HERBERT
SMITH
FREEHILLS

PE PULSE

AUSTRALIAN PRIVATE EQUITY & VENTURE CAPITAL 2018

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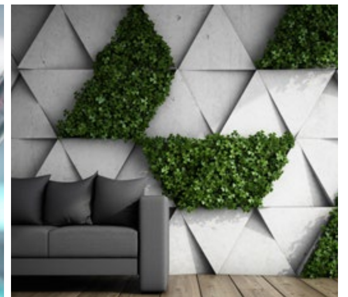
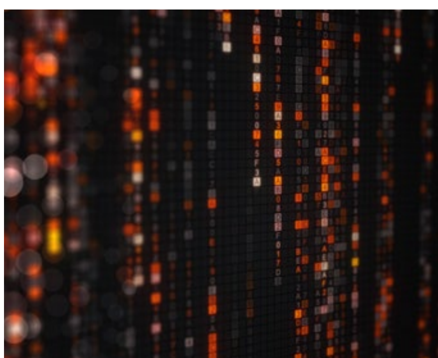
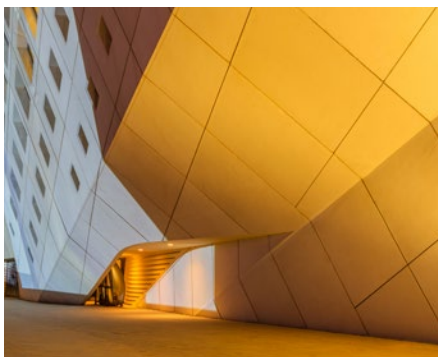
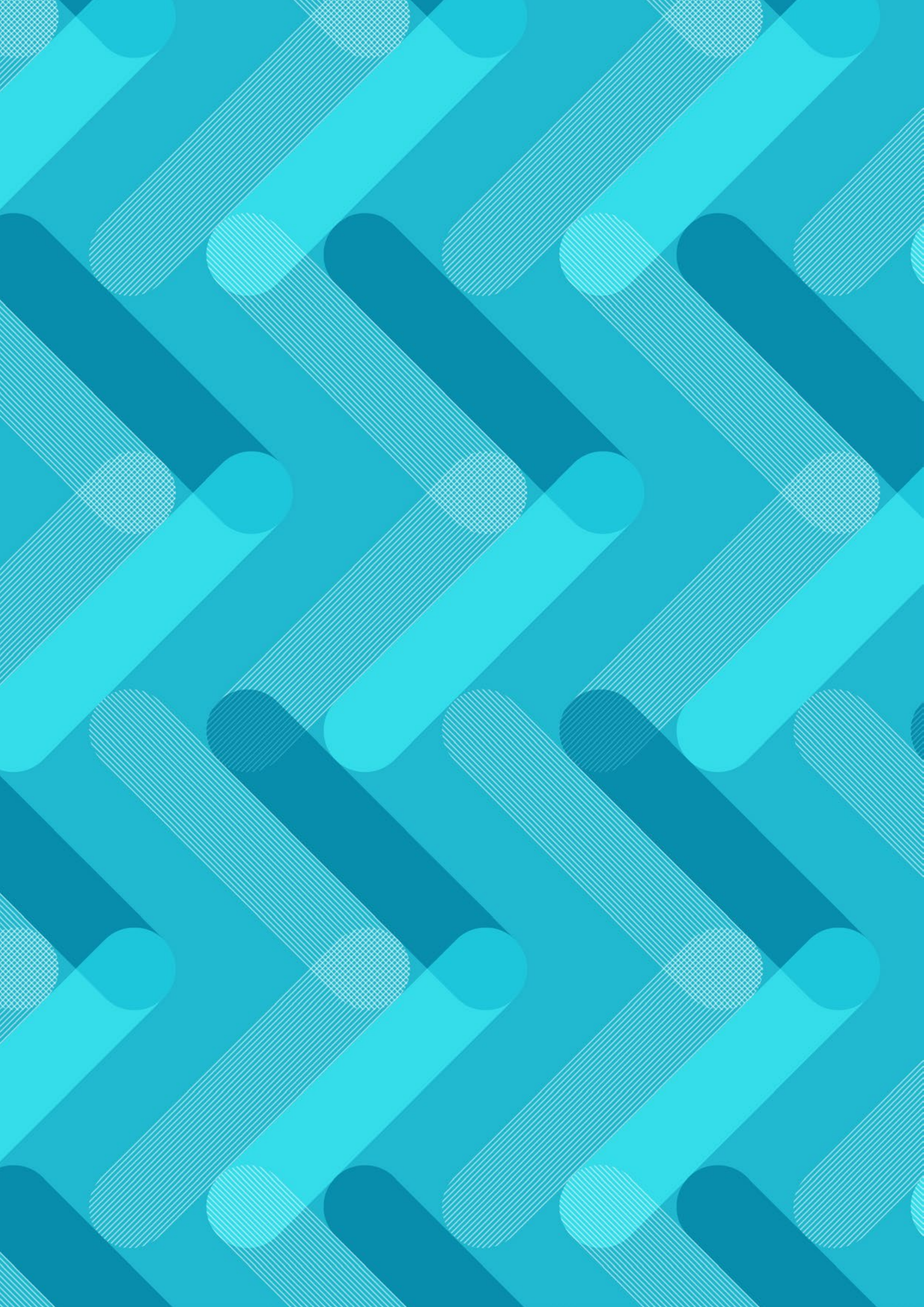






ISSUE 1 SPRING 2018



Welcome

Welcome to the first edition of the PE Pulse.

In this edition we cover:

- Key themes in Private Equity in the year to date
- Tech trends
- Insights on take-private transactions
- Leveraged finance
- Tax developments in Private Equity & Venture Capital
- Transaction insurance

Should you have any questions in relation to the PE Pulse, please contact our Private Equity team.

