (representing 33 per cent of all transactions).

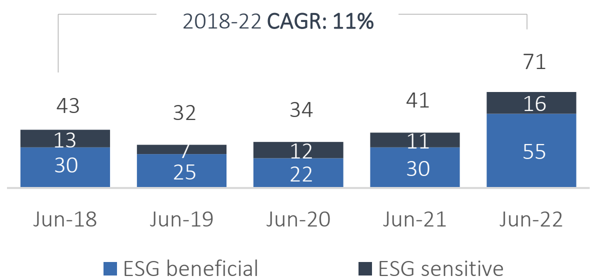
Interestingly, they have not increased significantly in volume over the same period.

A significant increase in values, without an equivalent increase in volumes reflects an increase in average transaction sizes.

By value (A$bn)[1] 5 years to 30 June 2022



Types of Australian ESG motivated transactions[1]
by volume (#) 5 years to 30 June 2022



Sources: 1. Mergermarket, Gresham analysis.

Section II: Beneficial Target transaction motivators

Environmentally economic motivations are a key transaction driver

Ten high-potential emissions beneficial sectors will generate revenue of US$9 - US$12 trillion per annum by 2030. M&A offers an opportunity for organisations to accelerate or pivot their strategy to achieve leadership in these high growth sectors.

There were 117 Australian environmentally focused transactions with an enterprise value of A$165 billion completed, in the five years to 30 June 2022.[1] Environmentally beneficial transactions are currently dominated by emissions transactions. This is a trend that is likely to accelerate. As the dangers of climate change have become more apparent and urgent, so has the potential value capture associated with being a leader in the transition to net zero.

Globally, there are approximately ten high-potential sectors that will generate revenue of anywhere from US$9 trillion to more than US$12 trillion per annum by 2030.[2] Australia represents approximately 1.7 per cent of the global economy, implying US$150 billion to US$200 billion in additional revenue annually. This revenue will provide a 10 to 15 per cent real increase in total global and Australian revenue pools.[3]

At present, about 65 percent of annual capital spending globally goes into high-emissions assets. But in a scenario where the world reaches net zero in 2050, analysis suggests that this pattern will reverse and 70 percent of capital outlays through to 2050 will be spent on low-emissions assets.[2] As organisations adjust their priorities and budgets, they will spend trillions on climate-friendly goods and services and the green energy, equipment, and infrastructure needed to produce them.[2]

Growth opportunities associated with being a leader in the transition to net zero are driving environmental transactions.

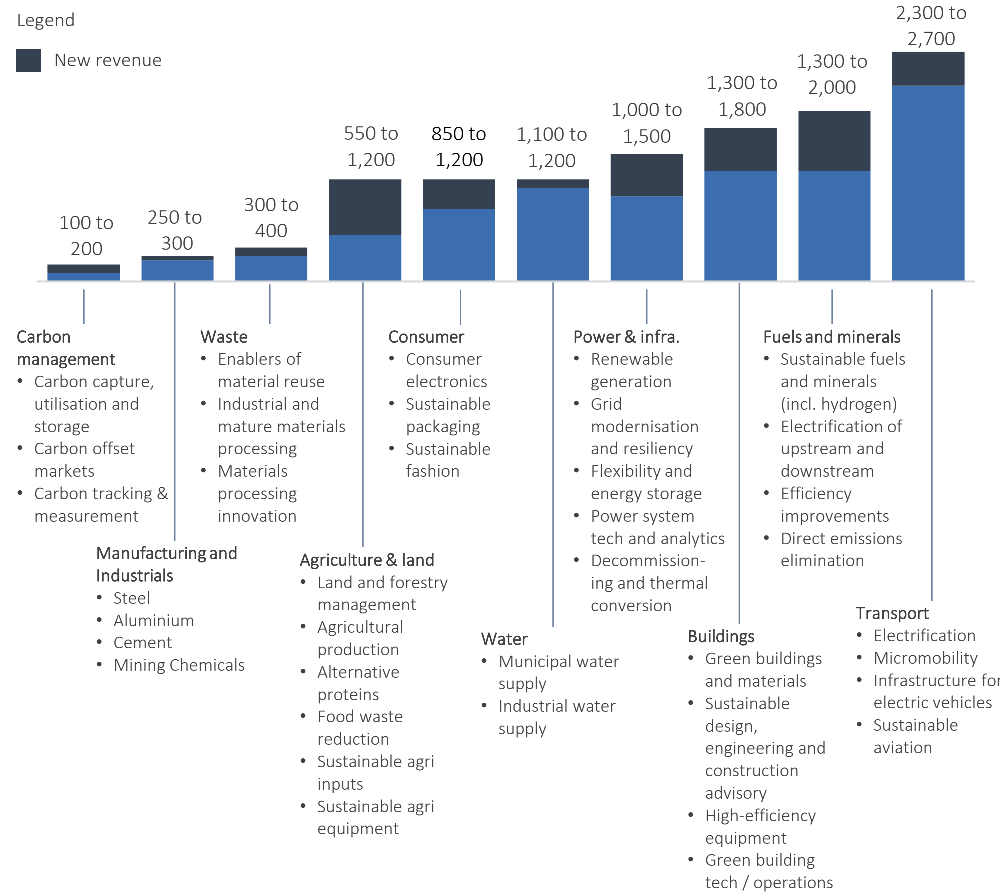
Emissions related transactions are already underway across all sectors identified to the right. Over time common transaction sub-sectors are expected to evolve as technology and processes evolve, and broaden as emissions reduction becomes a focus for a greater number of businesses.

Net zero commitments

Nearly 90 per cent of greenhouse gas (GHG) emissions are now targeted for reduction under a net-zero commitment and this is creating opportunities across nearly all sectors.[2]

Addressable market size by revenue, in 2030

US$ billion[2,4]



Sources: 1. McKinsey, "Playing offensive to create value in the net zero transition", Apr 2022. Includes countries that have achieved their net-zero targets or have put them into law, in policy documents, or made a declaration or pledge; and 2. Austrade, "Australia: Benchmark Report", Oct 2021.

Notes: 3. Waste and water, were traditionally considered as environmental sectors, but not sectors that were closely aligned with GHG emissions reductions. This view is changing as these sectors are essential for a circular economy; and a circular economy eliminates waste, lowers material and resource consumption and consequently reduces GHG emissions.

Carbon price risks are supporting transaction growth

Expected increases in the cost of carbon credits are driving Beneficial Target transactions.

The achievement of global net zero pledges will be challenging and costly for businesses. Some industries will never achieve zero emissions, while for others it will take many years.

Organisations that are committed to net zero are increasingly adjusting their operations and investing in a broad range of organic projects to close the gap to net zero. However for many organisations, even if these projects achieve their goals, they will need to also:

1. purchase carbon credits;
2. divest heavy emitting assets or operations; and/or
3. acquire assets or operations with low or negative emissions.

1. Purchases of carbon credits

Carbon markets are fragmented, complicated and undergoing change. There are currently more than 60 carbon pricing systems in operation globally, covering around 22 per cent of global GHG emissions.[1,2]

Price volatility in many carbon markets is high. As an example, within Australia the most common type of credits traded are ACCUs, which are federally sponsored. The Australian Federal Government announced changes to the operations of ACCU's in March 2022, which resulted in a 24 per cent spot price adjustment in one day and damaged investor confidence in the market.[5]

Carbon credits are a relatively straight-forward way to achieve net zero.[3] However, carbon credits are expected to become increasingly scarce and expensive in the years ahead.

Analysis indicates that by 2035 demand for carbon credits will need to grow by 30-40x to achieve Paris Agreement climate goals. This in turn will drive price rises of 3-6x, to US$80-150 per tonne CO2e (in real dollars), up from c.US$25 per tonne CO2e. Between 2035 and 2050, demand for carbon credits is expected to grow more slowly, but prices may continue to rise to US$150-200 per tonne CO2e in 2050 (in real dollars).[4]

2. Divestment of heavy emitting assets or operations

Transactions to divest heavy emitting assets or operations offer emission reduction benefits to the seller. However, historically, this type of transaction has commonly resulted in the transfer of, not reduction in, emissions. Emissions reduction transactions are discussed in the next section of this report.

3. Acquisition of assets or operations with low or negative emissions

An acquisition of assets or operations with low or negative emissions offer several potential benefits:

- Ability to reduce emissions intensity and/or absolute emissions, potentially reducing the need to purchase carbon credits; and/or
- Ability to sell carbon credits if the target is a recognised carbon credit producer, thus delivering a long term revenue.

As a result, across all types of Beneficial Target transactions, there is high demand for targets offering low or negative emissions.

Carbon credits forecasts by 2035

Demand: expected to increase by at least 20x, and will need to grow by **c.30-40x current levels** to achieve Paris Agreement obligations

Prices: expected to rise of **3-6x current levels**, to US$80-150 per tonne CO2e (in real dollars)

Sources: 1. World Bank, "State and trends of carbon pricing 2021", May 2021.; 2. International Carbon Action Partnership, "Emissions trading worldwide", Mar 2022; 3. A carbon credit is a certified and transferable instrument representing one tonne of CO2 emissions that are avoided or removed. 4. EY, "How can carbon offsets create new value in a rapidly changing world?", May 2022.
Notes: 5. Changes were announced to enable holders of historical contracts with the Emissions Reduction Fund (ERF) to pay an exit fee to be released from their obligations to the Commonwealth Government. The fee is the contract price multiplied by the number of ACCUs. The purpose of the changes was to open up the market and reduce upward pressure on ACCU prices. The changes are beneficial-linked to the producers and aggregators of ACCUs whose contracts are an average of A$12 per unit, significantly below the spot market high of A$56.80 in 2021. However, the change creates a loss to taxpayers.

Socially focused transaction motivations vary by sector

Social sector transactions are largely being driven by individual sector trends and conditions. There were 84 Australian transactions with a total value of A$69 billion completed across these sectors, in the five years to 30 June 2022.[1]

Socially focused ESG beneficial sectors vary significantly between developed and developing nations due to differences in socially-linked risks, opportunities and community requirements. Within developed nations, transactions have traditionally been associated with health care, pharmaceuticals and life sciences (health sector), aged care, early learning & care and education. In addition, transactions are emerging that are not associated with any particular sector, but are instead associated with organisations that offer benefits to a disadvantaged community.

Most social sectors are not experiencing significant business model shifts or growth opportunities.[3] As a result, social sectors are not experiencing the same growth in transaction value and volumes witnessed in environmental sectors. The potential for social transactions to deliver material shared-value is consequently limited. If a transaction is structured to deliver benefits to a community (e.g. through improved health outcomes), then in most situations there is a limit to benefits that can be achieved before expenses increase and negatively impact shareholder value.

However, social sectors activities are important for delivering against a range of UN SDGs and transactions will continue to be motivated by factors including changes in government policy, changes in community expectations, advances in technology, outcomes of Covid-19 as well as revenue opportunities and expense pressures. Several sector-wide trends driving social sector transactions are outlined to the right.

Social commitments

>65 per cent of the world’s N100 companies connect their business objectives and targets to UN sustainable development goals (SDGs), the first five of which are focused on social goals:[2]

Health sector trends:

- Digitised and de-centralised patient services such as telehealth, virtual health and online pharmacies.
- Technology-enabled practice management and back-office remote work capabilities that drive growth and close related capability gaps.
- Vaccine innovation and development, lifestyle disease investment (e.g. obesity and diabetes), fertility service improvements and greater focus on care at home, prevention and intervention in social determinants of health.
- Covid-19 driven payer mix changes, R&D, innovation, localised manufacturing and supply chains.

