GA-Courtenay Special Situations Fund

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From Non-Binding to Shining: The Pre-Deal Opportunity type

February 3rd, 2025

"There's something about the great opportunity – you know are going to make the acquisition about three minutes into the meeting, and then it is this sort of strange sense – ok we will still have to do due diligence now."

Peter Fenton, Benchmark Partners, abridged comments, 2022[1]

"Merger arbitrages – these are securities with a timetable. They arise from corporate activity – sell-outs, mergers, and reorganisations.

And we are not talking about rumours or 'inside information' pertaining to such developments, but to publicly announced, binding agreements."

Warren Buffett, writing in Buffett Partnership letter, 1964[2]

"When we become rule-driven we stop investing –

Exceptional means the exception to the rule."

Peter Fenton, Benchmark Partners, public comments[3]

"And I like understanding what works and what doesn't in human systems. To me, if you are capable of understanding the world, you have a moral obligation to become rational."

Charlie Munger, public comments, 2008[4]

"Logic, reason and common sense are your best tools for synthesising reality and understanding how to respond to it"

Ray Dalio, Principles: Life and Work, 2017[5]

Introduction

This white paper examines the *Pre-Deal Opportunity* – the non-binding precursor to merger arbitrage situations. And while merger arbitrageurs typically avoid non-binding deals due to their speculative nature and lack of legal enforceability, we argue that certain opportunities merit attention.

> *"Merger arbitrages – these are securities with a timetable. They arise from corporate activity – sell-outs, mergers, and reorganisations.*
>
> *And in this category we are not talking about rumours or 'inside information' pertaining to such developments, but to publicly announced, binding agreements."*

Warren Buffett, writing in Buffett Partnership letter, 1964[6]

> *"When we become rule-driven we stop investing – exceptional means the exception to the rule."*

Peter Fenton, Benchmark Partners, public comments[7]

Our premise is not to suggest that *pre-deal opportunities* should constitute a significant portion of merger arbitrage portfolios. Indeed, as Warren Buffett has observed, their speculative character generally makes them unsuitable for substantial allocation.

However, in our assessment there is, within the *pre-deal opportunity* set, every year a handful of a predictive form of situation. In this white paper we unpack the takeover process from pre-deal to binding deal, isolate the optimal form of *pre-deal opportunity* that can be identified for allocation, and as such present our blueprint to take advantage of this selected form of opportunity where market scepticism is co-incident with predictable outcomes.

The takeover process path: from non-binding to definitive merger agreement

The merger arbitrageur targets situations with *enforcement* characteristics. However, situations with comparable forecast accuracy in selected cases may also be offered by the *pre-deal opportunity*

The successful investor seeks opportunities that satisfy Kelly formula conditions, which optimise capital allocation based on either maximum forecast accuracy (*enforcement*) or maximum asymmetry (*indifference*). According to Kelly's framework, these two factors – accuracy and asymmetry – are interchangeable.

As per Figures 1 and 2, merger arbitrageurs traditionally pursue *enforcement* opportunities, where market outcomes are governed by binding or binding-like agreements with minimal potential for interference. The merger arbitrage archetype is a company under a binding takeover offer without antitrust opacity.

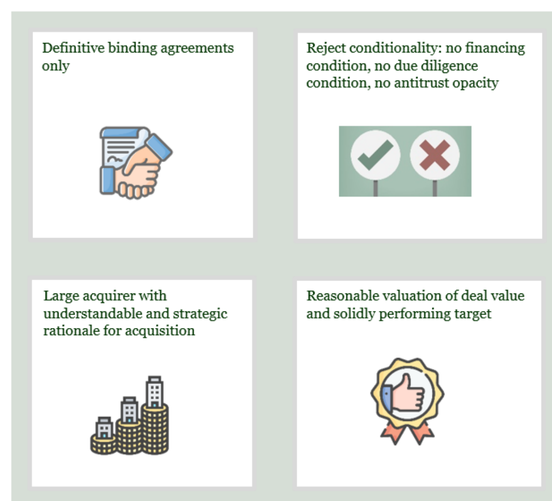
While *pre-deal opportunities* can theoretically exhibit *indifference* characteristics through deep undervaluation, such cases are rare. Instead, we argue that select pre-deal situations can more commonly be identified which exhibit characteristics with *enforcement* equivalence, though these characteristics also differ from the legal enforcement found in traditional merger arbitrage.

