Taste of Australia

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Hamilton Locke

Taste of Australia provides a high-level look at the current issues facing deal makers in Australia. Specifically designed for foreign investors and their advisers, we provide a 'taste' of these issues. Our experts would be delighted to expand on any aspect that may be of interest.

In this edition we discuss:

Australian politics after the "Voice"

Political discourse in the last quarter was dominated by the constitutional referendum held in October. The proposal to amend the Australian constitution to enshrine a "Voice" to Parliament for indigenous peoples was defeated by a majority of approximately 60% "no" votes to 40% "yes" votes. The result will have a profound impact on indigenous relations and policy for many years to come. However, the immediate implications for national politics are less obvious.

At one level, the result was a clear defeat for the Prime Minister, who strongly supported the "Voice". It was equally a win for the opposition, who campaigned against it. However, a closer analysis of voting patterns suggests that voters did not necessarily vote along party lines. Many seats held by the government voted "no", and many seats held by the opposition voted "yes". Geography and education were much stronger predictors of voting outcomes than traditional party allegiances.

The last referendum, held in 1999, considered a proposal to establish the Commonwealth of Australia as a republic - with the monarchy being replaced by a President elected by the Parliament. It was voted down by a majority of 55% to 45%. Interestingly, the voting patterns from the republic referendum bear a striking similarity to the "Voice" vote. Only 20 of Australia's 151 electorates voted a different way on the "Voice" to how they voted in 1999.[1]

It seems therefore that, even a generation apart, there are parts of Australia that are inherently progressive and others that are inherently conservative as regards constitutional change. To that extent, the outcome of the "Voice" referendum is not necessarily a harbinger of electoral change.

M&A and Capital Markets update

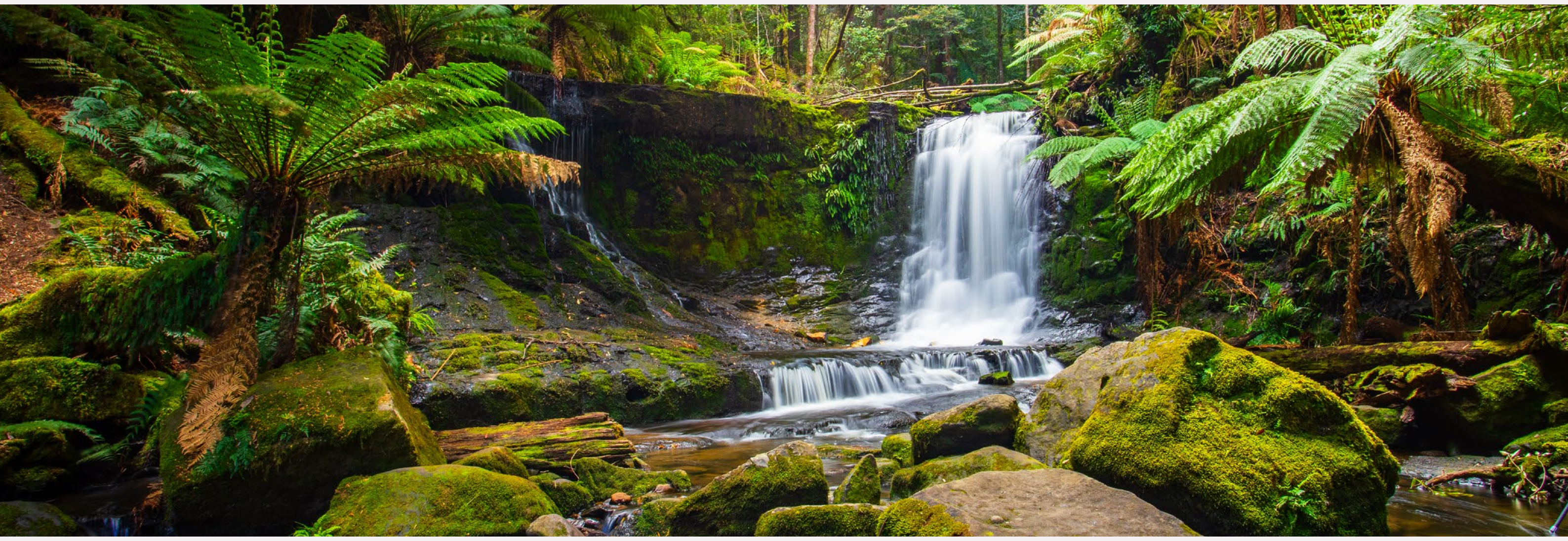
M&A activity in Australia remains down on FY22 levels but is consistent with long term averages. The stronger first half of C23 was tempered in the September quarter by stubborn inflation, ongoing uncertainty around lending rates and geo-political concerns.