All the best,

The Herbert Smith Freehills
Australian Private Equity Team

LAW FIRM OF THE YEAR
LAWYERS WEEKLY AUSTRALIAN LAW AWARDS 2018

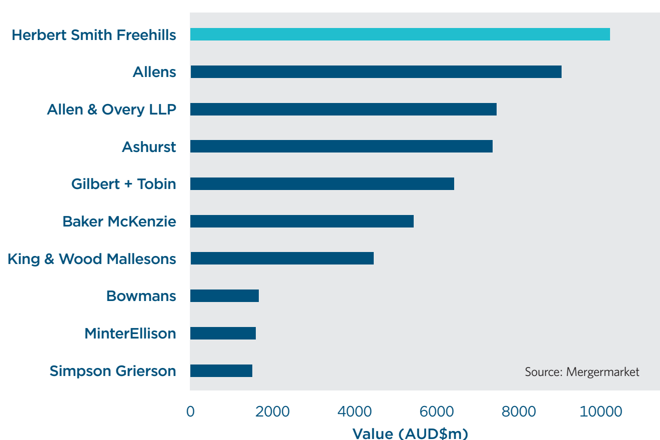
COMMERCIAL TEAM OF THE YEAR
LAWYERS WEEKLY AUSTRALIAN LAW AWARDS 2018

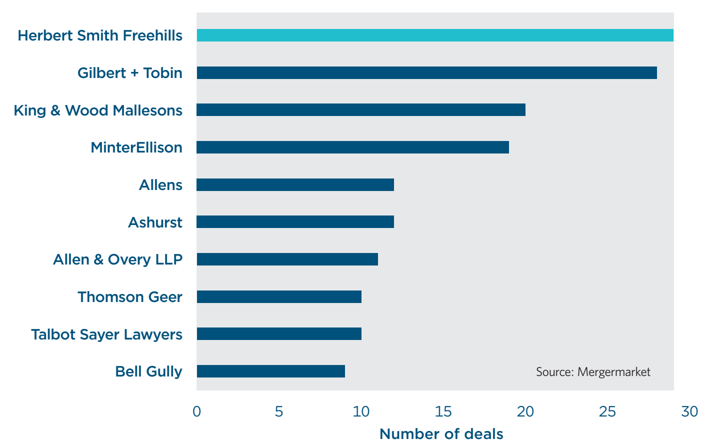
LAW FIRM OF THE YEAR (>500 EMPLOYEES)
AUSTRALASIAN LAW

PRIVATE EQUITY LAW FIRM OF THE YEAR – AUSTRALIA –
BEST LAWYERS AWARDS 2018

BAND 1, PRIVATE EQUITY – AUSTRALIA –
CHAMBERS ASIA PACIFIC 2012-2018

Leaders in Private Equity – Market Recognition





PRIVATE EQUITY: An overview of private equity in 2018

At the end of 2017, the Australian private equity industry was sitting on record levels of dry powder. This, along with positive market conditions for funding, bolstered activity in early 2018, with strong buy-side activity by private equity players across a variety of sectors. The market has trended towards large value deals. Below we explore the state of the private equity market in 2018 in more detail, and set out our predictions for 2019.

From top

Clayton James
Partner

Candice Heggelund
Senior Associate

Sector overview

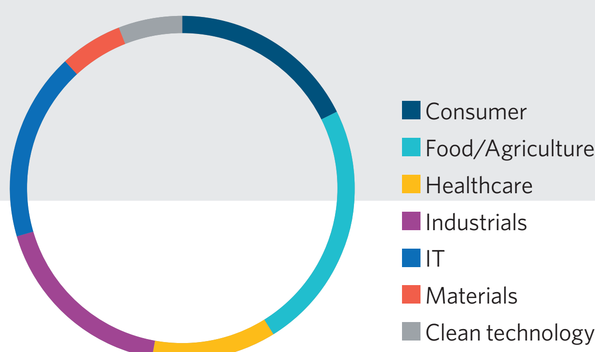
So far in 2018, sponsor activity has been spread across a diverse range of sectors, alongside the continued trend for lower deal volumes and larger value investments. Preqin data for 2018 reveals that the food and agriculture sector has attracted the most investment. This is unsurprising given the continued growth in demand worldwide for quality Australian food and produce.

Other sectors attracting sponsor interest this year include consumer products and services, with a particular focus on education, healthcare, industrials and information technology. These sectors have seen fairly consistent levels of activity over the past 3 years and their continued prevalence is not surprising. However, the marked lack of activity in the business services sector is surprising. Pegged as a potential growth sector by many commentators, the sector has been remarkably quiet with no deals recorded by Preqin in this sector for 2018. Technology, media and telecommunications was also highlighted as a growth sector to watch for 2018, but so far this has not proved true, with deal volume remaining fairly constant. This is perhaps a reflection of the blurring of the lines between traditional information technology sectors and increasing incorporation of technology into businesses that are more often categorised in other sectors. A third notable absence is the lack of investment in the materials, energy and utilities sectors.

Deal value and volume

Published deal values for 2018 so far indicate a continuation of the tendency for larger value deals that are published in the market. The sale of I-MED Network Ltd, the sale of Accolade Wines Limited and the sale of The Real Petfood Company took out the top 3 recorded deal values, proving that healthcare and food & agriculture continue to attract not only high levels of interest amongst sponsors, but also high value transactions. The number of recorded deals by Preqin for 2018 at this point indicates a lower total deal volume compared to 2016 and 2017, however we predict that this may change as more deals are announced and recorded in the final four months of 2018.

SECTOR OVERVIEW

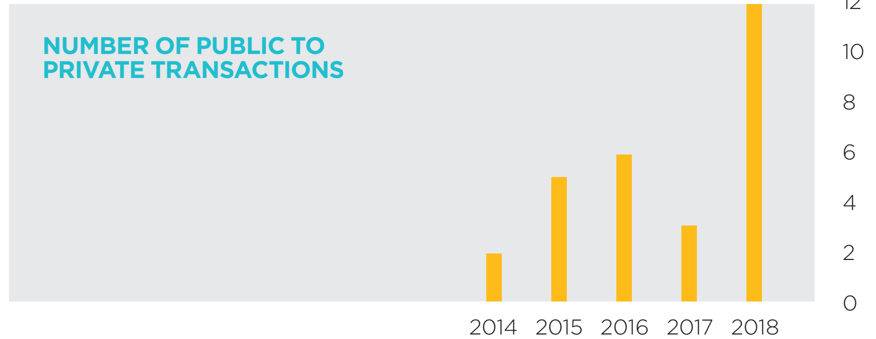


Public to private

One of the more notable trends to have emerged in 2018 is the significant increase in public to private transactions. The acquisition of Pepper Group by KKR in late 2017 started something of a resurgence in this space with Connect 4 reporting 12 public to private transactions being announced so far this year. This is almost triple the amount of announced public to private deals in the 2017 calendar year, and we have only just passed the halfway point of 2018, with the potential for the announcement of additional deals by the end of the year.