Figure 1: John Paulson's white paper, "The Risk in Risk Arbitrage" emphasises a focus on rules-based situations, exhibiting enforcement characteristics[8]

Table 1 Screening criteria

	Avoid	Focus	
Condition →	Agreements in principle	Definitive agreements	← Lack of condition
Condition →	Deals subject to financing	Strategic rationale	
Condition →	Deals subject to due diligence	Large acquirer	
	Targets with poor earnings trends	No financing condition	← Lack of condition
	Targets with negative earnings	No due diligence condition	← Lack of condition
	Deals in cyclical industries	Solidly performing target	
Condition →	Deals in highly regulated industries	Reasonable valuation	
		Limited regulatory risk	← Lack of condition

Figure 2: Comparable GA-Courtenay arbitrage principles: rules-based situations, exhibiting enforcement characteristics[9]



The path from non-binding to definitive merger agreement

Our analysis first reviews the pathway from the initiation of a takeover situation, to the point at which a definitive binding agreement is publically announced. The undertaking of this mapping, presented by Figure 3, is instructive as guiding thereon our isolating of the form of *pre-deal opportunity* where rational capital allocation can occur.

The process begins with situation initiation (orange box), typically involving either an investment stake build-up by the prospective acquirer or activist intervention advocating for a merger. The acquirer then makes a private, non-binding offer to the target company, which either rejects it outright or forms a Special Committee of independent directors to evaluate engagement.

During this phase, an inadvertent leak (L1) may occur as information is shared with third parties such as bankers and lawyers. However, at this stage, the situation lacks the *enforcement* characteristics we seek – outcomes remain uncertain, with insufficient public information available to determine a likely conclusion.

From this point, several paths may unfold. If the company rejects discussions, the process either ends or the acquirer may publicly announce its non-binding offer (P1) to pressure shareholders to advocate for due diligence access. Alternatively, the acquirer may intentionally leak its offer (L2). However, at either stage, outcomes remain uncertain with public information remaining insufficient.

For characteristics with *enforcement* equivalence to be present, the takeover process must first enter and then remain within the *green box* in Figure 3. This means the situation must be progressing from initial talks through successful due diligence to a binding agreement announcement. The process additionally must not exit the green box through either the acquirer withdrawing post-due diligence (F1) or the target rejecting the offer (F2).

As shown in the figure, upon entering the green box, the target company may issue a public statement (P2) confirming receipt of a non-binding offer and commencement of due diligence. This moment potentially presents our target *pre-deal opportunity*. Most takeovers proceed without such public disclosure until the final announcement. In these cases, our target *pre-deal opportunity* will not materialise. Yet when leaks have occurred, regulatory requirements (detailed in Figure 4) may compel the company to disclose material developments. This results in a public statement by the target company upon entering the *green box*, and creates our opportunity.

Figure 3: The pathway from the initiation of a takeover situation, to the point at which a definitive binding agreement is publically announced. The figure aims to represent that to deliver forecast accuracy, the path of the takeover must enter the *green box*, and furthermore, most not leave this box[10]