Education sector trends:

- Greater demand for degrees in countries with more accommodating border policies than Australia, driven by prolonged border closures.
- Online and mixed learning including professional short courses, specialist corporate workforce training and smart-phone based internet user content.
- Prioritisation of capital investments and expenses that focus on digital assets and ed-tech.
- Collaborations with industry to utilise surplus space, offer integrated learning and enable research collaborations.

Early learning and care sector trends:

- Attendance and revenue that is limited by childcare subsidy caps, noting that NSW and Vic government policies are creating pre-school opportunities.
- Cost pressures driven by substantial staff shortages due to Covid-19, reduced migration and wages.

Aged care sector trends:

- Aging population driving demand for high care, low care and aging in place.
- Tax benefits associated with operating as a not-for-profit.
- Royal commission-driven regulatory reforms, Covid-19 related cost pressures and broader economic cost pressures.

Sources: 1. Mergermarket and Gresham analysis; 2. KPMG survey of Sustainability Reporting, 2020; 3. A notable exception is the specialist and disability accommodation sector. See over for details.

Deep dive into emerging socially focused transaction

M&A is supporting the development of the specialist and disability accommodation (SDA) sector.

M&A can contribute to the development of new ESG beneficial business models through the combination of external and internal assets or capabilities, in order to deliver a new product or service.

A good demonstrations of how M&A can contribute to an ESG beneficial business model is currently being seen in the specialist and disability accommodation sector. In recent years the disability accommodation policy environment in Australia has shifted from:

1. funding incumbent disability institutions and services with the intent of these being accessed by recipients of their services; to
2. funding individuals so they are able to make their own choices on how and where they live.

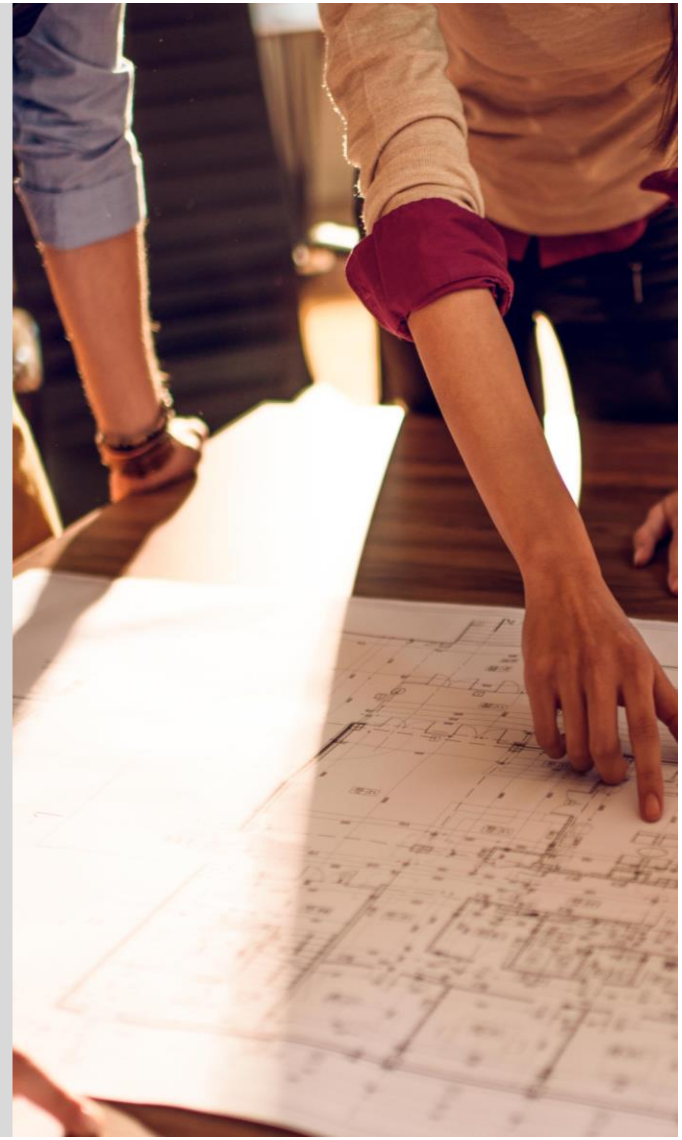
This shift has fundamentally changed specialist disability housing accommodation supply and demand dynamics and is resulting in better outcomes for individuals requiring SDA accommodation. This shift has also created a new sector with relatively low barriers to entry, high potential for value adding services (such as physical support and on-site assistance) and high (partially government-backed) returns.[1]

The government has currently allocated the NDIS A$700 million p.a. (indexed to inflation) to be provided to participants. These are characteristics which are attractive to asset managers.[1]

That being said, there are complexities around the provision of SDA services, primarily associated with NDIS specific requirements. One approach being taken by investors to accelerate investments and mitigate the risks unique to the sector is to partner with an established SDA provider.

In the short term small scale M&A will help support market development through the acquisition of suitable properties which can be used to build and develop SDA capabilities. As an example, the Synergis Fund established managed by Social Infrastructure Investment Partners (SIIP), a joint venture between Federated Asset Management and Social Ventures Australia (SVA) and Federation Asset Management is targeting $1 billion in investments over the next five years to deliver housing for people with disabilities.[2]

In the medium to long term M&A trends are likely to shift to consolidation, with the most successful market participants taking market share and capturing value.



Sources: 1. Corrs Cambers Westgarth, “Specialist disability accommodation: an emerging asset class for investors”, Sept 2020; 2. Synergisfund,“synergisfund.com.au/fund”, Aug 2022.

Investor requirements have underpinned transaction volumes for some time

Asset owner pressures in particular are driving asset manager and corporate led Beneficial Target transactions.

Asset owner demand is driving investor and corporate demand for Beneficial Target transactions:

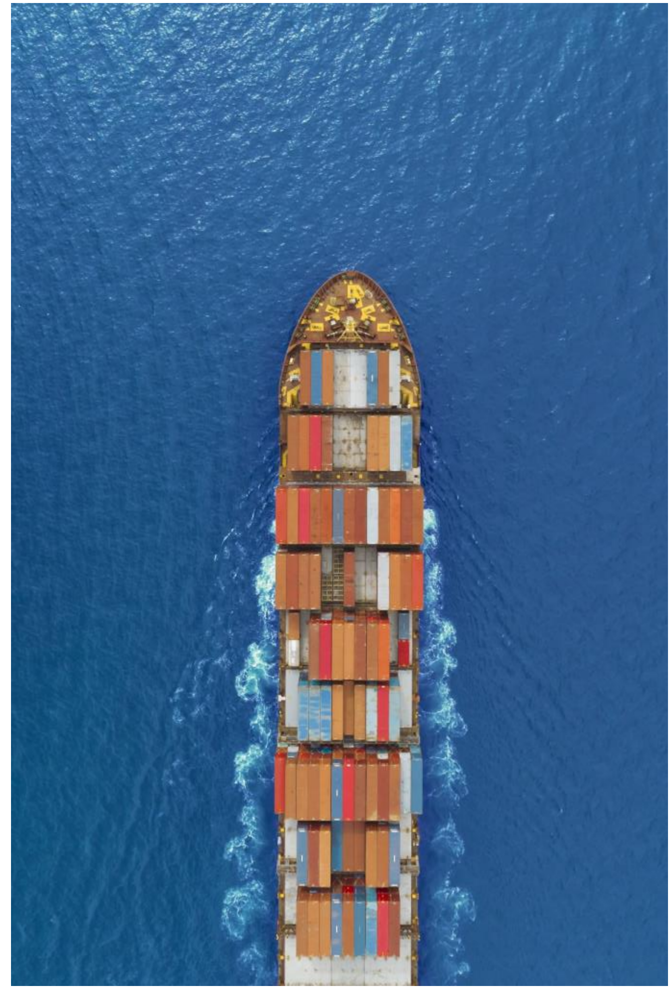
1. Asset manager led Beneficial Target transactions

Funds with a high proportion of ESG investments experience higher fund inflows than equivalent funds without a high proportion of ESG investments. Against a backdrop of institutional management fees that have largely been in decline for over a decade, profitability increases are being achieved by asset managers who are successfully able to attract and invest funds from asset owners. This is driving investor demand for Beneficial Target transactions.

- **Sustainable investing influences:** Sustainably invested funds may invested in any sector or company, but prioritise investment techniques such as ESG integration and screening to ensure investments are sustainable. Over 36 per cent, or US$43 trillion of global AuM, and A$1.3 trillion of Australian AuM, are sustainably invested.[1] Sustainably invested AuM is growing at over 10 per cent p.a., which is well above industry norms.[1] This growth reflects underlying asset owner demand. Sustainably invested fund strategies favour specialist environmental and social investments. This is in turn driving M&A demand for these assets. Globally, Investors accounting for more than 75 per cent global AuM have signed up to UN Principles of Responsible investing (PRI) and in Australia there are over 170 Australian based signatories to the UN PRI. This is higher than any other market in Asia Pacific.[4]
- **ESG themed investing influences:** ESG themed funds invest to support specific outcomes (e.g. decarbonisation, or good health) and prioritise deliver of ESG benefits to the community. Over 3 per cent, or US$4 trillion in global AuM, and A$30 billion in Australian AuM, is invested in thematic funds.[1] Thematic funds invest with the intention of generating identifiable positive social and environmental benefits as well as financial returns. Due to high levels of asset owner demand, AuM flows to thematic funds are growing at over 30 per cent p.a.[1] This is directly driving demand for environmental and social transactions.

2. Corporate led Beneficial Target transactions

Corporates are being influenced by asset manager demand for Beneficial Target assets and operations. In a recent survey, over 80 per cent of corporates identified asset manager pressure as a key reason why ESG factors are taken into account when making M&A decisions.[3] Asset managers are increasingly applying pressure on their portfolio companies to influence their strategy, priorities, initiatives and M&A activities. This pressure is being applied through 'stewardship' which includes voting and engagement. Stewardship is one of the most common ESG related activities undertaken by asset managers.[1,4]



Sources: 1. Global Sustainability Investment Alliance, "Global Sustainability Investment Review 2020", Mar 2021; and Think Ahead Institute, "The world's largest 500 asset managers", Oct 2021; 2. Australian Investment Council and Preqin, "Australian private capital market overview", May 2021; 3. Mergermarket, "ESG on the Rise: Making an Impact in M&A", n.d.; 4. PRI, "The evolution of responsible investing: an analysis of advanced signatory practices", Mar 2021.

Section III: Beneficial Target transaction types and trends

ESG Beneficial Target transactions are experiencing strong growth across all transaction types

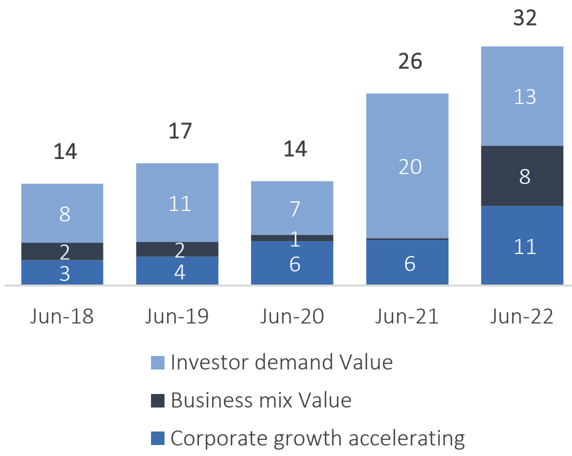
They have increased from 18 per cent to 28 per cent of all Australian transactions by volume over the past five years. Average Beneficial Target transaction values have increased to A$591 million from A$460 million over the same period.