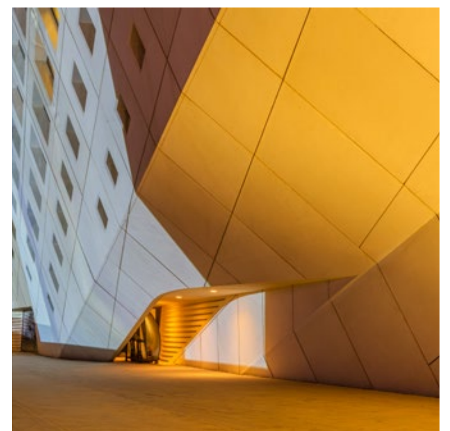
The factors driving this increase can be traced back to record levels of fundraising in recent years, leading to unprecedented levels of capital becoming available to sponsors. The amount of dry powder sitting across Private Equity and Venture Capital funds is estimated to be at least $7 billion. This has created competition for quality assets in the unlisted space. These underlying drivers suggest the increase in public to private transactions will continue as larger domestic and global sponsors look for opportunities in the listed space to negotiate bilateral deals (and not only participate in competitive auctions).

Following on the back of this trend, please see the article on page 6 which considers the key considerations for a private equity bidder in a public to private transaction.



PREDICTIONS FOR 2019

- Financial services as a sector to watch
- Public to private transactions will continue to be pursued, along with the use of warranty and indemnity insurance in public deals
- Longer hold periods can be expected as sponsors seek to drive stakeholder value through long term strategies



Venture Capital: **Tech trends in 2018**

Overview: Increasing fund flows to venture capital

In June this year, the Economist noted that the flow of European venture capital had hit its highest level for a decade. According to the Trade Association InvestEurope of the €6.4 billion in venture investments in 2017, 45% went to information and communication start-ups and 23% to biotech and healthcare. There are similar stories in America, Asia and the emerging markets of Africa and the Americas. In Australia, AVCAL has reported that in 2017 venture capital fund raisings surged to a record level of $1.32 billion. 19 VC funds completed successful fundraisings with superannuation funds increasing their appetite for exposure to the venture market accounting for 32% ($421 million) of the aggregate funds raised (Australian Private Equity & Venture Capital Association Limited 2017 Yearbook).

It is likely to be the case that capital continues to flow to emerging industries, and to venture investments. In an Australian context the largest share of investments went to the ICT sector including an increase in funding from overseas based venture funds. By way of example Deputy, a cloud based workforce management tool that allows users to manage scheduling, timesheets, tasking and other employee communications closed a $33.2 million Series A funding from Boston based OpenView Venture Partners in December 2017. Healthcare and life science assets followed closely behind accounting for 33% of all venture investments in the Australian marketplace (Australian Private Equity Capital Association Limited 2017 Yearbook).

Venture Capital transactions: Snapshot of deal terms

While there are some similarities between private equity transactions and venture capital investments, traditionally venture capital involves the financial investor acquiring a non-controlling stake. As such, there are a number of areas to a venture transaction that are different to a more traditional private equity transaction. The main areas that are covered as part of a venture investment (whether in Series Seed, Series A, Series B or beyond) fall under three main categories:

- Priority of capital;
- Governance arrangements; and
- Exit parameters.

In terms of underlining deal economics, market practice is moving towards an investment taking the form of a 1x non-participating preferred instrument, coupled with a weighted anti-dilution protection. Essentially, latest money comes back first with the investor retaining the ability to convert its stake to ordinary shares to sell as part as an exit but maintaining downside protection (the preferred position) in the event that the proceeds available on a liquidity transaction are not sufficient to pay out all equity claims. The anti-dilution protection is designed to adjust the conversion in the event that a venture investor invests at a particular valuation, and a subsequent capital raising is undertaken at a lower valuation.

In the circumstance where the venture investor does not control the equity (nor the board), board appointment rights are significant (and it is critical for a venture investor to obtain at least one board seat so as to ensure a flow of information and an involvement in the board room), coupled with a detailed list of veto items to ensure that the business is conducted in accordance with the parameters on which the investor invested. As there is no positive control for the venture investor, composition of the board and due diligence on the founder/management team assumes a much higher importance.

While venture governance documents will include a drag along mechanism consistent with that contained in private equity deals, the liquidity provisions are triggered by the shareholder majority (the definition of this is negotiated on a deal by deal basis but it is rare that this means the venture investor on its own). For this reason there needs to be a conversation at the outset around proposed exit horizons, coupled with the venture investor having the right to sell its stake (and the company providing all assistance required for such sale to occur) in the event that an exit has not been achieved within a particular time period.

Herbert Smith Freehills has been privileged to have acted on some of Australia's largest and most successful technology capital raisings including Atlassian, Campaign Monitor, Deputy, Nura, Social Garden, Cognitive Platforms, Buckitdream, Docta, Canva, Culture Amp, Instaclustr, Predict HQ, Identitii, Tyro Payments, OzForex, 99designs, Cloud9, PageUp People, Iron Mountain, Bluestone, BigCommerce, TimeBase, Shopsmart, Simple Technology, Elanation, Unlock'd, SafetyCulture, ArgiSystems, We are Social and Brands on Show.

From top

Peter Dunne
Partner

Claire Bamford
Solicitor

KEY TRANSACTIONS

Herbert Smith Freehills advised:

Atlassian on its US$60 million Series A fundraising round from Accel Partners.

Campaign Monitor, an Australian email marketing software company on its US$400 million Series A capital raising.