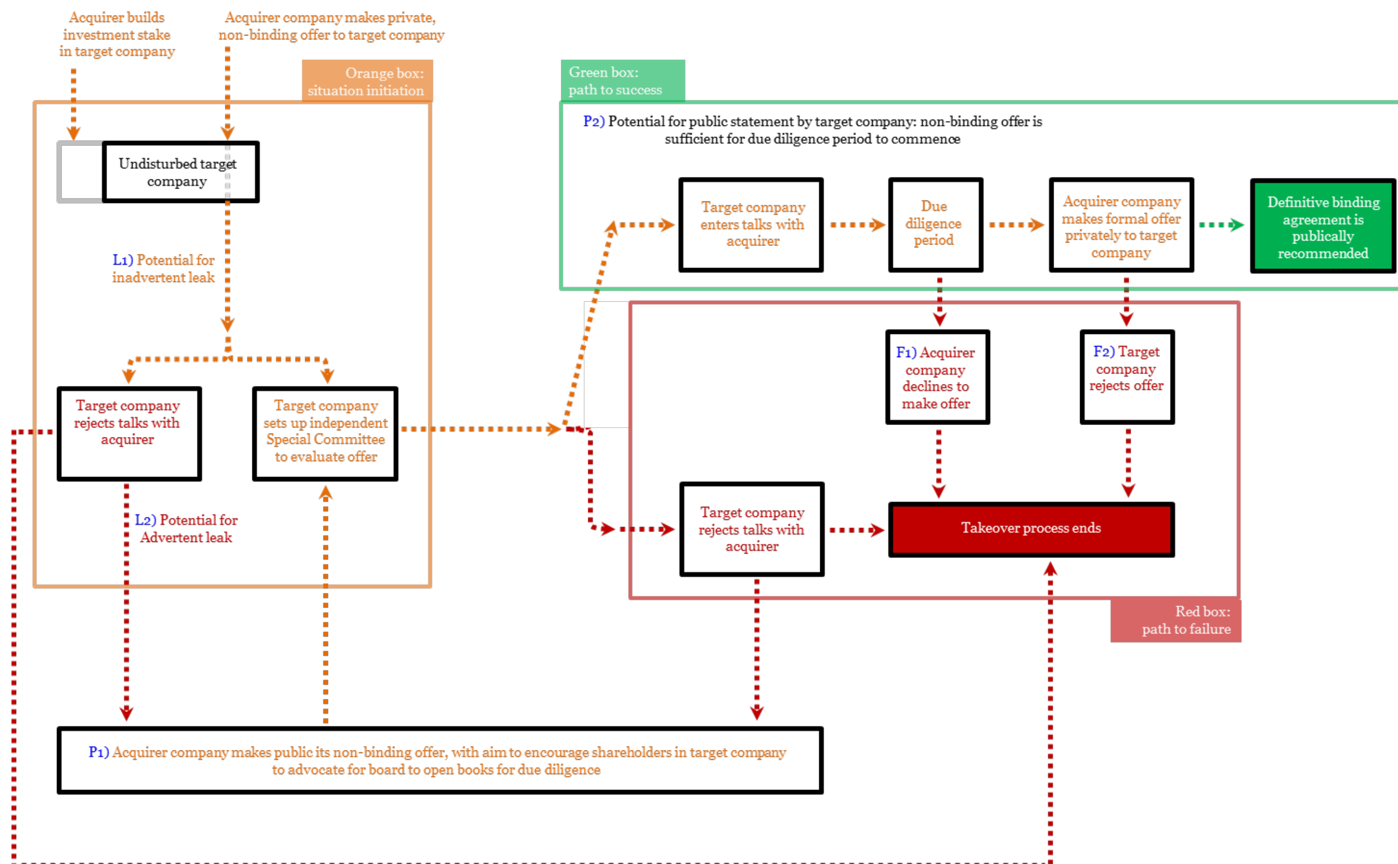
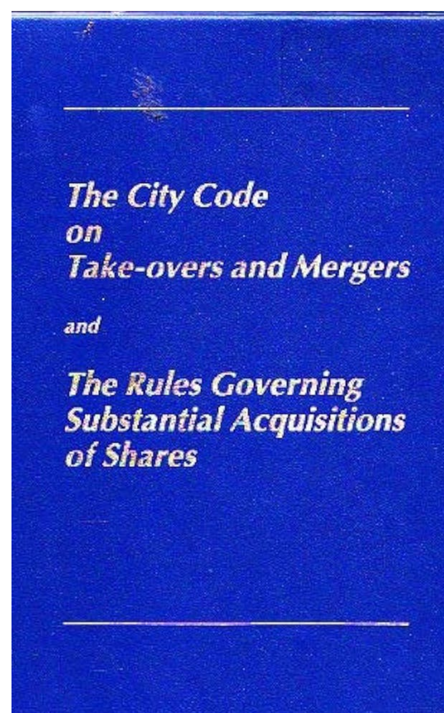


Figure 4: The UK Takeover Code is representative as to the regulations which force public, non-binding statements in situations where leaks have occurred, or where other criteria are met, and such statements can reveal to investors that our *green box* (Figure 3) has been entered[11]

"An announcement [by the target company] is required,

- *when a firm intention to make an offer is notified to the board of the offeree company by or on behalf of an offeror, irrespective of the attitude of the board to the offer*
- *when, following an approach by or on behalf of a potential offeror to the board of the offeree company, the offeree company is the subject of rumour and speculation or there is an untoward movement in its share price;*
- *when, after a potential offeror first actively considers an offer but before an approach has been made to the board of the offeree company, the offeree company is the subject of rumour and speculation or there is an untoward movement in its share price and there are reasonable grounds for concluding that it is the potential offeror's actions (whether through inadequate security or otherwise) which have led to the situation*
- *when negotiations or discussions relating to a possible offer are about to be extended to include more than a very restricted number of people (outside those who need to know in the parties concerned and their immediate advisers)."*

The UK Takeover Code, Rule 2.2



Our blueprint for identifying the pre-deal opportunity with optimal predictive characteristics

Figure 5 outlines our blueprint for identifying the pre-deal opportunity with optimal predictive characteristics that thereon enhances the probability of successful takeover completion (represented by the green box in Figure 3).

These criteria fall into three categories: first, the takeover proposal must be public, friendly, and with due diligence confirmed as commencing; second, there must be conditions that minimise the likelihood of acquirer withdrawal; and third, conditions must exist that reduce the probability of target company antagonism or rejection.

When all criteria are satisfied, the situation can approach the *enforcement* probability typically associated only with legally binding agreements, thus defining our target *pre-deal opportunity*.

Figure 5: When an announcement has been made and due diligence has begun – our blueprint for the pre-deal opportunity with optimal predictive characteristics to exist[12]

The deal price is public, takeover is friendly, due diligence has commenced

In the following sections, we examine the criteria underpinning our blueprint for optimal *pre-deal opportunities*. First, we explore why the deal price must be public, the proposal friendly, and due diligence underway.