Investor demand transactions are the most common type of Beneficial Target transaction, but are also experiencing the lowest growth rate in this category. This type of transaction accounted for 44 per cent of all Beneficial Target transactions in FY22.

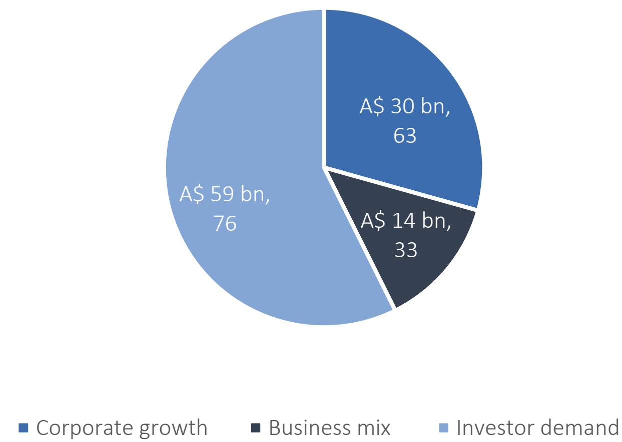
Corporate growth and business mix transactions have both grown significantly off a low base as acquirers pursue ESG related growth opportunities. Together these transaction types accounted for 56 per cent of all Beneficial Target transactions in FY22.

Across all categories, environmental and social transactions are common. There were 77 environmental transactions with a total value of A$57 billion, 82 social transactions with a total value of A$46 billion and three governance transactions, with a total value of A$0.5 billion completed in the five years to June 2022.[1]

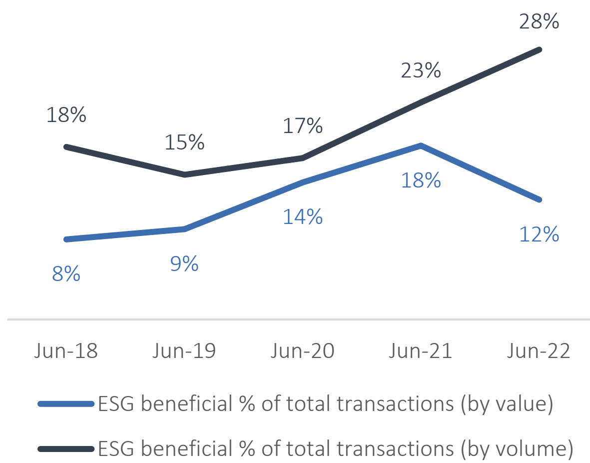
Types of Beneficial Target transactions by value (A$bn)
5 years to 30 June 2022[2,3]



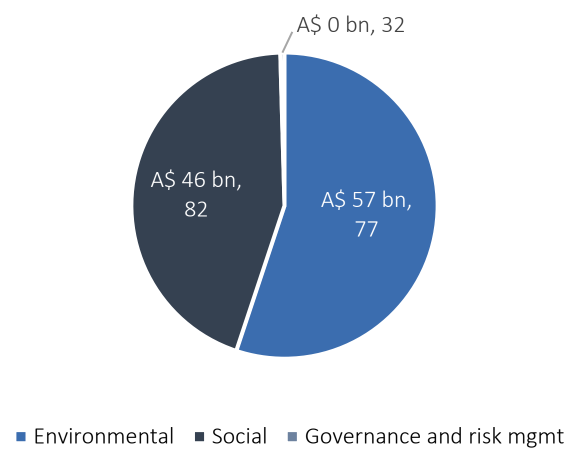
Types of Beneficial Target transactions, FY18-22
Transaction volumes (#) and values (A$bn) [3]



Beneficial Target as % of all transactions by value and volume 5 years to 30 June 2022[3]



Benefits of Beneficial Target transactions, FY18-22
Transaction volumes (#) and values (A$bn)[3]



Notes: 1. There are three Beneficial Target transactions that offer governance benefits. These are related to software to employee experience and productivity and are different to Governance and Risk Management related transaction types that are ESG sensitive. 2. The three largest transactions over the period influencing the data were the Brookfield Asset Management acquisition of Healthscope Ltd for A$6.1 billion (May 2019); the Powering Australian Renewables and Mercury Energy acquisition of Tilt Renewables Ltd for A$3.3 billion (Aug 2021); and the First Sentier acquisition of Wheelabrator for A$3 billion (Feb 2021). All three were investor demand transactions
Sources: 3. Mergermarket, Gresham analysis.

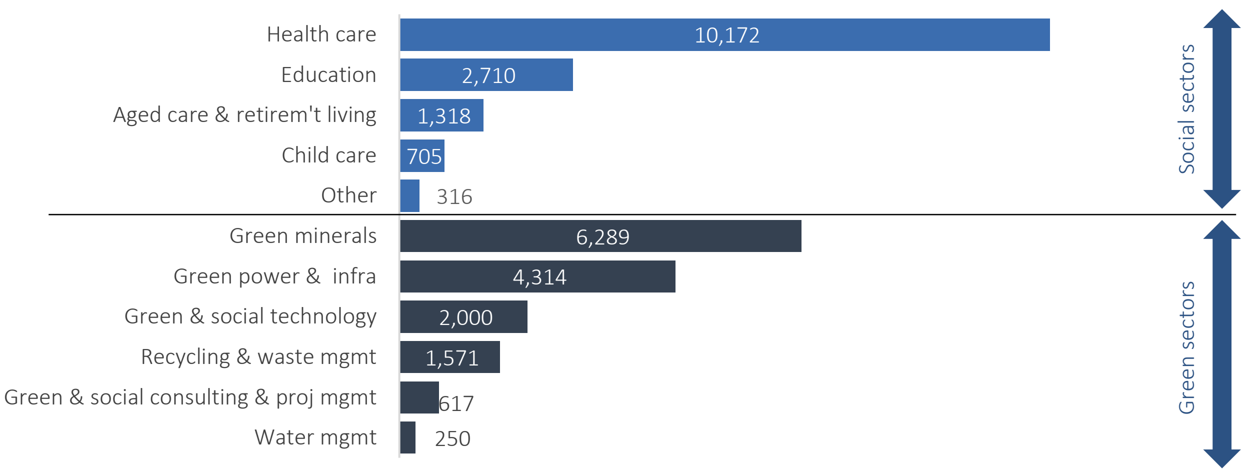
1a. Corporate growth transactions

Corporate growth M&A is most commonly associated with targets and acquirers in sectors such as health care, green minerals and green power & infrastructure.

Over the past five years, 63 corporate growth accelerating transactions with a total value of A$30 billion were completed. These transactions represented 39 per cent of all Beneficial Target transactions over the period. Corporate acquirers undertaking growth accelerating transactions have meaningful existing capabilities in the same, or similar sector, to the target.

Environmental sector targets have predominantly been associated with green minerals, green power and infrastructure, and green and social technology. Green minerals is a sector that is relatively mature in terms of green capability development, while green and social technology is an emerging sector. In the future, environmentally focused transactions are expected to become common across a broader range of target sectors, as these sectors improve their green credentials. Socially focused growth accelerating transactions have been undertaken across all major social sectors, but with a focus on health care and education. Socially focused growth accelerating transactions are expected to remain relatively stable, subject to economic conditions.

Corporate growth target sectors, 5 years to 30 Jun 2022[1]
Transaction values (A$m)



Sources: 1. Mergermarket, Gresham analysis.

Transaction examples

Sandfire Resources Ltd's 100 per cent acquisition of Minas de Arguas Tenidas SA (MATSA), from Trafigura Group Pte Ltd and Mubadala Investment Co, for A$2.6 billion, completed on 1 February 2022. MATSA is a copper mining complex in Spain. The acquisition increases Sandfire's reserves of copper, giving it greater exposure to a key raw material for components driving the clean energy transition.

Ramsay Health Care Ltd's 100 per cent acquisition of Elysium Health Inc, from BC Partners Holdings Ltd, for A$1.4 billion, completed in February 2022. Ramsay Health Care provides health care through a network that extends across 10 countries, with over eight million admissions/patient visits to its facilities in over 460 locations. Elysium is a UK-based independent operator of hospitals and complex care homes for individuals with mental health conditions and has a strong partnership with the National Health Service.

Little Company of Mary Health Care Ltd's (Calvary Health Care) 100 per cent acquisition of Japara Healthcare Ltd (ASX:JHC) for A$380 million, completed November 2021. Calvary is a charitable Catholic not-for-profit organisation with 14 public and private hospitals, 17 retirement and aged care facilities, and a national network of community care centres. Japara is an Australian aged care operator with one of the country's largest private-sector residential aged care portfolios.

1b. Business mix transactions

Business mix driven M&A is currently dominated by acquirers and targets associated with green minerals.

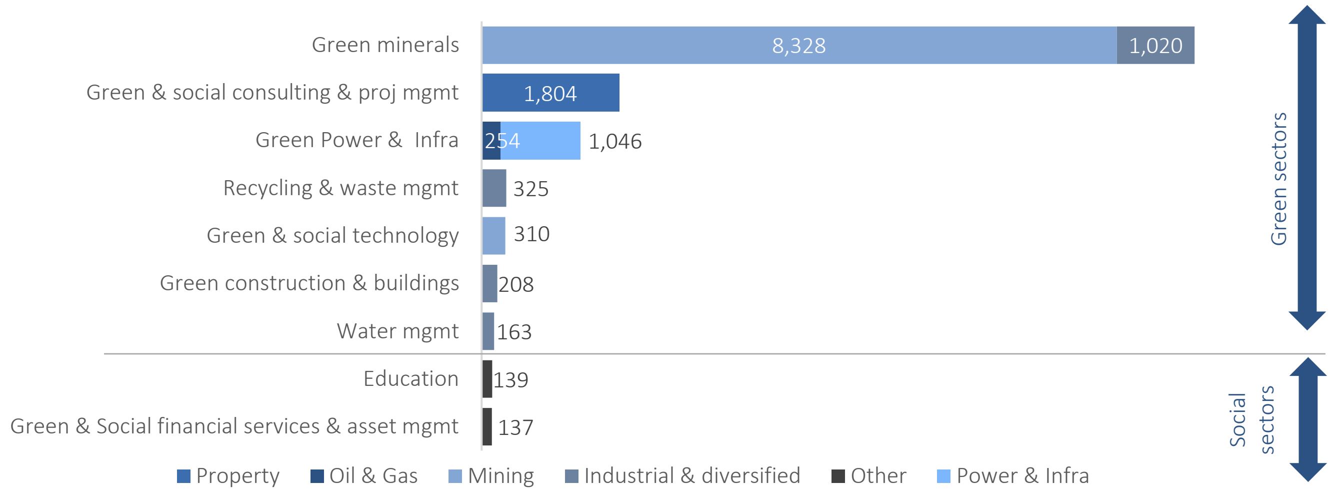
Over the past five years 23 business mix transactions with a total value of A$14 billion were completed. These transactions represented 14 per cent of all Beneficial Target transactions over the period.

Targets of business mix transactions are nearly exclusively environmentally and decarbonisation focused. Business mix transactions are most commonly led by companies that operate in heavy emitting sectors including mining, industrial and diversified, property, and power and infrastructure.

Transactions are being led by companies seeking to benefit from demand for products required for decarbonisation (e.g. green minerals) and companies under pressure from a range of stakeholders to decarbonise their own activities.

Acquirers usually undertake M&A in green sectors that are adjacent to their own sector. In the future, business mix transactions are expected to increase in popularity across all sectors associated with material emissions.