On 7 November, the Reserve Bank of Australia raised the official cash rate for the 13th time since May 2023 to 4.25%. We therefore continue to see reduced levels of sponsor involvement in deals, and more deals being funded off existing balance sheets rather than external debt.

The top of the market has been dominated by mining and mining services deals such as the Newmont/Newcrest merger and the sale of Ausenco to Eldridge Industries (on which Hamilton Locke advised). Outside of the energy and resources sector, there have been few blockbuster deals.

We continue to see strong activity in the mid-market, where the low Australian dollar has seen foreign investors acquiring high quality assets

Capital markets remain extremely quiet. IPO activity is tracking at less than half of the normal run rate. Anecdotally, underwriters have found it hard to secure support for large capital raisings intended to fund major acquisitions. A number of major shareholders have chosen to take listed companies off market, reflecting a growing preference for private capital.



[1] www.abc.net.au/news/2023-10-15/voice-results-explained-map/102978520

ASIC focuses on 'greenwashing'

The Australian Securities & Investments Commission (**ASIC**) has made it clear that they are prepared to take strong action against issuers who misrepresent the extent to which investment products, corporate strategies or financial products are environmentally friendly, sustainable or ethical (referred to as "greenwashing").

ASIC is targeting, in particular:

- net zero statements and targets which do not appear to have a reasonable basis or are factually incorrect;
- terms such as 'carbon neutral', 'clean' or 'green' being used without a reasonable basis for the implied claims; and
- the use of inaccurate labelling or vague terminology in sustainability-related funds and products.

In its most recent report, in response to alleged greenwashing, ASIC noted that in the six months prior it had issued:

- 23 corrective disclosure notices;
- 11 infringement notices; and
- 1 civil penalty proceeding

ASIC has subsequently commenced civil penalty proceedings against Vanguard Investments Australia in relation to claims made about exclusionary screens applied to Vanguard's fund investments (which ASIC alleges were ineffective). Further, ASIC has commenced proceedings against LGSS Pty Ltd (Active Super) alleging that it was misleading for Active Super to represent itself as an ethical and responsible fund while it held investments in gambling, tobacco, coal mining and certain Russian entities.

We expect that greenwashing will remain a key focus point for regulators. It will be important for issuers to thoroughly verify any ESG related claims they make in promoting their products.

Merger control update

In our previous edition, we flagged that the Australian Competition and Consumer Commission (**ACCC**) had called for reforms to Australia's merger laws which, if adopted, would give rise to a more interventionalist regulatory environment.

In response, the Australian government has just released a Merger Reform Consultation Paper (**Paper**) which requests feedback and comments from the public to inform options for modernising Australia's merger regulation. The Paper proposes options for a reformed merger control process (to replace the existing informal merger review process) and changes to the merger control test. Of the options put forth in the paper, the ACCC's proposal is by far the most expansive from a regulatory perspective. Submissions in response to the Paper close early next year, and we expect the government will take its time to consider the submissions before implementing any changes.

On another front, the ACCC's recent decision to authorise Brookfield and EIG Partners' A$18.7 billion takeover of Origin Energy (ASX:ORG) was notable, in that the deal was approved by the ACCC notwithstanding that the regulator concluded that the transaction would substantially lessen competition in some markets.

In approving the Origin deal, the ACCC concluded that any competition concerns they had were outweighed by the overall public advantages represented by an accelerated reduction of Australia's greenhouse gas emissions likely to be achieved if the deal proceeds. This is an unprecedented basis for the ACCC to authorise a merger. It will be interesting to see whether the Origin decision is the start of a broader, policy led approach to competition regulation in Australia.

Foreign investment

The Foreign Investment Review Board (**FIRB**) has now released its final quarterly report for FY23.

The total value of proposals for FY23 reached $171.5 billion, sourced from a total of 1,310 proposals. This is lower than FY21 and FY22 (where the total investment value was $227.2 billion and $330.5 billion respectively). However, the approval figures for those periods were inflated by the temporary zero-dollar thresholds imposed during the COVID-19 pandemic.