The deal price is public, and the takeover proposal is friendly

The necessity of public disclosure on pricing, and a friendly proposal, stems from the practical realities of takeover success in modern financial markets. Our optimal *pre-deal opportunity* recognises that takeovers rarely succeed without board recommendation – the approach must be collaborative or 'friendly,' defined as the board indicating willingness to recommend a disclosed offer price.

This requirement reflects the corporate board of the target company possessing an outsized influence on outcomes. In today's markets, institutional shareholders and index funds typically follow board voting recommendations, making board support crucial.

The result is that successful takeovers must also address the corporate principal-agent problem inherent in the takeover process. The negotiations necessary to achieve target board recommendation may extend beyond standard non-disclosure agreements and include target company management incentives such as so called 'golden parachutes' and post-merger roles. Acquirers generally accept these terms, viewing them as minor costs that facilitate both the success of the takeover and the process of post-merger integration.

However, the scale of incentives required to secure management and board support may be underestimated by most public market participants. Success payments can be substantial – analogous to compensating a caretaker to allow an estate sale, and only by shareholder activism is an alternative path to assert owner rights achieved.

Figure 6: It is likely under-appreciated the level of 'carrot' that prospective acquirers may need to offer to the management and boards of a target company for the takeover to be welcomed[13]

"In our judgement a conflict exists within the takeover deal design itself. The board of directors of [target company] are recommending the offer by [acquirer company] to shareholders, yet at the same time, as part of the offer, a cash payment of 5.4% of the takeover market capitalisation, is being made to executives at [target company] including to selected directors sitting on the board, contingent upon completion of the takeover. Selected provisions of the Support Agreement, which [acquirer company] has voluntarily agreed to and which directs this payment, have no place in the deal design, in our view.

Any bonus payments to either management or board directors at [target company] should first be put to a separate shareholder vote (with the alternative option at the election of shareholders being the same payment amount is instead a dividend to shareholders, preceding the takeover), and with the vote on any takeover being separate from this."

Excerpt from GA-Courtenay activist letter in historic takeover situation exhibiting conflicts of interest, company names redacted[14]

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ASSESSING THE ACTIVIST OPPORTUNITY TYPE WITHIN MERGER ARBITRAGE

December 6th, 2024

"The typical stockholder is a most docile animal. They do what the board of directors tell them to do and rarely think of asserting their individual rights as owner of the business and employer of its paid officers.

The result is that the effective control of many, perhaps most, large corporations is exercised not by those who together own a majority of the stock but by a small group known as – 'the management'."

Ben Graham, Security Analysis, 1934[1]

"Ask yourself – why is somebody willing to pay $60 for Philips Petroleum, without corporate management, but only $35 with management? It is sort of simple – a corporation with management is worth half of its value without management."

Carl Icahn, speaking at a corporate law seminar in 1985[2]

"You see, a person who rises to the top of a big corporation and yet owns none of it is much more interested in control than they are in economics. Whereas the person that owns the business never has to fight for control, they are used to control. What they fight for is economics."

John Malone, quoted in Cable Cowboy by Mark Robichaux, 2005[3]

"When an active role is necessary to optimise the deployment of capital, you can be sure – we will not be standing in the wings."

Warren Buffett, writing in 1964[4]

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The board's leverage is further enhanced by their control over due diligence access. This detailed information is crucial for acquirers to secure favourable financing and plan effective post-merger integration and synergy capture.

Without due diligence access, in most cases takeover success will become impractical. Private equity firms require due diligence for optimal financing, while corporate acquirers require the detailed insights only possible from due diligence for integration planning. Thus, target board cooperation becomes essential for deal completion.

Figure 7: The control premium exists because 100% ownership offers unique benefits to the acquirer: the ability to value and capture inside information advantages gained through due diligence, access to cheaper and unmargined financing, full capture of synergies, and elimination of listing costs.

Since shareholders must vote on each deal despite their information disadvantage, the premium serves as compensation for their handicap in information resolution.[15]

Thus, the friendly requirement between target company and acquirer is absolutely necessary: acquirers need due diligence for detailed insights, while boards require incentives to grant access. The deal structure that results typically includes both target management financial incentives (negotiated to achieve target board support) and a control premium (necessary to successfully compensate target company shareholders, who remain enfranchised to vote on each deal despite their information resolution handicap relative to the acquirer).

A successful outcome results when the control premium is also agreeable from the perspective of the acquirer, its magnitude reflecting the unique benefits that the acquirer stands to achieve: access to inside information through due diligence, access to lower cost and unmargined financing commensurate with 100% ownership, complete synergy capture, and eliminated listing costs[16].

The due diligence process must have commenced and remain as the only pre-condition

The board's leverage in dictating outcomes in our assessment necessitates not just a friendly approach, but explicit public disclosure that due diligence has commenced. Press releases with softer language suggesting friendliness or price agreement, but lacking explicit confirmation of due diligence commencing, may indicate other negotiations that remain pending. Given the board's negotiation leverage, these talks could collapse if demands aren't met.