An investor in Zoox, a robotics company pioneering autonomous mobility on its A$650 million Series A capital raising.

Tyro Payments on its A$100 million expansion capital raising.

Deputy on its US$25 million Series A capital raising from US based OpenView Venture Partners.

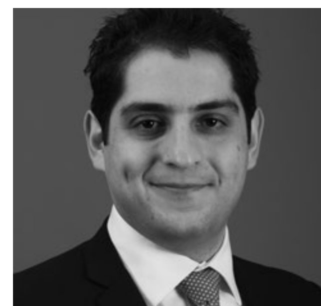
SafetyCulture on its A$30 million Series B capital raising.

Culture Amp, a software company building a people analytics platform on its Series A, B, C and D capital raisings.

Take-private transactions – Key considerations for a Private Equity bidder

We are witnessing a welcome renaissance of Private Equity bidders in the Australian public market and we think this trend will continue.

There are some key issues that Private Equity bidders need to keep front of mind.



From top

Raji Azzam
Partner

Kam Jamshidi
Senior Associate

Jill Davis
Senior Associate

Current market trends

Private equity takeover bids are coming back to the Australian market in a big way.

Since the glory days of a decade ago when TPG, KKR, Macquarie and other sponsors were bidding for Coles, Qantas and Alinta, we've seen a shortage of Private Equity bidders participating in Australian public M&A.

However, in the last 18 months, there has been a welcome renaissance of Private Equity bidders in the Australian public market and we expect that trend to continue over at least the next 12 months.

So, what should potential Private Equity bidders consider when running their eye over a listed target?

Participation of target directors and management in the bid

A Private Equity bidder will commonly look to secure the ongoing participation of certain target directors or management in the running of the target following the takeover. This participation is typically achieved by giving equity in the bid vehicle, or the offer of attractive employment terms, to the directors and management.

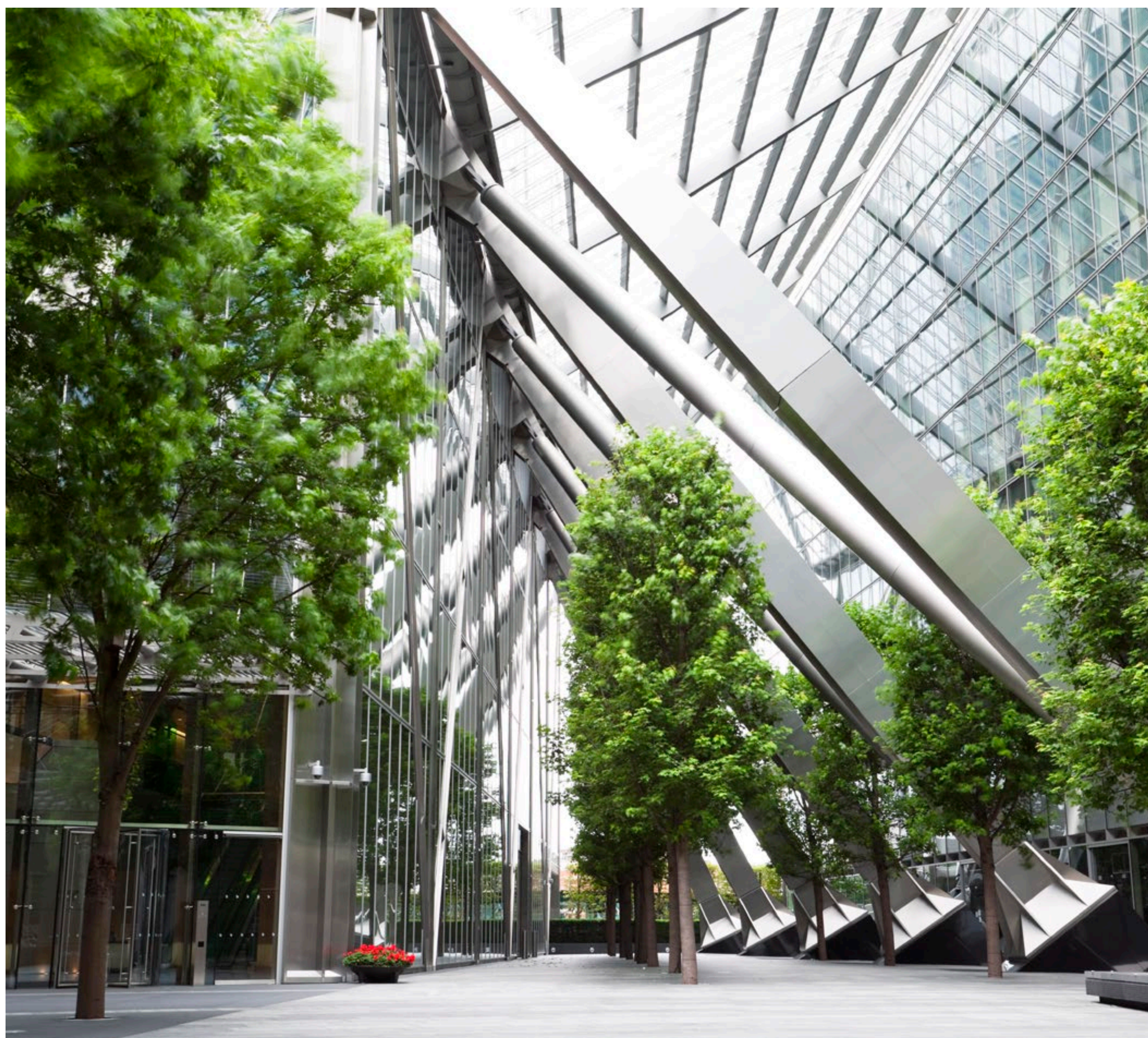
When approaching a target, Private Equity bidders should be conscious of the conflicts present in this scenario.

The Australian Takeovers Panel has a policy around the duty of directors to avoid such conflicts. In essence, the Panel's policy is that, as soon as the target board becomes aware of a potential bid in which there is participation by insiders, it should establish appropriate protocols.

Such protocols will involve the establishment of an independent board committee consisting of non-participating directors, who will oversee the takeover response in the interests of target shareholders. Any directors who are participating in the bid will not be present at any consideration of the bid.