Business mix target and acquirer sectors, 5 years to 30-Jun-22[1]
Transaction values (A$m)



Transaction examples

IGO Ltd's acquisition of 49 per cent interest in a global lithium joint venture from Tianqi Lithium Corporation for A$1.9 billion, completed in June 2021. The transaction was transformational for IGO, accelerating their strategy of becoming a globally relevant supplier of metals critical to enabling clean energy. Lithium is essential for rechargeable batteries that use renewable, carbon-neutral sources of energy (for example, solar, hydro, or wind) instead of gasoline or diesel.

Mitsubishi Corporation's 40 per cent acquisition of Australian Integrated Carbon Pty Ltd (AIC), for an undisclosed value, completed July 2021. AIC is an Australian nature-based carbon farming developer, assisting landholders in generating Australian carbon credit units (ACCUs). The acquisition will assist Mitsubishi in achieving its sustainability objectives, which include 'transitioning to a low-carbon society' and 'growing together with local communities'.

Wesfarmers Ltd's 100 per cent acquisition of Kidman Resources (ASX:KDR), for A$738 million, completed September 2019. Kidman Resources is an Australian lithium explorer and developer. The transaction built on Wesfarmers' existing mining and chemical processing capabilities, while supporting the renewable energy sector.

Sources: 1. Mergermarket, Gresham analysis.

1c. Investor demand transactions

Investor demand transactions are the most common type of Beneficial Target transaction. This reflects the significant demand for Beneficial Target transactions being seen by all major investor types.

Over the past five years, 76 investor demand transactions with a total value of A$59 billion were completed. These transactions represented 47 per cent of all Beneficial Target transactions over the period.

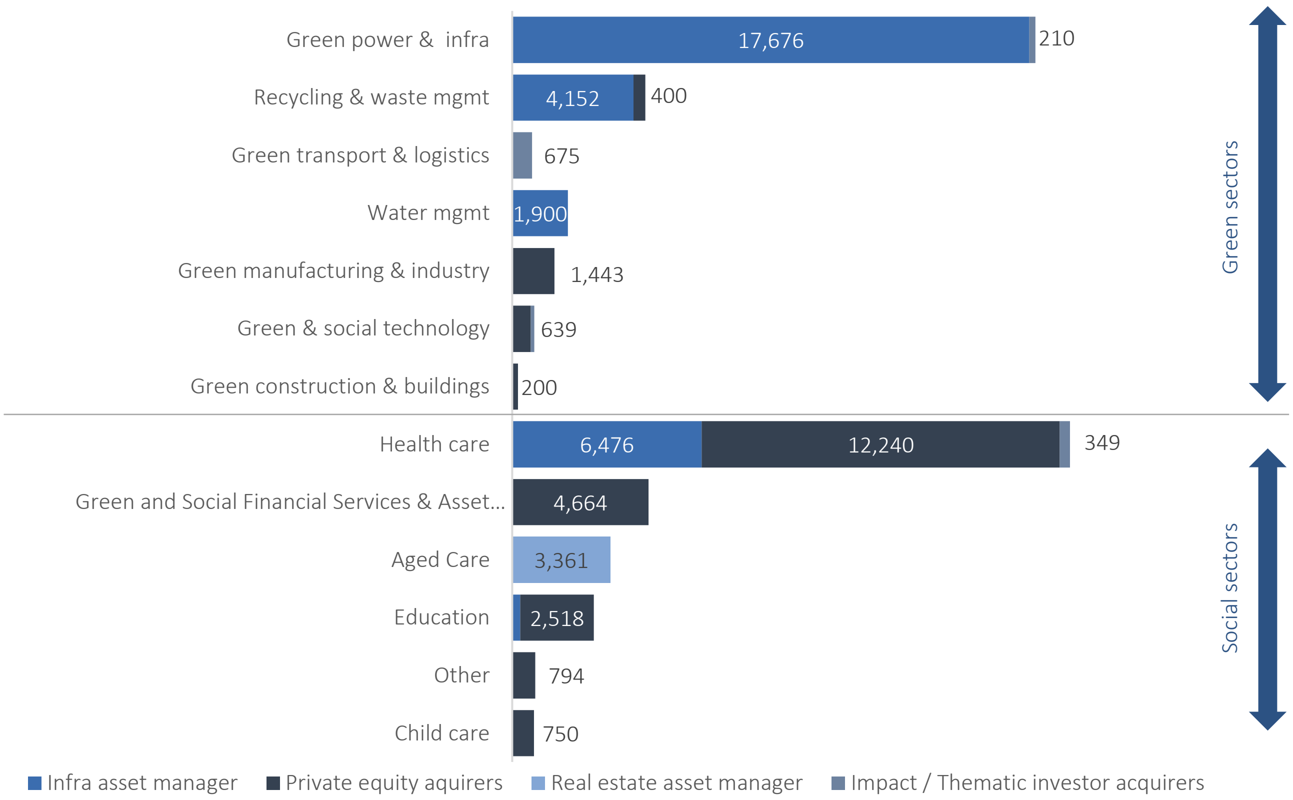
Infrastructure asset managers have traditionally led acquisitions across major environmental sectors such as green power and infrastructure, recycling & waste management, and water management. However, as the shift from public to private ownership continues these opportunities may become scarcer. As a result, infrastructure investors are increasingly seeking opportunities in social sectors, particularly within sectors that offer resilient long term returns such as health care.

Private equity have traditionally dominated acquisitions across most social sectors where they have strong capabilities, as well as many emerging environmental sectors. Private equity demand for transactions across all these sectors is expected to remain strong, given the growth outlook of these sectors.

Real estate asset managers are active in the aged care sector as well as a selectively in other sectors. Most traditional property transactions either do not appear in merger market data, are less than A$100 million in scale (the minimum size for inclusion in the data set) or are not ESG motivated.

Finally, although thematic investors only manage a very small proportion of global AUM, their market share is growing and they have a long history of involvement in transactions across a range of sectors where there is opportunity to deliver high levels of shared value.

Investor demand target and acquirer sectors, 5 years to 30 Jun 2022[1]
Transaction values (A$m)



Sources: 1. Mergermarket, Gresham analysis.

1c. Investor demand transactions

A large number of recent Beneficial Target transactions have been investor-led. The most significant of these are outlined on the right.

Transaction examples

Powering Australian Renewables (PowAR) consortium's 100 per cent acquisition of Tilt Renewables' Australian operations, from Tilt Renewables Ltd, for A$2.2 billion, completed August 2021. The transaction was undertaken by a Scheme Implementation Agreement (SIA) between Mercury, PowAR and Tilt Renewables. The PowAR consortium is a partnership comprising Queensland Investment Corporation, the Future Fund and AGL Energy. The consortium acquired Tilt Renewables' Australian operations while Tilt's New Zealand subsidiaries were acquired by Mercury NZ, an electricity generator and retailer. The acquisition will position PowAR as Australia's largest owner and operator of wind and solar generation, bringing the company's installed capacity to 1,313MW and its development pipeline to more than 3,500MW.

AustralianSuper, QIC, new and existing investors' acquisition of a stake in Generate Capital for A$2 billion. Generate is structured differently from the typical private investment firm. Rather than raising capital for funds that have specific vintage years and exit deadlines, Generate's investors are buying permanent stakes of the company itself. Generate primarily invests in sustainable energy, transportation, and waste management. It also considers investments in water, agriculture, and smart cities including digital access and microgrids.

ICG / Shell / Meridian Energy - Infrastructure Capital Group (ICG) and Shell Energy Operations acquired Meridian Energy's Australian operations for $729 million. As part of the transaction, ICG acquired a portfolio of renewable generation assets and development projects and Shell acquired Powershop, an online energy retailer focusing on renewable energy.

KKR led consortium's 100 per cent acquisition of Spark Infrastructure Group (ASX:SPK), for A$6.3 billion, completed November 2021. Other members of the consortium were Ontario Teachers' Pension Plan Board and Public Sector Pension Investment Board. As Australia transitions away from coal, Spark Infrastructure's electricity transmission and distribution networks are well-positioned to support and benefit from the clean energy transition toward a low-carbon economy

Beneficial Target transactions often have common requirements for success

These include an ability to leverage in-depth industry and ESG knowledge to identify, assess, value and execute transactions in fast evolving and incredibly competitive landscape.

Requirements for success relative to other transaction types, include the ability to:

1. leverage industry, ESG and strategy expertise to develop exceptional M&A strategy that effectively considers emerging business model and growth opportunities;
2. establish origination processes and develop relationships that support high value transaction execution;
3. ensure valuation and due diligence activities fully consider the impact of material ESG opportunities and risks to identify undervalued vs. overvalued assets through an ESG lens.
4. manage key stakeholders' ESG requirements

Key drivers of these requirement are a need to understand fast changing business and operating models and successfully identify and execute on areas of opportunity in an environment of intense competition for high quality operations and assets.

Case study: Origin acquisition of Octopus Energy

The acquisition of Octopus Energy has allowed Origin to bring a new tech-enabled "renewable gentailer" business model into Australia. This business model offers long term growth opportunities that Origin's existing business model does not.

In May 2020, Origin Energy (ASX: ORG) announced a strategic partnership with Octopus Energy, a UK renewable energy gentailer / technology company that is focused on accelerating green energy transition. As part of the agreement, Origin acquired a 20 per cent stake in the company and a perpetual license to Octopus's proprietary technology platform, Kraken. The combined consideration was approximately A$500 million.[1]

A key driver for the transaction was access to an emerging business model via Kraken. Kraken uses advanced data and machine learning capabilities to coordinate demand from individual assets in its network (e.g. EVs, home batteries, rooftop solar, heating & AC systems) with peak / off-peak tariff times. Customers are billed based on a dynamic smart tariff, which has more frequent readings compared to traditional electricity meters. The outcome is reduced stress on the grid, real-time visibility of energy consumption, as well as significant cash savings for customers.

Use of Kraken's technology is rapidly expanding, with over 25 million customer accounts already contracted on the platform. Kraken has been deployed in the UK, US and New Zealand, France, Canada and Japan. In the UK, Kraken is used by over 3.1 million Octopus customers and 8.7 million third party retailer customers.

Through the acquisition, Origin became the first energy retailer to deploy the Kraken business model into Australia. Origin has migrated over half of its customer base to Kraken (~2.3 million accounts) as of July 2022, and is on track to migrate its full electricity and gas customer portfolio by the end of 2022. Guidance on cost savings from Kraken are $70-80 million in 2022, implying a cost-to-serve reduction of 14-16 per cent. These cost savings are expectation to grow to c.$150 million annually within five years.

Origin's 20 per cent stake in the company is now estimated to be worth A$1.2 billion, based on the latest round of funding through which Canadian Pension Plan Investments acquired c.6 per cent of Octopus for £212 million. This represents a 69 per cent gain on the Origin's $712 million equity investment. Origin made subsequent investments in 2021/22 to maintain its shareholding.[2]

Section IV: Sensitive Target transaction motivators

Economic motivators are encouraging both disposals and acquisitions

Sensitive sector transactions may be motivated by economic factors including: 1) reduced long term exposure to sectors with a low growth outlook; 2) increased exposure to sectors with high short term prices; and 3) economies of scale.

The growth outlook of sensitive sectors are at times limited by high levels of regulation and changing societal expectations.

The Australian tobacco industry provides an example of this. Over the past three decades, the Australian daily smoking rate has more than halved from 25 per cent in 1991 to less than 12 per cent in 2021. This is a result of government policy, education and changing consumer preferences. Changes in consumption has significantly impacted the economics of the Australian tobacco industry. [1]

In the future, heavy emitting sectors will be impacted as economies transition to net zero. The International Energy Agency (IEA) has estimated that, to achieve net zero by 2050, fossil fuel use will need to fall from 80 per cent of total energy supply to slightly over 20 per cent by 2050.[2] It is estimated that, as a result of the shift away from fossil fuels, US$2.1 trillion of assets in the global power sector could be stranded by 2050, plus many trillions more in other sectors.[3]

Although the long term outlook for most fossil fuel sectors is negative, in the short to medium term many fossil fuel-based products and services will at times benefit from high prices. Transition is unlikely to be a smooth process in which demand and supply for critical resources are constantly balanced.