Our criteria also require that due diligence be the sole remaining condition for a binding agreement. If other conditions remain necessary, the situation falls outside prudent allocation parameters.

For instance, when antitrust risk exists, acquirers typically engage with regulators or foreign investment boards before formal offers. In such cases, even successful due diligence may not lead to completion if preliminary regulatory discussions prove unfavourable.

The pre-deal opportunity must also exhibit a low probability of acquirer withdrawal

The second criteria put forward by our blueprint in Figure 5 is that there is a low probability of acquirer withdrawal from the *green box*, in Figure 3, as a result of the information gained during the due diligence process, or for any other reason.

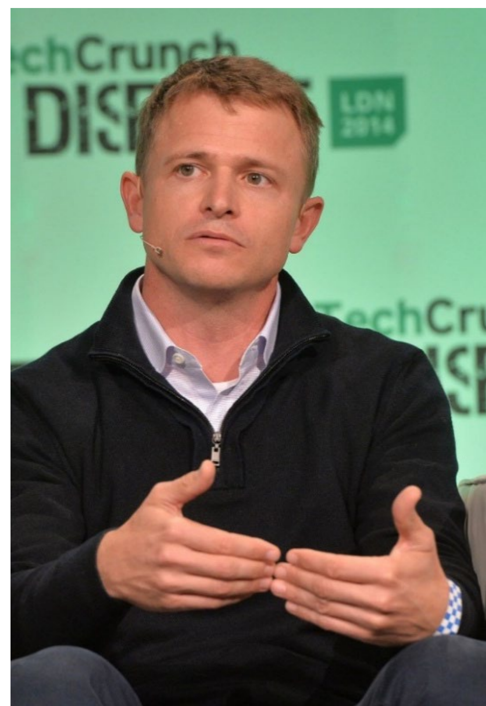
A low probability of acquirer withdrawal will be a consequence of the group of sub-conditions that this next section of the white paper reviews. The first is that the target business is highly attractive in its own right. The second is that the desirability of the target business from the perspective of the acquirer has low sensitivity to changes in economic conditions, and the third is that there is a low probability of antagonism emerging from the target company board, or its shareholders, with regard to the ongoing takeover process.

Figure 8: For an acquisition that the acquirer has already recognised is their exceptional opportunity, whilst due diligence will remain a necessary formality, it will not be the primary determinant of their commitment to continue to takeover completion

There's something about a great opportunity from the perspective of its investors, the slowing down of time, the expansion of awareness. I can spend unfortunately three years to four years and never feel that way.

But then I remember meeting Nicolas Julia [founder of Sorare], and it is not only rare but it is weird because you know you are going to invest about three minutes in to the meeting, so it's this is sort of strange sense of okay we have to do due diligence now and we have to ask good questions, but Nico expresses it in a way that's so pure you just sit there and think ah okay well that probably won't happen again for another five years so I should enjoy this moment."

Peter Fenton, Benchmark Partners, interview by Jeannette zu Fürstenberg, 2022[17]



The target business should be highly attractive in its own right

First, the target business must possess inherent, compelling attractiveness. This intrinsic appeal creates a 'halo effect' for the acquirer, ensuring their interest persists beyond due diligence specifics.

Our target pre-deal opportunity seeks situations where, as venture capitalist Peter Fenton describes in Figure 8, the acquirer recognises an exceptional asset and in particular from the perspective of its business position. In such cases, while due diligence remains a formal requirement, it should be judged as unlikely to derail the acquirer's commitment to completion, thus reducing typical due diligence risks.

In defining 'highly attractive,' we start with *Buffettian* criteria: the target should be a market-dominant, profitable company with high returns on equity, promising sustained returns for the acquirer[18]. These fundamental qualities should be compelling enough to significantly lower the probability of buyer's remorse risk.

Additionally, our criteria seeks businesses that are both easily understood pre-due diligence and reasonably valued based on net cashflow. A transparent business model reduces the risk of counter-case findings during due diligence, while rational pricing provides a margin of safety countering findings that change earnings forecasts.

The target business should have a low sensitivity to a deterioration in economic conditions

A second factor in reducing abandonment risk is the target business's resilience to external developments, particularly economic downturns.

This resilience requires several elements. First, the target should be a blue-chip business and market leader in a sector that maintains stability during economic turbulence. Since market conditions can deteriorate rapidly, even within the timeline of due diligence, the target business must be fundamentally sound enough to prevent meaningful changes in economics in such scenarios. A market leader in waste collection for example, whose services remain in steady demand regardless of economic conditions, would be an ideal pre-deal opportunity. Conversely, an investment banking business, highly susceptible to economic fluctuations, would not.