In the most recent quarter, Japan was the largest source country for approved commercial investments by value ($11.7 billion), followed by Singapore ($3.6 billion), the US ($3.0 billion) and South Korea ($1.8 billion). However, the US topped the list overall for FY23 with a total investment value of $34.5 billion, followed by Singapore and Canada ($14.4 billion each).

FIRB reports that the median processing time for approvals is now 36 days (which has reduced from 52 days in FY21 and FY22). Whilst this is promising, it's worth noting that this is the average processing time across a range of investment proposals (including long term commercial leases) and does not reflect the time for more complex clearances. Therefore, we would still caution clients to expect an approval time of between 2 to 3 months for M&A transactions, particularly for those involving national security targets and/or 'foreign government investor' acquirers.

It is also worth noting that FIRB will be closed from the afternoon of Friday, 22 December 2023 and will re-open on Tuesday, 2 January 2024. During this shut down period, foreign investment proposals will not be processed. Applications submitted in December will not be processed until well into the new year.

Real estate

The Australian real estate sector continues to navigate choppy conditions.

The office sector is experiencing cautious investment sentiment, with a notable decrease in transaction volumes compared to the previous year. Landlords are offering substantial incentives to attract tenants amid persistently high demand for premium office spaces. However, there is a noticeable downturn in the market for lower-grade office spaces within the central business districts, where significant vacancies reflect the impact of a contracting economy.

In response to housing shortages in the major cities and the accompanying rise in demand for new residential projects, an 'adaptive re-use' strategy is gaining traction. This approach aims to transform vacant office spaces into residential units and revitalise central business districts. A significant number of these property owners are favouring the build-to-rent model, which is appealing to institutional investors due to its potential for long-term, stable revenue and government tax breaks.

The industrial and logistics sectors have maintained their strength post-pandemic, with rent growth continuing, albeit at a slower pace. This is consistent with a general retooling of the Australian economy towards the stability of supply chains. The uptake rate in this sector for the third quarter of 2023 has been consistent with the five-year average, driven by a rise in pre-lease transactions. The year is expected to conclude with a record-breaking amount of new floor space, addressing the strong, consistent demand.

In the retail sector, a rebound in consumer confidence could signal a revival in spending. Rents have held stable, with certain retail sectors experiencing modest increases, reflecting the sector's resilience amidst broader economic shifts.

The hotel sector is maintaining momentum as international travel begins to recover and the low Australian dollar fuels domestic travel. Capital transactions in the hotel sector are significantly up year on year, with further premium hotel offerings coming up for sale of development in the near future. There are a number of premium hotel assets coming to market in the next few months which will give the market a clear indication of values.

Construction

The construction industry continues to face challenges in the form of escalating costs and labour shortages, compounded by extreme weather and inflation. The sector's high insolvency rate is indicative of these ongoing struggles. However, demand remains robust against the backdrop of a persistent housing shortage.

Federal and State governments have indicated that public infrastructure spending will likely be reduced in the short to medium term. Following persistent budget blowouts on existing projects, governments are exploring options to cover the increasing costs of mid-build projects. This may result in a return to favour of the public-private partnership contracting models for projects in the pipeline allowing for more private sector investment in large infrastructure projects.

Cyber Security and Privacy

The Federal Government will imminently release its 2023-2030 Australian Cybersecurity Strategy, following extensive consultation earlier this year. This will include 6 "National Cyber Shields" to be implemented in 2 yearly increments.

A key component of the Cyber Security Strategy will be the introduction of a mandatory ransomware incident reporting scheme. This will require organisations to report any ransomware incident, demand or payment to the Government soon after being subject to an attack. Failure to comply with the scheme may result in civil penalties. The mandatory reporting scheme will operate on a "no fault" basis, the key objective of the scheme being to encourage reporting and sharing of threat information.

The Government maintains its view that the default position on ransom payments to cyber criminals should be "no pay". As yet there is no confirmation (or otherwise) of whether the Government will also look to introduce a new Cyber Security Act or amendments to the directors' duties provisions of the Corporations Act to specifically address cyber security risks.