In recognition of these economic trends, some organisations are seeking to buy sensitive sector assets, while other organisations are seeking to divest these assets.

Sources: 1. Australian Government, Australian Institute of Health and Welfare, "Tobacco Smoking", Jul 2021; 2. IEA, "Net Zero by 2050: A Roadmap for the Global Energy Sector", May 2021; 3. 1. McKinsey, "Playing offensive to create value in the net zero transition", Apr 2022.

General ESG related cost and availability of capital motivators are material

Organisations are motivated to divest sensitive sector activities to: 1) reduce the cost of capital of non-sensitive sector activities; and 2) ensure sensitive sector businesses are clearly focused on the specialist ESG requirements of the relevant business.

The concept of ESG sensitive sectors and activities has been around since investors and businesses initially started using faith-based approaches to avoid, or divest, companies involved in activities seen as incompatible with their beliefs or values.

In recent years the number of sectors and activities that may be considered ESG sensitive have increased. As an example, Australian institutional investors and banks have increasingly started screening or prohibiting sectors such as tobacco, thermal coal and select areas of oil and gas. These are sectors that would not have raised concerns seven to ten years ago but are now ESG sensitive.

For companies that generate revenue from ESG sensitive activities, increases in the breadth or application of screens and prohibitions is negatively impacting availability and cost of capital. As an example, the impact of operating in a sensitive sector has a material impact on MSCI ESG scores and the average difference in cost of capital between companies with the highest vs. lowest MSCI ESG scores is 40bps.[1]

Again this backdrop companies are under pressure to divest sensitive sector activities to:

1. reduce the cost of capital of their non-sensitive sector activities; and
2. ensure Boards and management teams of sensitive sector businesses are clearly focused on the specialist ESG requirements of the relevant business.

This trend is driving a range of sensitive sector transactions.

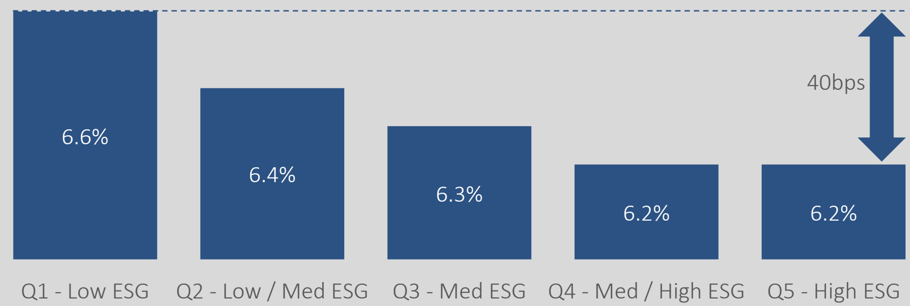
ESG scores and cost of capital

Operating in an ESG sensitive sector often has a material impact on MSCI ESG scores and the average difference in cost of capital between companies with the highest vs. lowest MSCI ESG scores is 40bps

Common sensitive sector negative screens (used by asset managers) and prohibitions (used by banks)

- **Historical:** activities that are illegal or subject to treaties; prostitution & pornography; weapons of mass destruction; select areas of gambling (e.g. synthetic); and nuclear related activates.
- **Recent:** tobacco related activities; thermal coal activities; new mining or mineral processing with riverine tailing or waste disposal; select areas of oil and gas.
- **Emerging:** broader fossil fuel related activities.

Global MSCI ESG scores vs. cost of capital[1]



MSCI ESG scores penalise companies exposed to sensitive sectors and activities through environmental, social and governance factors outlined below:

- **Environmental factors:** Physical climate value at risk, brown sector exposure, fossil fuel exposure, carbon intensity, reported vs. estimated GHG emissions, high climate impact sector, green revenue, green bonds.
- **Social factors:** weapons involvement, tobacco involvement, social violations, lack of due diligence policy, gender pay gap, male to female board ratios, injury rate, bribery and corruption controversies.
- **Governance factors**: Board independence and Board diversity.

Sources: 1. MSCI, "ESG and the cost of capital", Feb 2020; 2. Net Zero Asset Owners, "Change the rules of the game", Apr 2022; 3. Think Ahead Institute, "The world's largest 500 asset managers", Oct 2021; 4. Netzeroassetmanagers.org., May 2022; 5. unepfi.org., May 2022
Notes: 6. Warming limits of 1.5 degrees are against pre-industrial levels and assumed to be achieved by 2100 (equivalent to net zero by 2050).

Emissions specific cost and availability of capital changes are emerging and becoming a very significant transaction motivator in some sectors

Net zero commitments require asset owners, asset managers and banks to develop science based portfolio decarbonisation curves, and to manage their portfolio emissions against these. Financial institutions are finding that across most sectors, portfolio companies are not decarbonising fast enough to allow achievement of net zero commitments. This is encouraging divestment activity.

Net zero commitments are influencing ESG sensitive transactions. The key bodies that financial institutions sign with when making a net zero commitments are as follows:

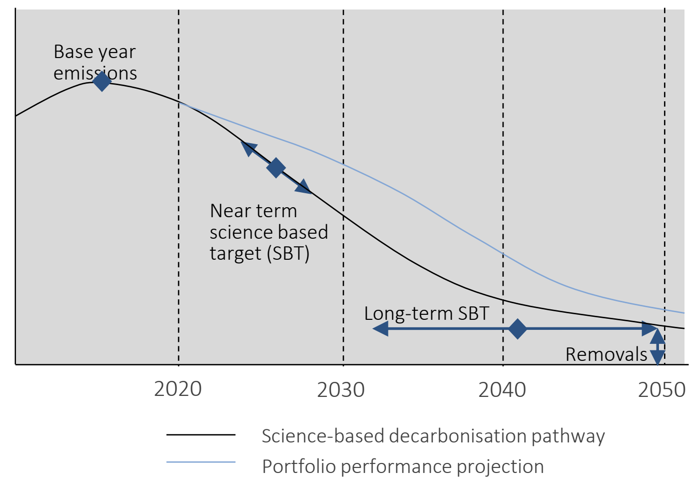
- **Net Zero Asset Owners (NZAO):** Asset owners with US$10 trillion AuM, or >7 per cent global institutional AuM have signed up to NZAO commitments.[1,2]
- **Net Zero Asset Managers (NZAM):** Asset managers responsible for US$58 trillion AuM, or >44 per cent global institutional AuM have signed up to NZAM commitments. [2,3]
- **Net Zero Banking Alliance (NZBA):** Banks with US$68 trillion, or >38 per cent, of global banking assets have signed up to NZBA commitments.[4]

Commitments are made at a Board level and they all have very similar requirements. They target warming limits of 1.5 degrees Celsius above pre-industrial levels by 2100; are focused on ensuring relevant financial institutions measure, report and continuously reduce their entire portfolio's emissions (both on an absolute and emissions intensity basis); and require establishment of robust and science based interim (2025 or 2030) and long term (2050) emissions targets using widely accepted science-based decarbonisation scenarios.

Financial institutions that were early net zero signatories, who have already developed target decarbonisation curves, are consistently finding that across most sectors their portfolio companies are not (as a group) decarbonising fast enough to allow achievement of net zero commitments. This is placing pressure on financial institutions and corporates as follows:

- **Financial institutions** are under pressure to meet their decarbonisation targets by divesting portfolio companies with high emissions, relative to their sector. Investor appetite for portfolio acquisitions that increase exposure to companies with high emissions is limited.
- **Corporates** will often avoid acquisitions of heavy emitting targets even if they are well placed to support the relevant targets' transition to net zero because of their own net zero targets and commitments. Where a corporate entity is able to participate, they are receiving limited support from their institutional investors and banks. It is not uncommon to witness cost of equity and debt penalties in excess of 300bps in sectors closely aligned to thermal & metallurgical coal mining or oil & gas extraction.[5] Over time the number of high emitting sub-sectors that are subject to penalties of this level will increase, because financial institutions' commitments require sector by sector decarbonisation.

Illustration – projected portfolio performance against a science based decarbonisation pathway[6]



Emissions and cost of capital

Cost of equity and debt penalties in excess of **300bps** are not uncommon in sectors such as thermal & metallurgical coal mining or oil & gas extraction.

Sources: 1. Net Zero Asset Owners, "Change the rules of the game", Apr 2022; 2. Think Ahead Institute, "The world's largest 500 asset managers", Oct 2021; 3. Netzeroassetmanagers.org., May 2022; 4. unepfi.org., May 2022; 5. Nature Energy, "The cost of debt of renewable and non-renewable energy firms", Feb 2021; and NAB, "ESG and Capital: Part 1 Equity, Oct 2021;and 6. Sciencebasedtargets.org and Gresham analysis.

Heavy emitting divestment and acquisition motivators are complicated

Decarbonisation of the Australian economy would benefit from net zero commitments that encourage the acquisition of heavy emitting operations and assets by acquirers with the ability to transition them to net zero.

In their current form, financial institutions' net zero commitments 1) encourage the sale of heavy emitting operations and assets; and 2) discourage the acquisition of heavy emitting operations and assets by acquirers with the ability to support transition to net zero. There are two key reasons why NZAO, NZAM and NZBA have yet to create carve-outs to support transactions with transition goals.

1. **Primary objectives of net zero commitments:** The value of equity and debt capital required for green technologies, systems and processes to shift economies to net zero is greater than the capital currently being invested. One of the main objectives of NZAO, NZAM and the NZBA is to ensure capital is directed towards low and zero emitting decarbonisation solutions and current commitments support this objective.
2. **Greenwashing concerns:** Sectors associated with the highest emissions that will benefit the most from strong emissions management often do not have established or well accepted pathways and guidance to achieve net zero. Where sector wide pathways and guidance does exist it is usually new and will require adjustment for individual company characteristics (see right). Without well understood and established pathways and guidance there is scope for a transaction to be labelled as 'transition' focused when in fact the decarbonisation motivations for the transaction are low, and the business profit motivation for the transaction are high. Advocacy groups and businesses often have different views on where the line between greenwashing and transition sits. Where no consensus exists on a credible pathway to net zero, organisations such as NZAO, NZAM and NZBA don't want their commitments to facilitate transactions that deliver no or minimal emissions benefits.

All of the major net zero commitment bodies are either convened by, or closely linked with, the United Nations Environmental Program Finance Initiative (UNEPFI). In this capacity, the UNEPFI has recognised the benefit of supporting transactions to transition organisations to net zero. Discussions are underway regarding how NZAO, NZAM and NZBA commitments could be augmented to achieve this goal. As science based pathways and guidance for sub-sectors improve this goal will become easier.

Despite their challenges, and regardless of the exact requirements of emissions reduction commitments, some corporates asset owners and managers are pursuing informal transition transactions. These transactions are usually not labelled as transition transactions, as without a clear path to net zero it is difficult to support a transaction's transition credentials.