Second, the acquisition should be highly strategic and synergistic for the acquirer. In optimal cases, achievable synergies can double or more the target company's earnings. Such potential for enhanced earnings through strategic integration reduces the risk attached to scenarios of earnings deterioration and of subsequent buyer's remorse during the due diligence phase of a non-binding offer.

Third, abandonment risk decreases when the acquirer's business plan includes substantial post-acquisition capital investment to accelerate the target company's growth. This approach recognises that the target company possesses significant competitive advantages but lacks the capital to fully leverage them. An undemanding market valuation thus creates an opportunity for a new investor to accelerate the business plan, with new investment diminishing the importance of current or historical financial performance that the due diligence process greater reveals.

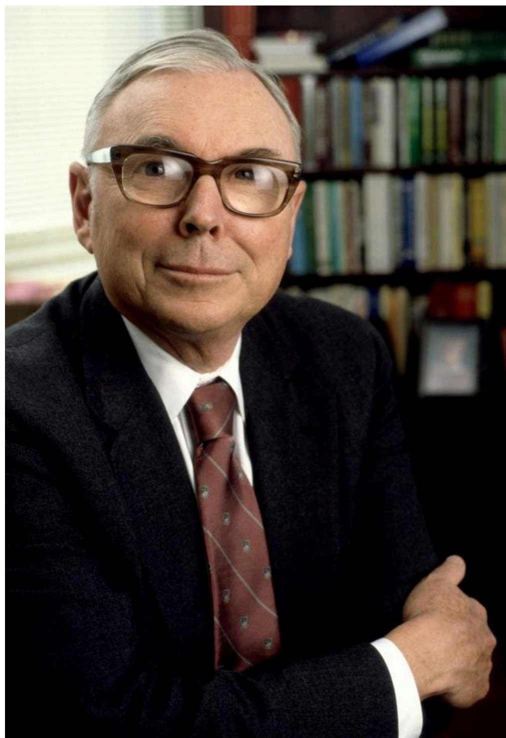
The acquirer characteristics and business position should be those likely to result in mindset rigidity

Abandonment risk is further reduced by a third factor: the likelihood of mindset rigidity in the acquirer. In our observation such rigidity typically emerges when acquirers exhibit corporate ossification, which tends to reduce their decisional flexibility.

Such ossification naturally occurs in mature, scaled industries over time. As corporations age and scale, their leaders face a fundamental conflict: while their fiduciary duty requires maximising workforce productivity and talent, their management are personally incentivised to protect their positions and lucrative compensation packages within these large-scale organisations.

This misalignment often leads to the systematic exclusion of emerging talent from senior positions, as these potential leaders might threaten existing management's tenure and as such resulting in corporate ossification.

Figure 9: Charlie Munger in his essay The Psychology of Human Misjudgement recognised that for corporations rejecting a flat hierarchical structure the result was a loss of dynamic decision making, and a rigidity in choices which are absent re-examination, which we refer to as corporate ossification



"Living in dominance hierarchies as he does, like all his ancestors before him, man was born mostly to follow leaders, with only a few people doing the leading. And so, human society is formally organised into dominance hierarchies, with their culture augmenting the natural follow-the-leader tendency of man.

So strong is the undue respect for authority that many CEOs have been allowed to remain in control of important business institutions for long periods after it was clear they should be removed.

This is combined with the brain of man conserving programming space by being reluctant to change, which is a form of inconsistency avoidance. And so, people tend to accumulate large mental holdings of fixed conclusions that are not often re-examined or changed, even though there is plenty of good evidence that they are wrong."

Charlie Munger, The Psychology of Human Misjudgement, 1995[19]

Decision-making rigidity in established, scaled industries is amplified when companies reject flat hierarchical structures, creating cultures that discourage subordinates from proposing unconventional solutions outside established frameworks.

Thomas Kuhn's 1962 '*The Structure of Scientific Revolutions*' illuminates this dynamic, demonstrating how scientific progress emerges through revolutionary advances led by individuals willing to challenge rigid paradigms[20]. Kuhn noted that when anomalies oppose existing paradigms, they trigger crises of confidence in established leadership among a small group, who then break away from hierarchical constraints to pursue truth more freely.

Understanding these hierarchical dynamics reveals that without leadership-level flexibility, innovative thinking at lower levels often remains unexpressed. In established, scaled industries, this leads to entrenched management positions and heightened rigidity in decision-making – precisely what we seek in the acquirer company for our target *pre-deal opportunity*, as it suggests initial appraisals by the acquirer are unlikely to shift even if other factors change during the due diligence process.

A low probability of rejection by the target company

The final criterion from our blueprint (Figure 5) is a low probability of target company rejection during the *'green box'* period (Figure 3), whether due to strategic considerations or shareholder influence. This requires two conditions: the strategic rationale must also be compelling from the target company's perspective, and the target's shareholders should actively support, and in the best case enforce, the acquisition's success.