Separately, the Australian Privacy Act (which applies to the private sector, overseas companies with an "Australian link", and Commonwealth Government agencies, with some exceptions) is also undergoing review. The Government recently responded to the Attorney-General's Privacy Act Review Report, which contains 116 proposed reforms to the Privacy Act. The majority of the proposals were "agreed-in-principle" and are subject to further consultation with industry, including with respect to the proposed removal of the small business and employee records exemptions. However, the report (and the Government's response) sets out a pathway for privacy law reform in Australia

The Government has committed to introducing a reform Bill in 2024. If implemented as proposed, the reforms would significantly impact data handling practices, and require organisations to up-lift their existing privacy programs. While we await the details of the Bill, the key message to regulated entities is that work needs to start now to ensure they are compliant with the current requirements of the Privacy Act.

Artificial Intelligence

Microsoft recently announced that it would spend A$5 billion on expanding its cloud computing and Artificial Intelligence (**AI**) capabilities in Australia over the next two years. This is Microsoft's single largest investment in its forty-year history in Australia and is only one part of the company's wide ranging efforts to meet the growing demand for cloud computing services, which are expected to increase from A$12.2 billion in 2022 to A$22.4 billion in 2026.

On the back of increasing investments in AI and the rapid emergence of AI-driven technologies, the Australian government has sharpened its focus on ensuring there is an appropriate regulatory framework in place to support the safe and responsible development and use of AI in Australia.

While there are various laws and regulations that apply to AI technologies, there is currently no AI-specific regulatory framework that addresses its associated risks and challenges, particularly where AI is used for automated decision-making that impacts individuals or where it relies on large data sets that often include or are trained on personal information.

The review of the Australian Privacy Act will also likely impact the use of AI technologies. As mentioned above, while the details of the reforms are not yet known, there will likely be increased transparency and accountability for organisations that use AI technologies to handle personal information, as well as enhanced enforcement powers for Australia's privacy regulator. These changes to the Privacy Act will be implemented as part of the Government's broader review of the regulation of AI and automated decision-making.

Battery Metal Investment

The battery metal space is a hot topic for investors amid the increasing demand for electrical vehicles globally. Australia is the world's largest producer of lithium (a key component in batteries for electric vehicles) and the largest concentration of lithium resources is in Western Australia. Lithium prices boomed throughout 2021 and 2022, with Australia producing over half of the world's lithium supply in 2022.

However, the price of lithium has dropped significantly in 2023, and has dragged the share price of lithium miners listed on the Australian Stock Exchange (ASX) down with it. The fall in the price of lithium is understood to be driven by a surge in lithium production coupled with weakened demand for electric vehicles in China and slower than expected growth rates in other key sectors, including the energy storage sector.

This has left the market in an interesting position and views about where the lithium industry is headed in 2024 are divergent. Established lithium miner Pilbara Minerals (ASX:PLS) is a good reflection of this position, as it is currently the most actively traded ASX stock on CommSec (a trading platform for retail investors) and the most shorted stock on the market by hedge funds. However, a giant superannuation fund in Australia recently disclosed it had become a substantial holder owning 5.1 per cent of Pilbara Minerals, which indicates there is optimism about the lithium industry's long-term prospects. We expect both project owners and investors will be keenly watching developments in this space in 2024.

Agribusiness

After three exceptional years of production and higher than average rainfall across significant parts of the country, the agricultural sector is starting to feel some headwinds as we move into an expected dry summer and the start of an El Nino weather cycle. As a result, the number of drought declared areas across the country is starting to tick upward.

Beef and lamb prices have dipped considerably from the historic highs that were being enjoyed by producers 18 months ago. The Federal Government is still moving ahead with its pre-election commitment to phase out live sheep exports, which will have a major impact on sheep production in Western Australia.

Over the last six months, the Australian grain sector has faced a dynamic and challenging environment. The country experienced a mixed harvest season, with some regions grappling with drought conditions while others enjoyed more favourable weather, leading to variations in crop yields. In addition, global supply chain disruptions and shipping constraints impacted the export of Australian grains. The sector also had to navigate trade tensions, especially with China, which affected grain exports to this significant market. Despite these challenges, Australian grain prices have remained relatively stable, supported by strong demand from domestic livestock and feed industries. The industry has been resilient, adapting to the changing conditions and exploring opportunities to diversify markets and reduce reliance on specific export destinations.

Also, the last commodity still affected by the 2020 trade imbroglio with the Chinese Government, namely live lobsters, is expected to resume trading as a result of the recent visit to China by Prime Minister Albanese.

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