Aside from the Panel's policy, most listed companies will have a "conflicts policy" that directors will be expected to follow and target directors and management will also need to comply with their legal, fiduciary and statutory duties.

Australian listed company directors will not only seek to comply with the Panel's policy



and their general duties, but also be seen by target shareholders and the wider stakeholder community as doing so.

Bidding in a consortium

A Private Equity bidder will often bid in a consortium, either alongside another financial investor or a strategic bidder, or a combination thereof.

An interesting trend in the Australian market, which we predict will fuel future Private Equity-led consortium bids, is the growing appetite of Australian superannuation funds for direct investments. The recent BGH Capital-led A$4 billion bid for Healthscope, alongside AustralianSuperannuation, may represent the beginning of a new era of super funds participating in bids.

A Private Equity bidder will often participate in a consortium alongside a strategic bidder with the intention of breaking-up the target business between the bidders if, say, either party does not want all of the target's business or regulatory issues would preclude one of the participants from acquiring the entire business.

The successful 2016 consortium break-up bid for Asciano by Brookfield and Qube, alongside various pension funds, illustrates the potential to bring together financial investor and strategic bidder in one consortium.

Issues raised by consortium bids include:

- Premature disclosure: avoiding premature disclosure of a potential bid is critical for success. Under Australian rules, a party that has, either alone or with its "associates", a relevant interest in control over 5% or more of shares in a company must disclose the holding, and the "association", to the market. The tests for whether an "association" exists are complex and the 5% holding concept can capture derivative positions (in addition to physical holdings). If a potential consortium member has a pre-bid interest, the parties should proceed carefully to avoid a premature disclosure.
- 20% ceiling: our rules prohibit an acquisition of shares, if the acquisition

results in the number of shares controlled by the acquirer and its associates increasing from 20% or less to more than 20%. A contravention of this restriction can potentially result in a forced divestment of the relevant shares (in addition to being a criminal offence). Again, the parties should proceed carefully to avoid a breach, if one or more has a pre-bid interest.

- Insider trading: Australian insider trading rules prohibit the communication of non-public material price sensitive information to another person where the communicator knows that the recipient is likely to deal in the relevant shares (the "tipping offence"). Any shareholder that is aware of such information is prohibited from trading the relevant securities (the "trading offence"). Any approach to a potential consortium member will need to avoid both a breach of the tipping offence by the communicator and bringing the recipient "inside" without consent (such that they can't trade target shares). This is achieved by the parties following a "wall crossing" process.

KEY TRANSACTIONS

Herbert Smith Freehills advised:

Capilano Honey on A$190 million takeover proposal from Roc Partners and Wattle Hill.

Pepper Group Limited's Independent Board Committee in relation to the A$750 million acquisition of Pepper by Red Hot Australia Bidco Pty Limited, an entity indirectly owned by certain funds, clients or accounts managed or advised by KKR Credit Advisors (US) LLC or its affiliates, by way of scheme of arrangement.

Senior lenders of the Bis Industries group (including entities managed by The Carlyle Group and affiliates of Värde Partners) in connection with the restructure of A$1.2 billion of Bis Industries group debt and the transfer of ownership of the Bis Industries group to its lenders through two parallel schemes of arrangement.

Leveraged finance

Strong borrower-friendly conditions remain prevalent, driven by high levels of debt liquidity and the entry of new market participants. Traditional bank debt, unitranche and term loan B products compete to provide the best financing solution on a deal by deal basis.

A borrower's market

The strong borrower-friendly conditions of 2017 have continued into and developed throughout 2018. Loan volumes have increased 24% year on year from 1H17. Sponsors have continued to benefit from high levels of debt liquidity and strong underwriting appetite to continue to push the envelope on pricing, leverage and terms.

There has been an increase in the use of alternative debt products. Unitranche has become commonplace on Australian leveraged buyouts. This is across a broader range of the market than its use in the European markets. We have also seen the development of an Australian law term loan B offering. Archer's recapitalisation of Craveable Brands via an innovative first- and second-lien term loan B financing, the first of its kind in Australia, broke new ground in Australian debt markets.

Deal volumes in both traditional bank debt markets and alternative debt product markets are strong. Sponsors are balancing their desired leverage, pricing, need for back-ended or low amortisation, financial covenant relief and need for operational flexibility, to determine which debt product is the most appropriate for any particular asset. While lender protections on the unitranche and term loan B products are less than traditional debt products, across the products the size of the equity cheque has remained relatively constant, with few transactions pushing below 40%.

The entry of new market participants and growth in financing options has placed pressure on traditional lenders to compete with alternative products by accepting more borrower-friendly terms. In particular, we have seen traditional lenders accepting looser terms around mandatory prepayment requirements and back-ended amortisation. There has also been pressure on pricing (albeit less significant compression than at other times in the market's history).

Traditional lenders have shown tentative signs of interest of being involved in unitranche and term loan B markets, generally seeking a super senior position in such financings, although a number of lenders are considering these very much on deal by deal and sponsor relationship basis.

Trends and predictions

Driven by the competition between the increased number of market participants and between the increased number of product offerings, it is anticipated that sponsors will continue to leverage their strong positions to push lenders for more flexible and borrower-friendly terms and pricing. As the ability of borrowers to access alternative debt products continues to increase, we are likely to see further convergence of the terms of various financing products.

* Includes all major currencies (USD, EUR, JPY, AUD, HKD, SGD, NZD, GBP, CAD, offshore CNY) syndicated and club loans based on country of risk.

SUMMARY

- Sponsors are continuing to receive strong support from both bank and non-bank institutions.
- Growth in the unitranche and term loan B markets has placed pressure on traditional lenders in both pricing and terms.
- It is anticipated that sponsors will continue to leverage their strong positions to push lenders for more flexible and borrower-friendly terms and pricing. This is likely to drive further convergence of the terms of various financing products.