Sector-based near and long-term 1.5 degree pathway and guidance availability[1]

Sector	Sub-sector	Near-term and long tern 1.5 degree pathway	Guidance to support plan
Agricultural, forestry and other land	Agricultural, forestry and other land	Available Mar 2022	Available Mar 2022
	Forests, land and agricultural commodities	Available Mar 2022	Available Mar 2022
Buildings	Buildings	Available pre-2022	Planned no date
Industry	Iron and steel	Available Jun 2022	Planned 2023
	Cement	Available pre-2022	Planned Jun 2022
	Chemicals	Planned (no date)	Planned no date
Transport	Road and rail transport	Uses cross-sector pathway	Available pre-2022
	Maritime transport	Available Jan 2022	Available Jan 2022
	Aviation	Available pre-2022	Available pre-2022
Other Energy	Oil and gas	Planned (no date)	Planned no date
Electricity & Heat	Power generation	Available pre-2022	Available pre-2022
Other sectors	Apparel and footwear	Uses cross-sector pathway	Available pre-2022
	ICT	Uses cross-sector pathway	Available pre-2022

Sources: 1. Sciencebasedtargets.org, "Net Zero Standards version 1.0", Oct 2021

The litigation landscape is changing fast and requires consideration

As ESG related litigation increases, companies are motivated to divest sensitive sector activities as a way of managing risk, even where this does not result in the best outcome for the environment or society. This trend is driving all types of Sensitive Target sector transactions.

ESG related litigation risks are most evident in relation to climate risk. The climate litigation environment is experiencing change and commitments or targets to limit warming are increasingly exposing organisations to litigation risks. Australia is subject to the second highest level of climate change related litigation globally.[1] There have been over 120 climate-change related cases filed in Australia, while globally the total number of climate-change related cases has exceeded 1,900. The legal environment in Australia is relatively supportive of outcomes that favour the plaintiff and penalties associated with climate litigation may place the company, its officers and Directors at risk of potential liability.[1]

Cases are targeting a wide variety of private and private sector participants and there is increasing diversity in the arguments being used. In response to increasing levels of climate related litigation some companies are divesting heavy emitting operations or assets.

Several types of climate cases are being used to target organisations. All of these case types are increasing and are encouraging the divestment of high emitting assets and operations:[2,3]

Corporate and financial market cases: Cases against private parties utilise several arguments and strategies:

Financial risks, fiduciary duties and corporate due diligence: cases often raise issues around lack of, or insufficient disclosure of, climate-related information to protect shareholders, consumers and investors. Examples include: 1) O'Donnell v. Commonwealth of Australia in which O'Donnell claimed that Australia's economy and reputation in international financial markets will be significantly affected by the adequacy of the Australian government's response to climate change and this creates risks for bond investors that should be disclosed; and 2) Abrahams v. Commonwealth Bank of Australia (CBA) in which the Abrahams as shareholders in the CBA, sought access to internal documents under the Corporations Act 2001 (Cth). The documents relate to the bank's involvement with several oil and gas projects that potentially infringed the bank's ESG framework and policy. The Abrahams' successfully gained access to relevant documents.

'Greenwashing' cases: are based on inconsistencies between discourse and action on climate change and arise when marketing is misleading and/or overstates performance or benefits. An example is the Australasian Centre for Corporate Responsibility (ACCR) vs. Santos in which the ACCR is suing Santos over their claims regarding natural gas being "clean energy" and having "a plan for net zero by 2040". This case is ongoing.

Climate change risk cases: target the potential failure of directors, officers and fiduciaries to adapt activities (often investment strategies) in line with climate risks. As example is McVeigh v. REST in which McVeigh alleged that the fund's trustees were not doing enough to disclose and manage climate change risks. The parties reached a settlement where the Australian pension fund agreed to incorporate climate change financial risks in its investments and implement a net zero by 2050 carbon footprint goal.

Constitutional and human rights cases: The majority of human rights cases have been brought against governments but a significant minority also target companies:

Duty of care and corporate human rights: cases rely on human rights law to define the scope of corporate duty of care and due diligence obligations, in order to limit fossil fuel companies emissions, often in line with the Paris Agreement. Examples include: 1) Milieudefensie et al. v. Royal Dutch Shell plc. in which the court found that Shell owed a duty of care to the plaintiffs to reduce emissions from its operations by 45 per cent by 2030 relative to 2019 emission levels.; and 2) Sharma vs. Australian Minister for the Environment in which the court initially determined that the Minister had a duty to exercise reasonable care to not cause the children of Australia harm from the extraction of coal and associated emissions of CO_2 into the Earth's atmosphere.

Several new types of litigation are also emerging that are likely to impact the Australian climate litigation environment in the future. Examples include: 1) adaption litigation as there is growing international consensus, as illustrated in the decisions of several national courts, that human rights obligations may apply in the context of both climate change mitigation and adaptation; 2) value chain litigation as it becomes increasingly clear that an understanding of value chains is important for both climate change mitigation and adaptation action; and 3) subsidy litigation as pressure is placed on governments to avoid subsidising high emitting industries.

Sources: 1. Norton Rose Fulbright, "Climate Change Litigation Update", Feb 2022.; 2. Joana Setzer and Catherine Higham, "Global Trends in climate change litigation: 2021 Snapshot", Jul 2021; 3. Sarah Barker, "To green or not to green? Navigating 'greenwash' risks in climate change targets & sustainability credentials", Oct 2021.

Poor corporate governance and risk management may motivate a deal

Even if a company has strong corporate governance and risk management practices, a transaction may be prompted by changes to legal, compliance, regulatory, operational and other risk management requirements that cannot be satisfied without material upfront or ongoing investment.

Royal commission and enquiry motivators

Recent federal and state royal commissions or enquiries have resulted in a range of transactions. These royal commissions and enquires have focused on three separate industries. In each of these industries stronger corporate governance and risk management practices, including robust oversight, clear accountability and informed decision making could have reduced or prevented the conduct that negatively impacted communities and ultimately triggered transactions.

Financial services: In 2019, Kenneth Hayne delivered the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Hayne Royal Commission). The report revealed misconduct including poor treatment of vulnerable customers, charging fees for no service, and offering unsolicited increases to credit card limits. Commissioner Hayne notes that "types of risk associated with misconduct" were compliance, conduct, regulatory and operational risks. He indicated that in many instances boards did not receive the right information that would enable them to either identify emerging non-financial risks or oversee and challenge management effectively.[1]

Gambling: In 2021, the NSW Casino Inquiry report was delivered. This found that Crown Resorts Limited had facilitated money laundering through its Melbourne casino, exposed its staff to the risk of detention in China, and partnered with junket operators that had links to organised crime. The NSW Casino Inquiry Commissioner noted that the former executive chairman's "stewardship led Crown to disastrous consequences", alongside "processes that exposed its directors to conflicts of interest", as well as "lack of robust Junket approval processes" and "lack of proper oversight and monitoring of risks to money laundering". These contributed to the Commissioner finding that Crown was "not suitable" to operate the Barangaroo casino in Sydney.[2]

Aged care: In 2021, Tony Pagone and Lynelle Briggs delivered the Final Report of the Royal Commission into Aged Care Quality and Safety detailing systemic problems in the sector resulting in shortfalls in the quality and safety of care for vulnerable older Australians. The Aged Care Royal Commission cited "deficiencies in the governance and leadership" of some aged care providers as well as deficiencies of structures in place to "ensure that governing bodies are properly informed of care deficiencies and risks." These governance factors ultimately contributed to a substandard quality and safety of care.[3]

Industry motivators

Oversight and regulatory changes drive M&A transactions, often due to increased expenses. Transactions may involve companies with strong or poor corporate governance. Over time most industries experience changes to oversight or regulation arrangements to reduce the likelihood that corporate governance, leadership and risk management shortcomings negatively impact customer or community welfare. The introduction of governance related regulations may be a catalyst for industry consolidation.

An example of an industry that is experiencing M&A as a result of increased levels of governance-related oversight and regulation is the superannuation sector. 'Your Future, Your Super' performance tests were introduced in July 2021 by the Federal Government and are designed to weed out poor performers over time. Funds that fail the test have to notify members of the underperformance and invite them to use an online super comparison tool run by the Australian Tax Office (ATO). In addition, trustees of funds that fail must "make the improvements needed to ensure they pass next year's test or start planning to transfer their members to a fund that can deliver better outcomes for them".[4] These requirements are driving M&A transactions.

Company motivators

Company specific corporate governance, leadership and cultural shortcoming will drive M&A transactions. It is the exposure of, or long-term consequences of, these shortcomings that drives M&A. It can take many years for the conduct-related outcomes of poor governance to come to light. As a result the Board members and senior management responsible for the events in question may have departed by the time a governance-related transaction occurs.

Corporate governance and risk management transactions may maximise long term value for relevant shareholders, while also offering incremental benefits to the community where a company: 1) does not have sufficient capabilities, compared to peers, to quickly and efficiently address the underlying causes of poor practices, or to meet changing requirement; and/or; 2) is unable to satisfy shareholders that necessary action has been taken, even if it has.

Sources: 1. Hayne, KM, "Royal Commission into the Misconduct in the Banking, Superannuation and Financial Services Industry: Final Report volume 1", Feb 2019; 2. Bergin, P, "Report of the Inquiry under section 143 of the Casino Control Act 1992 (NSW): volume 2", Feb 2021; 3. Pagone, T, Briggs, L, "Royal Commission into Aged Care Quality and Safety: Final Report volume 1", Mar 2021; 4. APRA, "APRA releases inaugural Your Future, Your Super Performance Test Results", Aug 2021.

Section V: Sensitive Target transaction types and trends

Growth in Sensitive Target transactions has been very substantial

Average transaction values increased from A$1.7 billion to A$5.5 billion over the five years to 30 June 2022.

In total, Sensitive Target transactions reached a total value of A$164 billion in the five years to June 2022, and have experienced a CAGR of 42 per cent over the past four years, by value. Sensitive Target transactions have remained constant at eight per cent of all Australian transactions by volume over the past five years. However, the value of these transactions has increased from 13 to 33 per cent of all Australian transactions over this period. As a result average transaction values have increased.

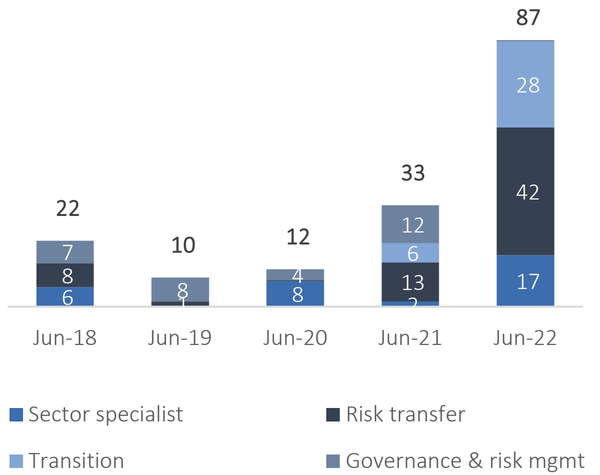
Sector specialist transactions have emerged as a transaction type, with 18 transactions over last five years at a total value of A$34 billion. This type of transaction has experienced a CAGR of 32 per cent by volume over the past four years.

Risk transfer transactions have experience huge growth, driven by organisations exiting thermal coal, oil and gas and gambling activities and are now the most common type of transaction, with a total value of A$64 billion over the period.

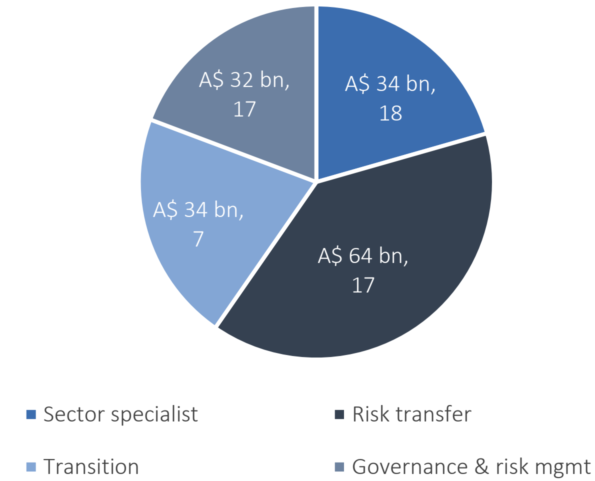
Transition transaction did not exist as a category five years ago, but are now common as acquirers recognise the opportunities offered by leadership in emissions reduction. The total five year value of transition transactions is A$34 billion.