There should be a strong strategic logic for the takeover from the perspective of the target company

The likelihood of reaching a definitive merger agreement increases when the target company recognises strong strategic benefits in the combination. This alignment often occurs when the target company acknowledges its standalone growth limitations and sees clear advantages in joining a larger organisation. The appeal is further enhanced when the acquirer has a strong reputation as an employer, combined with possessing existing scaled assets, making the combination more attractive from the perspective of the target's workforce.

Shareholders of the target company should be acting as an additional force toward takeover success

The second condition reducing target company rejection risk is when its shareholders act as a driving force toward takeover success. This occurs most prominently when a controlling shareholder or influential activist investor champions the sale. Such presence can not only resolve potential principal-agent conflicts between the target company's board and the prospective acquirer, but also additionally motivate the acquirer to complete the deal – as, with motivated shareholders still seeking a sale regardless, failure to complete by the current acquirer might result in the target being sold to a competitor.

Additionally, forecast accuracy relating to acquisition success increases when the prospective acquirer secures irrevocable commitments from key shareholders. These irrevocables serve dual purposes: they demonstrate the acquirer's heightened determination to complete the deal by pre-emptively securing shareholder approval, and they may further indicate the acquirer's concern about potential competing bids – both positive factors in defining our ideal *pre-deal opportunity*.

Our case study: the current non-binding takeover of Renewi Plc

To illustrate our framework, let us examine a current pre-deal opportunity that meets our blueprint's criteria: the proposed takeover of Renewi Plc, an $830m market capitalisation waste management company.

The Renewi deal price is public, the takeover proposal is friendly, and due diligence has commenced

The takeover process for Renewi commenced as early as October 2023 when the company revealed it had rejected two non-binding proposals from Macquarie Asset Management, the first at 775 pence per share and the second at 810p[21]. Following the rejections, Macquarie issued a statement that they no longer intended to make an offer for Renewi[22], and such a statement under Rule 2.8 of the UK Takeover Code prohibited Macquarie from making a new offer for Renewi in the following six month period[23].

However, Renewi also released its own statement rejecting the offers from Macquarie and this statement included the following wording: "*The Board conveyed to Macquarie that formal engagement was possible, but subject to price. However, the price level of the Revised Proposal did not provide a basis to provide Macquarie with access to due diligence.*"[24] The wording indicated clearly to Macquarie that Renewi remained open to a takeover proposal, yet only at pricing that the board deemed sufficiently valued the company.

One year later, in November 2024, the parties jointly announced preliminary agreement on a potential acquisition at 870p per share in cash[25]. The board indicated willingness to recommend this price to shareholders pending a binding offer and granted Macquarie access to confirmatory due diligence to finalise their offer.

Figure 10: The Renewi takeover situation meets all of our initial criteria: the deal price is public, the takeover proposal is friendly, and due diligence has commenced[26]

Australia's Macquarie offers to buy UK-listed waste management firm Renewi for £700m

Graeme Wearden

Thu 28 Nov 2024 11.38 GMT

Firms reach preliminary agreement on financial terms of deal that values Renewi at 870p a share

The asset manager Macquarie has launched a £700m offer to buy the waste management company Renewi in the latest takeover of a London-listed firm.

The two companies have reached a preliminary agreement on the financial terms of a deal that values Renewi at 870p a share, a 57% premium to its closing price of 554p on Wednesday night.

In a joint statement, they said the terms of the deal were final, and Renewi had agreed to provide Macquarie with access to its books so confirmatory due diligence could be conducted.

The agreement comes a year after Macquarie was thwarted in an attempt to take over Renewi, when an offer worth 810p a share was rejected.

Renewi, formerly known as Shanks Group until a 2017 rebrand, sold its UK municipal bin-collecting business to the rival Biffa earlier this year.

Renewi operates in Belgium, the Netherlands, France and Portugal. Photograph: Renewi