From top

Hayley Neilson
Partner

John Erbacher
Senior Associate

Marnie Fels
Senior Associate

TRANSACTION SPOTLIGHT

Herbert Smith Freehills is acting on, or recently acted on, the key transactions below:

- Adamantem and Liverpool Partners - on their public to private acquisition of Zenitas and associated roll-up acquisition of other entities.
- Pacific Equity Partners – on the financing of the acquisition by IntelliHUB Holdings Pty Ltd (a joint venture between Pacific Equity Partners and Landis + Gyr) of the Acumen electricity metering infrastructure business from Origin Energy.
- Archer Capital – on the recapitalisation of Craveable Brands involving the Australian dollar, first- and second-lien term loan B financing.
- Riverside Company – on the financing of the acquisition of Energy Exemplar involving a unitranche loan / super senior financing structure.
- Bis Industries – on the refinancing of its debt arrangements following its 2017 restructuring. The transaction included an innovative senior/super-senior structure.

TAX:
PE & VC tax developments

Tax continues to be a complex area for navigation for offshore and domestic PE and VC funds, with issues arising from new case law, ATO interpretations and new legislation.

Inbound investment – many hurdles to jump through

The last 12 months has seen a number of developments in Australia's approach to the taxation of inbound investment, including:

- Tightening the thin capitalisation provisions and the ability of Australian entities to revalue their assets to increase the amount of deductible debt that can be put into an Australian structure.
- Continued scrutiny of related party funding, including requiring that as part of FIRB applications, parties self-assess the "risk" of these funding arrangements being subject to ATO audit – this is relevant to the quantum of, and interest rate that can be charged on, related party debt.
- Introduction of "anti-hybrid" provisions, which (for example) can apply to deny Australian interest deductions on a loan from a non-resident, where that non-resident is not subject to tax or is taxed on a different basis on the interest income.
- The ATO asserting that non-resident companies are more likely to be Australian tax resident where the directors make decisions in Australia.
- The extension of the "significant global entity" provisions, which can trigger an obligation to lodge general purpose financial statements with the ATO and impose significant penalties for non-compliance with tax return lodgement obligations.

In good news for investors, the Federal Court in *Resource Capital Fund IV LP v FC of T* (**RCF**) largely endorsed the commonly understood position that where the ultimate investors are entitled to treaty benefits, Australian tax on exit from the investment should only arise where the Australian investment is held through an Australian permanent establishment, or the Australian investment is "land rich" for Australian tax purposes. However, aspects of the decision of RCF were puzzling, such as the suggestion that each limited partner, rather than the limited partnership itself, could have an obligation to file an Australian tax return. The decision is subject to appeal.

Australian structures

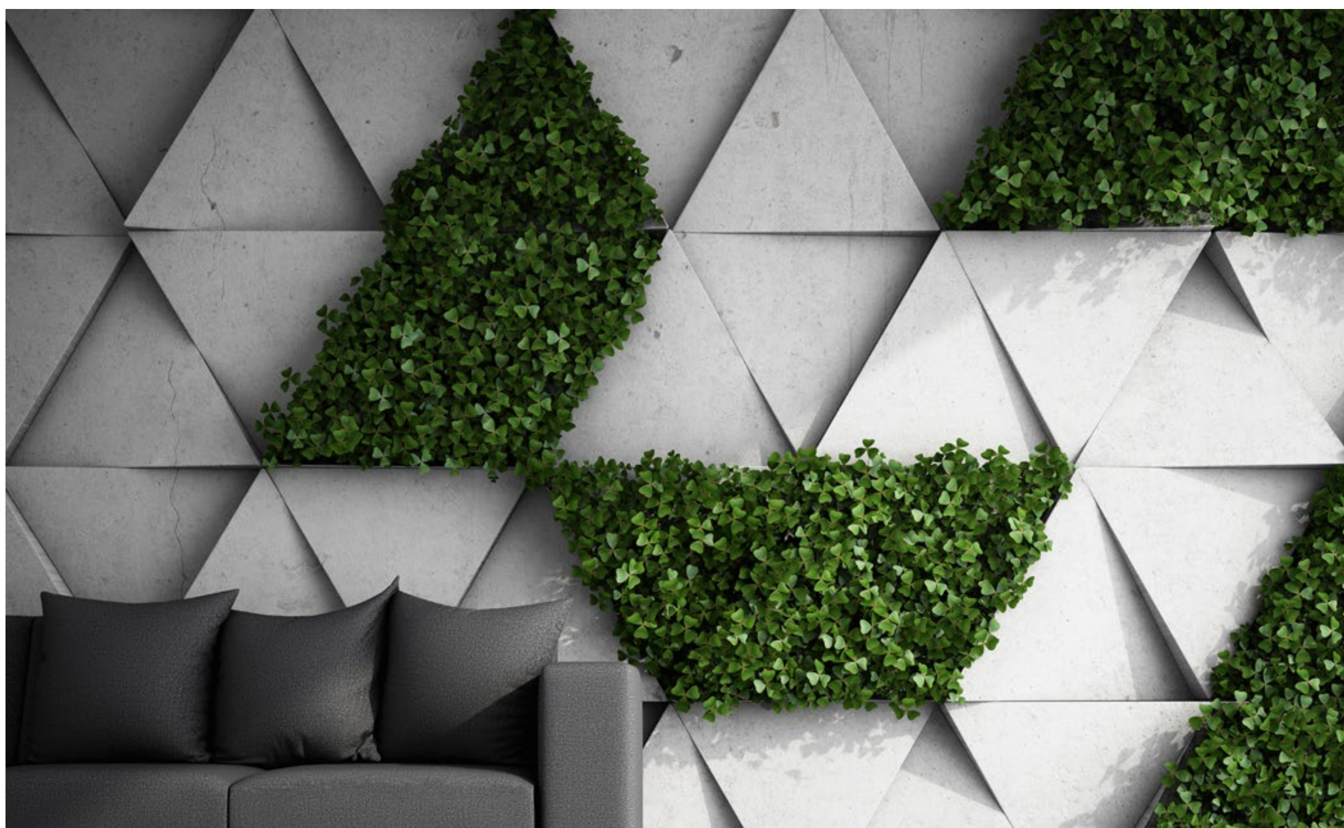
There are also a number of open issues for Australian Private Equity and Venture Capitafunds:

- MIT structures: One of the key requirements for a trust to be classified as a 'Managed Investment Trust' and therefore be able to have its assets taxed under the capital gains tax rules is that the trust cannot control, or have the ability to control, an entity that carries on a 'trading business'. The ATO is of the view that the phrase 'control' can be either by way of having the power to appoint the majority of the board of the entity, or by having veto powers over key decisions affecting the business. The ATO has for some time been developing a list of decisions which could be problematic but this process has now stalled.
- VC Funds: There are several key issues which have been discussed with the Treasury department including:
  - For Early Stage Venture Capital Limited Partnerships (ESVCLPs): Whether gains on an investment valued at more than $250m is to be taxed as income or capital gain. If the gain is taxed as 'income' then non-resident investors may be required to lodge an Australian income tax return.