Finally, governance and risk management transactions have occurred in cycles that are often linked to a particular industry.

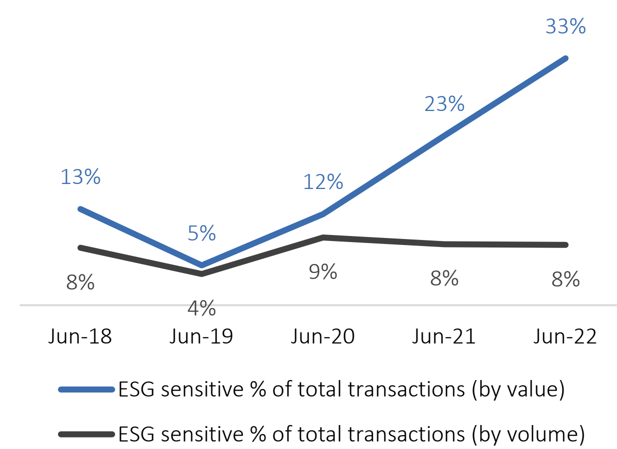
Types of Sensitive Target transactions by value (A$bn)
5 years to 30 June 2022[1]



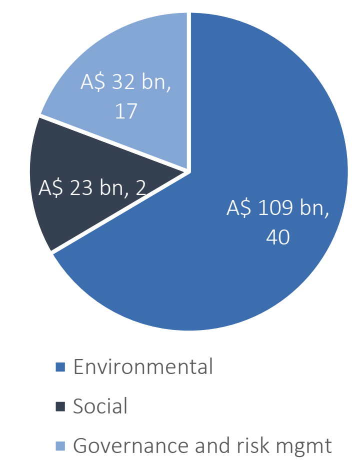
Types of Sensitive Target transactions, FY18-22[1]
Transaction volumes (#) and values (A$bn)



Sensitive Target as % of all transactions by value and volume 5 years to 30 June 2022[1]



Impact of Sensitive Target transactions, FY18-22[1]
Transaction volumes (#) and values (A$bn)



Sources: 1. Mergermarket, Gresham analysis. Note: The five largest transactions over the period influencing the data were the Woodside Energy Group Ltd merger with BHP Petroleum for A$27.1 billion (Jun 2022), the Brookfield Infrastructure Group consortium acquisition of Ausnet Services for A$18.4 billion (Feb 2022), the Spin-off of Endeavour Group Ltd. From Woolworths Group for A$12.8 billion (Jun 2021), the acquisition of Oil Search Ltd. by Santos Ltd for A$12.2 billion and the demerger of the Lottery Corporation by Tabcorp Holdings Ltd for A$10.5bn.

2a. Sector specialist transactions

Over the past five years, 18 sector specialist transactions have been announced involving targets from a range of sectors.

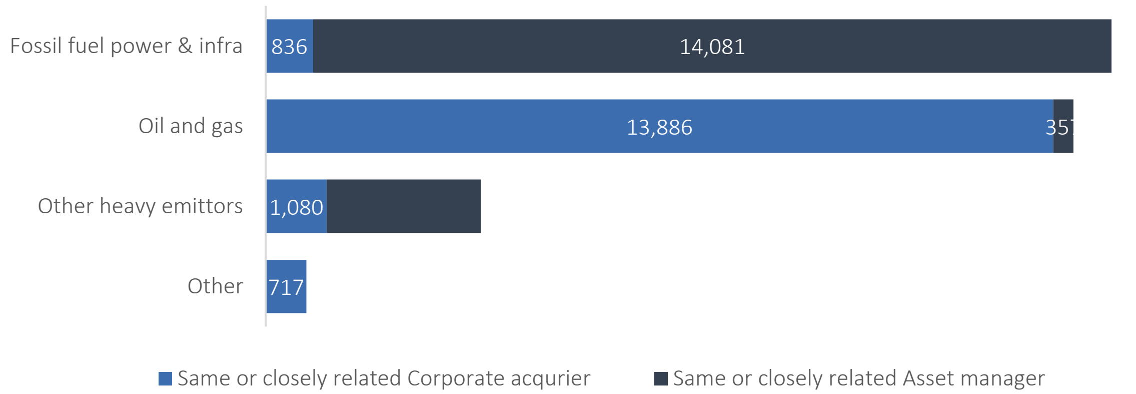
Over the past five years, 18 sector specialist transactions with a total value of A$34 billion were completed. These transactions represented 21 per cent of all Sensitive Target transactions over the period, by value.

Acquirers undertaking sector specialist transactions usually have specialist capabilities in the same, or a closely related, sector as the target. As ESG requirements and standards relating to sensitive sectors increase, it is becoming increasingly essential for acquirers to ensure that transactions deliver ESG benefits to the community. This is particularly evident with large sensitive sector acquirers.

Targets of transactions are most commonly associated with heavy emitting sectors as these sectors are associated with significant ESG pressures.

In the short to medium term, sector specialist transactions are expected to grow, subject to economic conditions.

Sector specialist target and acquirer sectors, 5 years to 30 June 2022[1]:
Transaction values (A$bn) and volumes (#)



Transaction examples

Santos and Oil Search all-stock merger, valued at A$22 billion, which completed in June 2022. The merged entity will provide pre-tax synergies of US$90-115 million+ per annum and a platform to deliver shareholder returns in addition to successfully navigating the transition to a lower carbon future. The merged entity is aiming to achieve net-zero emissions by 2040 by building one of the largest carbon reduction projects in the world, pursuing energy efficiency, investing in nature-based offsets and cutting edge technology for a clean fuels future.

Sources: 1. Mergermarket, Gresham analysis

2b. Risk transfer transactions

Risk transfer transactions involve heavy emitting targets in sectors such as coal and oil and gas, and sellers from a range of sectors who are seeking to transition towards low or zero emissions.

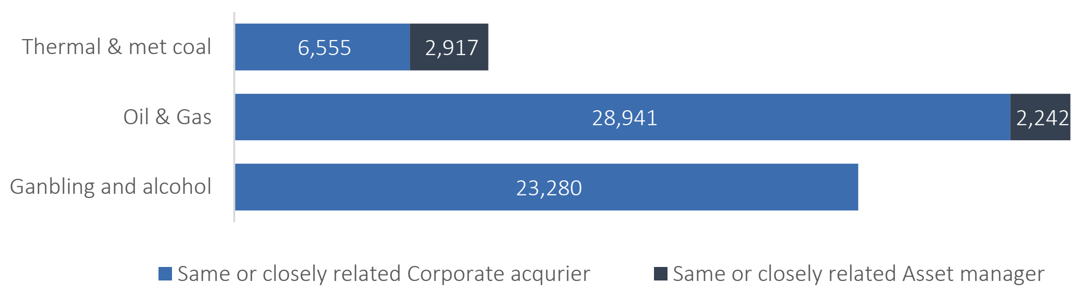
Over the past five years, 17 emission based risk transfer transactions with a total value of A$64 billion were completed. These transactions represented 39 per cent of all Sensitive Target transactions over the period, by value.

Risk transfer transactions are associated with targets in fossil fuel linked sectors such as coal and oil & gas as well as traditional 'sin' industries such as gambling and alcohol.

Acquirers undertaking risk transfer transactions nearly always have existing operations in the relevant sector, are usually corporates and may be domiciled offshore or in Australia.

The short to medium term outlook for risk transfer transactions is positive for all sectors as organisations respond to ESG related economic and cost of capital pressures.

Risk transfer target and acquirer sectors, 5 years to 30 June 2022[1,2]
Transaction values (A$bn) and volumes (#)



Recent completed transactions

Woolworths Group Ltd's demerger of its drinks and hospitality business (Endeavour Group), which was listed in August 2021 at a value of over A$10 billion. Endeavour has a liquor and gaming exposed businesses, which was recognised by the Woolworths' Board as being subject to changing community expectations. The rationale for the transaction included the simplification of each business, allowing a focus on different customer needs, supported by separate brands and strategies. In addition, the demerger provided an opportunity for investment in Woolworths Group post-demerger from investors who were previously deterred by liquor and gaming exposures.

The Woodside Energy Group Limited (Woodside) and BHP oil and gas business all-stock merger, valued at A$40 billion, which completed in June 2022. The transaction rationale included improved growth options and pre-tax synergies of US$400 million+ per annum to increase the merged entities ability to navigate the energy transition and achieve equity emissions reduction targets of 15 per cent by 2025 and 30 per cent by 2030, with a net zero ambition by 2050.

South32's sale of its South African thermal coal operations to Seriti Resources for a loss of up to AS$322 million. South32 will pay $200 million across a decade to partly fund the costs of the environmental clean up of the relevant mines (once they close), with a $50 million facility to pay for the costs of restructuring loss-making mining sites. The transaction was completed in May 2021 and allows South32 to reshape its business by exiting thermal coal.

Sources: 1. Mergermarket, Gresham analysis
Note: 2. Other categories include The Lottery Corporation's acquisition by Tabcorp and divestment of Endeavour Group by Woolworths,

2c. Transition transactions

Transition transactions have recently involved targets from fossil fuel-linked power and infrastructure sectors and acquirers from infrastructure asset management, and private equity sectors. Transition transaction are not common.

Over the past five years, seven transition transactions with a total value of A$35 billion were completed. These transactions represented 21 per cent of all Sensitive Target transactions over the period, by value.

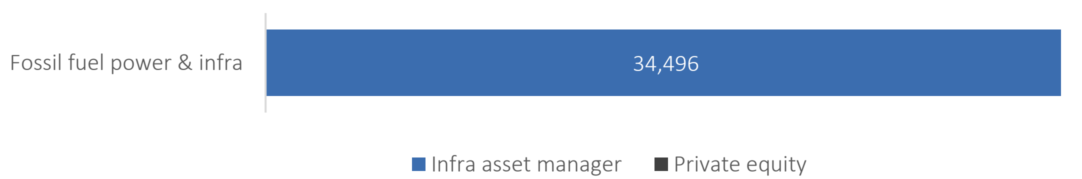
To date acquirers have been asset managers who already operate in a heavy emitting sector, while targets have been associated with fossil fuel linked power and infrastructure. This is because a transition transaction requires:

- a heavy emitting target with a credible scope 1, 2 and 3 decarbonisation pathway or plan; and
- an acquirer who is able to demonstrate that under their ownership the relevant heavy emitting target will decarbonise faster than otherwise (preferably in line with a science based recommendations).

Transition transactions are expected to become more common across a range of industries as decarbonisation pathways are developed for a broad range of heavy emitting sectors and as expectations regarding decarbonisation continue to increase.

Transition target and acquirer sectors, 5 years to 30 June 2022[1]

Transaction values (A$bn) and volumes (#)



Transaction examples

Brookfield and Grok Ventures proposal to acquire 100 per cent of AGL, at a price implying an equity value of >A$5 billion. The rationale for the bids was to accelerate decarbonisation while also maximising value for AGL shareholders. The bids followed a proposal by AGL to separate its retailing operations from its base-load electricity generation business in June 2021. AGL's retailing operations have a relatively low carbon footprint, while its base-load electricity generation business is highly carbon intensive. The AGL rationale for the separation was to "protect shareholder value, enabling each business to focus on their respective strategic opportunities and challenges presented by the accelerating energy transition". The Brookfield and Grok acquisition attempts were not successful. However, it was followed by an extensive campaign led by Atlassian founder Mike Cannon-Brookes, who is AGL's largest shareholder, to block the demerger on the grounds that keeping AGL together is vital to fund the company's transition to a low carbon future. Several key shareholders were ultimately convinced that a demerger would not best support decarbonisation and AGL abandoned its demerger plans in May 2022.