From top

Toby Eggleston
Director,
Greenwoods & Herbert Smith Freehills

Cameron Blackwood
Director,
Greenwoods & Herbert Smith Freehills



- For Venture Capital Limited Partnership (VCLP): resident investors which are super funds are taxed on gains under the capital gains tax rules whereas resident non-super fund investors are taxed on gains as income. Similarly for ESVCLPs, gains on investments above the $250m will be taxed depending on whether they are a super fund. Lobbying is continuing to enable a VCLP and ESVCLP to make a capital account election like managed investment trusts to address these issues.
- For both ESVCLPs and VCLPs: The exception to the 'in Australia' rule for eligible venture capital investments applies if at the time of making the investment, the total of the value of the investment and all other non-Australian investments does not exceed 20% of the funds committed capital. Lobbying is continuing to have the 20% determined by reference to the cost of the investment to the fund as opposed to the market value of the investments .

Incentive arrangements

There are a number of quirks with incentive arrangements for private companies:

- For private equity: there is no simple solution for private equity management incentives, which continue to use loan plans, converting preference shares and premium priced options as the mechanism for incentivising management with equity.
- For venture: While the startup concessions have enabled a cost effective roll-out of equity for most employees there are still issues remaining:
  - there are a number of technical nuances with the startup rules which we are lobbying the ATO and Treasury to fix with the startup concessions;
  - companies do not meet the early stage test often because a founder has used an existing company to commence the new venture rather than starting off with a clean entity. As a result employees of these entities are not able to take advantage of the startup tax concessions; and
  - there is still no easy mechanism to incentivise founders or adjust equity stakes between founders.

SUMMARY

- The use of related party debt continues to be an area of focus for the Australian Taxation Office.
- The ATO and Treasury continue to consider how managed investment trusts and Venture Capital funds should be taxed.
- A number of quirks remain with incentive arrangements for private companies.

Transaction insurance: **W&I Insurance**

2018

<1%
AVERAGE PREMIUM RATES (% OF THE LIMIT OF INDEMNITY)

~29%
AROUND 1 IN 5 POLICIES HAVE CLAIMS

$65m
AVERAGE LIMIT OF INSURANCE PURCHASED

What is W&I and how does it work?

W&I insurance is transaction insurance that typically covers a buyer against financial loss arising from a breach of warranty or a claim under a seller indemnity in a share or asset sale agreement. Insofar as it relates to warranties, this kind of insurance typically provides cover for historic risks – that is, unknown breaches of warranty that first become known following the point in time at which the warranty was given, i.e. signing or completion.

W&I insurance enables a PE seller to transfer the financial risk of a loss arising from a warranty or indemnity claim to an insurer, providing the PE seller with a 'clean exit', avoids the PE seller having to provide a 'holdback/escrow as security for such claims and, thereby, facilitates a fast and full return of sale proceeds to its investors. For a PE buyer, it enables them to generally deal with the insurer, rather than the seller, in relation to a claim. This provides greater security for claims and also protects any ongoing relationship between the PE buyer and the seller, for example where a founder seller has rolled some of their interest.

The process for putting in place a buy-side W&I insurance is generally encountered in one of two ways. The first is where the seller requires, or the parties to the negotiation agree, that the buyer will take out a W&I policy for the deal. The seller may engage the insurance broker and test the market for pricing, but nothing further is done. The broker then 'flips' to the preferred bidder when selected. The second is where the seller takes a more active role in the initial steps of implementing the W&I insurance, referred to as a seller-mandated policy. These steps may include: retaining the broker, reviewing indicative pricing, selecting a primary insurer, negotiating the base W&I insurance policy and facilitating the insurer and its advisers to undertake their review of the data room materials and any vendor due diligence reports (known as 'sell-side underwriting'). The seller then 'flips' the engagement of the broker and the insurer, together with the draft policy, to one or more selected preferred bidders.

Current market trends

As an established tool in the Private Equity and M&A markets and in one of the most developed global markets for this insurance, what are the current trends in W&I insurance in Australia?

- Seller-mandated policies: With the return of competitive sale processes to the M&A landscape over the last 1-2 years, there has been an increase in seller-mandated W&I insurance policies. Front-ending this process allows the seller to control and advance the W&I process. Undertaking sell-side underwriting can provide the seller with an early indication of uninsurable risks or areas that require further diligence (allowing the seller to address such risks via further information disclosures, by notifying bidders that their due diligence should cover such risks or in the sale agreement, before 'flipping' the insurance to the preferred bidder). This minimises the risk of gaps in the policy, i.e. risks that are not insured, or the likelihood of the buyer looking to the seller to cover any such gaps (which cannot be closed), and the time taken between the 'flip' and signing of the sale agreement.
- Pricing at records lows: It's a buyer's market. Brokers are reporting that average pricing for deals is now less than 1% of the limit insured because greater competitiveness in the Australian primary insurance market and "plummeting" excess layer rates have driven down the cost of programmes.
- Greater flexibility on retention structures: There is a greater willingness by insurers to offer different retention structures. Tipping retentions for policies (that is, a retention or excess that drops down to insure some or all of the retention amount once it is met) of 1% of EV tipping to 0.5% of EV are common. However, on occasion we are also seeing retentions that tip to nil (so that recovery is from the first dollar of loss), which have not been a feature of the Australian market for the last few years. In addition, insurers are now commonly offering fixed retentions of 0.5% of EV, whereas previously fixed retentions were not available below 1% of EV.
- Nil recourse is not necessarily sole recourse: Parties to deals are becoming increasingly sophisticated around their use of W&I insurance. While 'clean exist'/nil recourse is still the ideal for PE sellers for the reasons given above, we are seeing some PE sellers taking responsibility for uninsured exposures that are specific to the business, such as specific indemnities for environmental liabilities or other known business risks (rather than having those risks impact price). For PE buyers, on the other hand, we are seeing W&I on occasion being used as a first port of call, with secondary recovery to the seller negotiated for the retention, uninsured or excluded warranties and claims above limit of the insurance.
- Insurers are focusing on the robustness of the negotiation and diligence process: Insurers will assess the integrity of the sale process by carefully scrutinising the deal negotiations, the quality and scope of the buyer's due diligence and the seller's disclosure. Insurers make it known that the quality of a party's professional advisers can make a material difference to the ability for a buyer to obtain the desired insurance cover and within the time constraints of the deal environment.

Our experience

- Herbert Smith Freehills' market leading Private Equity practice is a one-stop shop for transactions involving W&I insurance. Our deal teams are supported by specialist M&A and insurance lawyers with extensive W&I insurance experience, who are up-to-date on market trends and who have long-standing relationships with each of the major W&I brokers and primary insurers in the Australian market, to provide comprehensive, seamless and efficient advice.
- We understand what W&I insurers are looking for when they assess deals. For example, there is a balance to be struck to ensure that buyer due diligence is scoped efficiently, but is sufficiently comprehensive to satisfy a W&I insurer. We have insights and experience gained not just from acting on many insured deals, but also from advising some of the leading primary W&I insurers on their underwriting processes.

From top

Ben Landau
Executive Counsel

Philip Hopley
Special Counsel

SUMMARY

- The Australian market continues to be at the forefront of global W&I insurance trends
- Increased competition between primary insurers in the Australian market is enabling buyers to secure broad cover at historically low premium rates
- Undertaking a 'seller-mandated' process before 'flipping' the W&I insurance to a preferred buyer can result in a significantly improved sale process and outcome for the seller
- Insurers are increasingly rigorous in their assessment of deals – specifically, there is a focus on the quality of the parties' professional advisers and the robustness of the negotiation and due diligence processes

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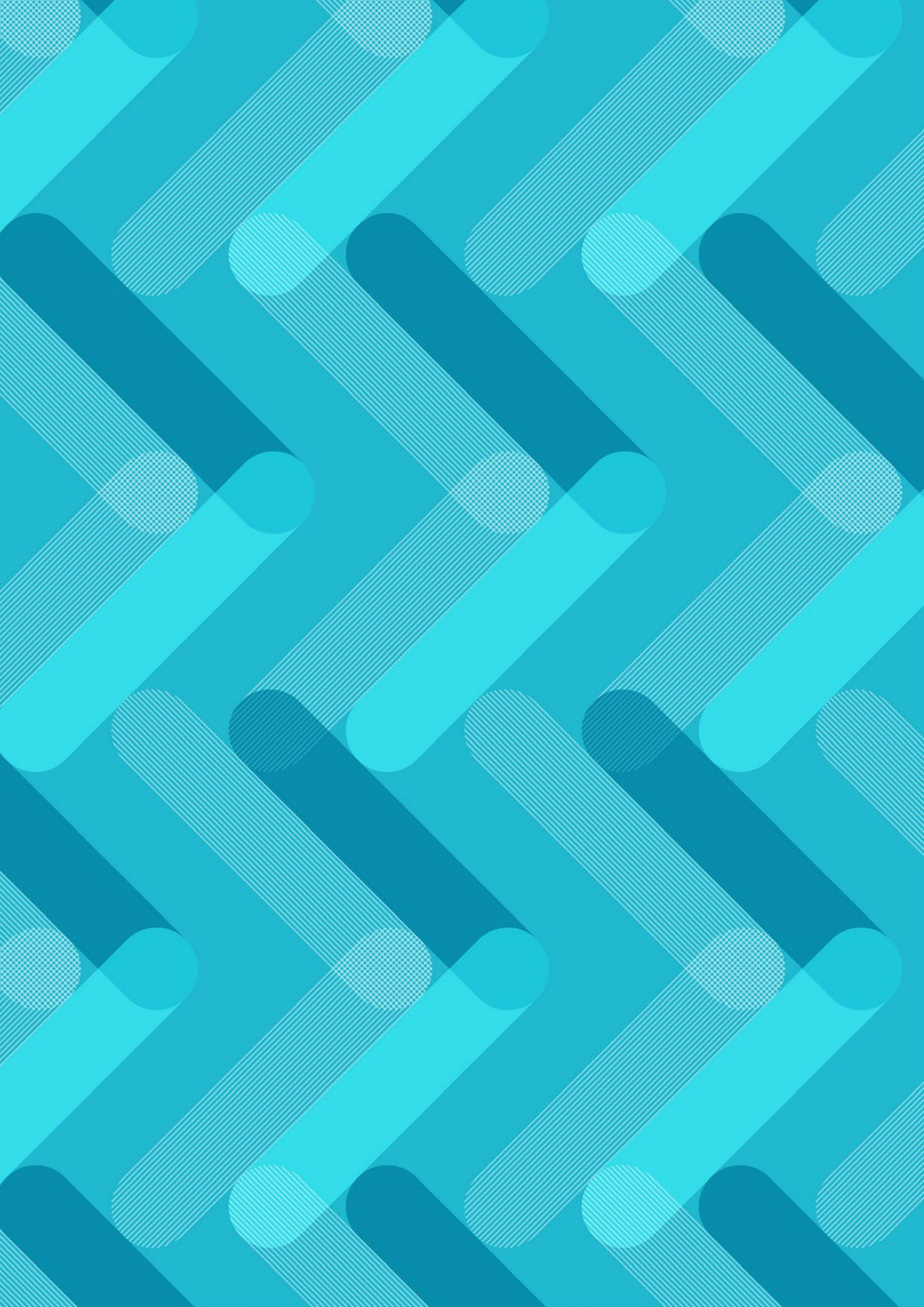

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