KKR led consortium's 100 per cent acquisition of Spark Infrastructure Group (ASX:SKI), for A$5.2 billion, completed December 2021. Other members of the consortium were Ontario Teachers' Pension Plan Board and Public Sector Pension Investment Board. The KKR-led consortium outlined one of the key transaction considerations as being "as Australia transitions away from coal, Spark Infrastructure's electricity transmission and distribution networks are well-positioned to enable the clean energy transition towards a low-carbon economy".

Sources: 1. Mergermarket, Gresham analysis

2d. Governance and risk management transactions

Governance and risk management transactions may be associated with any sector.

Over the past five years, 17 governance transactions with a total value of A$32 billion were completed. These transactions represented 19 per cent of all Sensitive Target transactions over the period, by value.

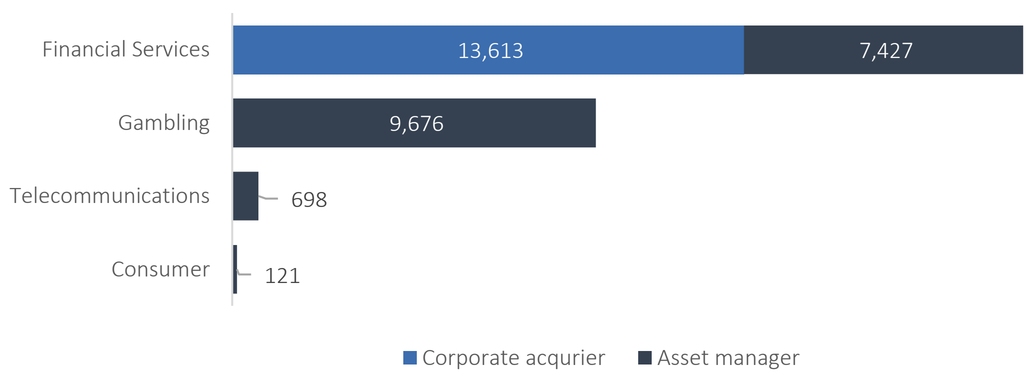
Governance and risk management transactions may be associated with any sector. They occur most frequently in industries that are responsible for financial benefits to the community.

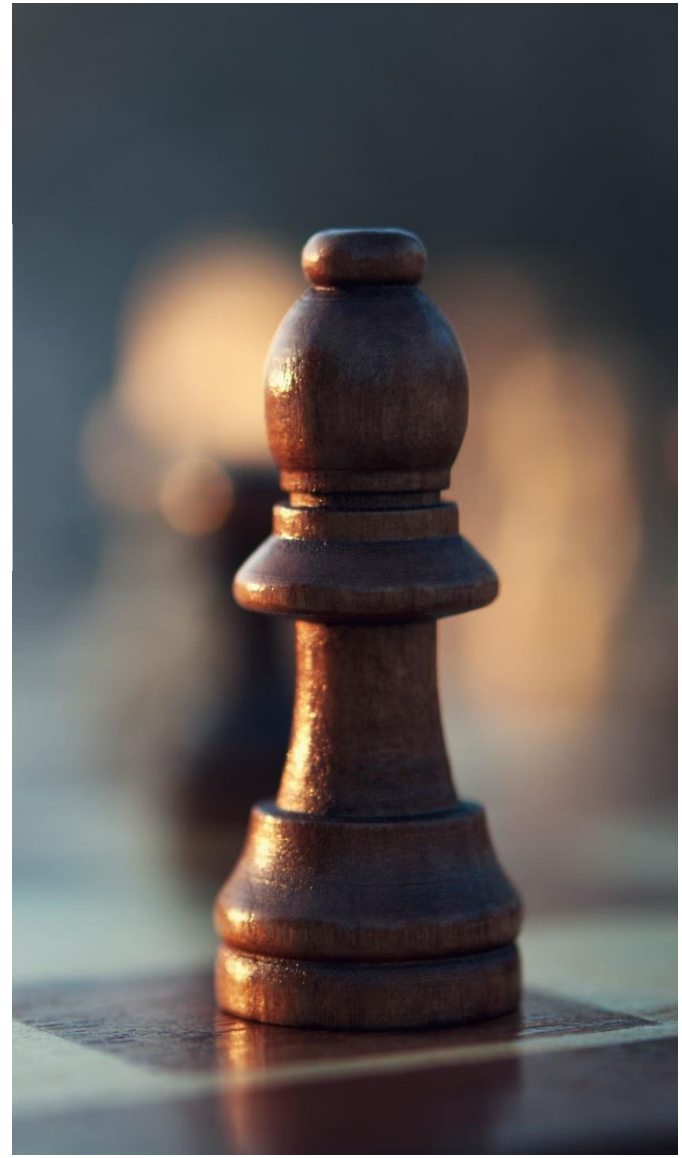
In recent years governance and risk management related transactions have predominantly involved targets associated with financial services sectors.

Governance transactions are not expected to become substantially more, or less, common in the short to medium term.

Governance and risk management target and acquirer sectors, 5 years to 30 June 2022[1]

Transaction values (A$bn) and volumes (#)





Sources: 1. Mergermarket, Gresham analysis

2d. Governance and risk management transaction examples

Some industries have demonstrated a high association with regulatory, legal, operational and/or community expectation breaches. Transactions within these industries are often triggered by: 1) changes to corporate governance and risk management requirements; and/or 2) the exposure of companies with poor corporate governance and risk practices.

Royal commission and enquiry related transaction examples

The divestment of select asset management, wealth management and advice, mortgage broking and life insurance operations by Australia's largest banks. Following The Hayne Royal Commission, the vertical integration model through which financial institutions both make financial products and provide financial advice, was a identified as creating a conflict of interest. This resulted in the:

- Commonwealth Bank of Australia's (CBA) sale of 55 per cent of Colonial First State Investments to KKR & Co Inc. for ~A$2.6 billion, completed November 2021.
- National Australia Bank's (NAB) sale of 100 per cent of MLC Wealth Management (MLC) to IOOF Holdings Ltd (IOOF), now known as Insignia Financial Ltd (ASX:IFL) for A$1.4 billion, completed May 2021.
- Westpac Banking Corporation's (Westpac) sale of 100 per cent of Westpac General Insurance Services to Allianz SE for A$725 million, completed July 2021.
- Australia & New Zealand Banking Group Limited's (ANZ) sale of 100 per cent of OnePath Pensions and Investments and aligned dealer group businesses to IOOF for A$825 million, completed January 2020

The 100 per cent divestment of Crown Resorts Ltd (ASX:CWN) to Blackstone for A$8.9 billion, completed in June 2022. Crown Resorts Limited is Australia's largest gaming and entertainment group. The takeover by Blackstone became essential after three state inquiries into the operation of Crown, class-actions lawsuits and an AUSTRAC probe, which collectively resulted in a range of penalties and operational requirements.

The sale of several smaller aged care providers and consolidation of the industry due to challenges raised by the compliance burden, attracting and retaining enough quality staff and likely ongoing changes to legal regulation.

Industry linked governance & risk management transaction examples

The takeover or merger of superannuation funds that have failed to meet Your Future, Your Super performance benchmarks. These benchmarks were established to protect the retirement saving needs of communities. Examples of transactions include:

- Labour Union Co-Operative Retirement Fund (LUCRF) merger with AustralianSuper, completed June 2022
- Australian Catholic Superannuation merger with UniSuper merger, yet to complete
- AvSuper merger with Commonwealth Superannuation Corporation (CSC), yet to complete
- BOC Gases Superannuation (BOC Super) merger with Equipsuper, yet to complete
- Christian Super merger with Australian Ethical, yet to complete

Company specific transaction examples

AMP Group's disposed of it Resolution Life business and the former 'jewel in its crown' AMP Capital, over several years, driven by scandals unearthed by the Royal Commission into financial services; long term operational and structural challenges; internal conflicts of interest; bullying and harassment exposed by staff whistleblowing; and poor judgement calls by various management regimes. A slow and often reactive divestment process resulted in material loss of value for shareholders through strategically questionable decisions, substantial separation costs and loss of customers. Key transactions includes the sale of the AMP Life business to Resolution Life for A$3.0 billion as well as the sale of AMP Capital's: 1) Global Companies capability to Fiera Capital for an undisclosed price; 2) Global Equities and Fixed Income business to Macquarie Asset Management for less than A$185 million; 3) Infrastructure Debt business to Ares Holdings LP for A$428 million; 4) Real Estate and domestic Infrastructure Equity business to Dexus for approximately A$450 million; and 5) Offshore Infrastructure Equity business to a subsidiary of DigitalBridge Group for A$699 million.

Sources: 1. Hayne, KM, "Royal Commission into the Misconduct in the Banking, Superannuation and Financial Services Industry: Final Report volume 1", Feb 2019; 2. Bergin, P, "Report of the Inquiry under section 143 of the Casino Control Act 1992 (NSW): volume 2", Feb 2021; 3. Pagone, T, Briggs, L, "Royal Commission into Aged Care Quality and Safety: Final Report volume 1", Mar 2021.

Sensitive Target transaction requirement for success are strongly linked to risk and stakeholder management

These transactions requires identification of key risks and exceptional engaging with all concerned stakeholders from an early stage.

Requirements for success relative to other transaction types, include:

1. effective assessment and management of critical areas of due diligence;
2. proactive engagement with groups such as regulators, unions, and local communities;
3. careful management of legal and regulatory requirements to ensure smooth execution process;
4. considered management of banks, proxy advisors and institutional investors;
5. excellent communications with retail investors and the broader market;
6. exceptional transaction governance and Board presentation preparations.

Key drivers of these requirements are the societal issues associated with relevant transactions; large number of stakeholders involved; significant regulatory and governance requirements; and social scrutiny associated with these transactions.

Case study: Blackstone acquisition of Crown

The acquisition highlights the importance of strong stakeholder management in an environment of heightened scrutiny

Blackstone acquired 100 per cent of Crown Resorts Ltd (ASX:CWN), for A$8.9 billion, complete June 2022. Crown is Australia's largest gaming and entertainment group.

The sale process was materially governance and risk management motivated after three state inquiries into the operation of Crown, several class-actions lawsuits and an AUSTRAC probe, identified a rang of governance and risk management breaches. These breaches resulted in a range of penalties and operational requirements including the establishment of multiple Board level oversight bodies within Crown to ensure adherence to state specific regulations and requirements.

Blackstone undertook nine months of preparation and before submitting a non-binding indicative offer for Crown in April 2020 and a further 11 months of due diligence before lodging a scheme of arrangement, in March 2021. These periods were used to develop and cost a plan to manage the legal, regulatory and compliance challenges facing Crown.

During these periods, Blackstone engaged with:

– State and commonwealth regulatory bodies (gambling, tax, and other) regarding short and long term requirements;

– A large number of unions representing different crown employee groups about changes to employment related matters;

– Major shareholders, asset managers and relevant banks;

– Crown management teams and experts from Blackstone’s casino and resort operations in other regions; and

– A broad range of legal, tax, operational, environmental and other third party advisors.

Blackstone’s stakeholder management activities ensured that by the time they submitted a final offer they received broad stakeholder support for the deal.

GRESHAM