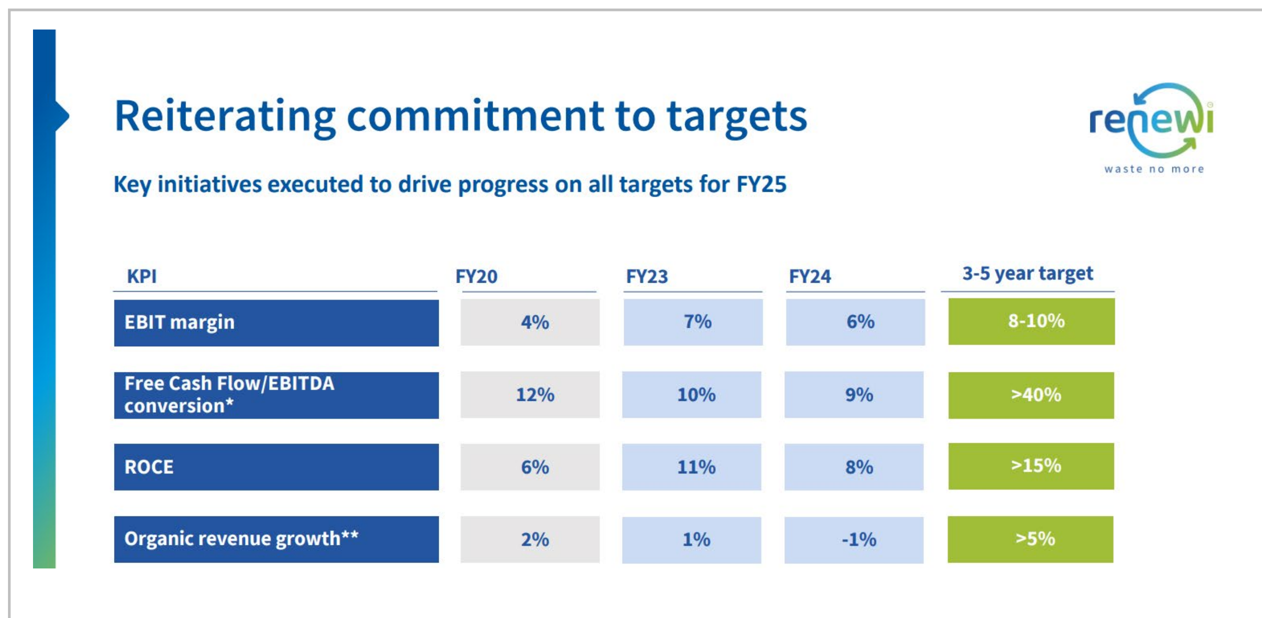
The Renewi takeover also matches our criteria consistent with a low probability of acquirer withdrawal

Renewi is a leading waste management company, operating 154 sites across Belgium, the Netherlands, France, and Portugal with over 6,000 employees. While currently generating mid-single digit EBIT margins and high single digit returns on capital employed, its business plan projects both metrics reaching double digits within 3-5 years[27]. The company's market dominance and strong profitability suggest sustainable high returns for its acquirer.

The business model of Renewi is straightforward, and Macquarie's non-binding proposal values Renewi at 5.7x consensus forward EBITDA[28]. With Renewi targeting an EBITDA-to-cash-flow conversion above 40%[29], this implies an attractive prospective cash flow yield of approximately 8%[30].

At 12x forward P/E[31], and given Renewi's additionally planned performance improvements illustrated in Figure 11, Macquarie's takeover price also represents, from the acquirer perspective, attractive value.

Figure 11: The business plan of Renewi targets significant improvement above current metrics which already imply the business is being acquired by Macquarie at a cashflow yield of 8% and a P/E ratio of 12x over the next 12 months[32]



KPI	FY20	FY23	FY24	3-5 year target
EBIT margin	4%	7%	6%	8-10%
Free Cash Flow/EBITDA conversion*	12%	10%	9%	>40%
ROCE	6%	11%	8%	>15%
Organic revenue growth**	2%	1%	-1%	>5%

Renewi's understandable business model and reasonable valuation, based on cash flow yield, also provide a margin of safety against any due diligence findings that might otherwise affect its attractiveness to the acquirer, in line with the requirements of our blueprint.

As a leading waste management company, Renewi's business also demonstrates inherent resilience to economic fluctuations, with demand for its services remaining relatively stable regardless of economics conditions.

The Renewi acquisition is also clearly strategic for Macquarie, offering integration potential with their existing waste management portfolio. As shown in Figure 12, since the early 2000s, Macquarie has viewed waste management as analogous to their infrastructure assets, investing over $2.4bn in the sector by August 2019[33].

Macquarie has recently accelerated this focus, acquiring DTG Recycle (Washington State's leading non-municipal recycler)[34], Suez Recycling and Recovery UK (€2.4bn)[35], and Coastal Waste & Recycling (a major Florida waste management operator)[36], all within 2022-2023.

> *"Macquarie Asset Management has invested in, managed and helped develop assets in the waste sector for more than 15 years. Today, through its managed funds, Macquarie Asset Management invests in companies that provide municipal solid waste, construction and demolition collection, transfer, treatment, recycling and disposal, as well as energy-from-waste (EfW), in Europe, the Americas and Asia-Pacific."*
>
> Joint statement by Macquarie and Renewi, November 2024[37]

The integration of Renewi into Macquarie's existing waste management portfolio offers clear synergistic potential, effectively reducing the acquirer's acquisition cost and lowering the risk of buyer's remorse during due diligence.

Figure 12: The acquisition of Renewi is clearly strategic from the perspective of Macquarie, with the potential to be merged with their existing, scaled assets in the waste management sector[38]

How Macquarie became one of waste's most influential companies

Macquarie Infrastructure and Real Assets has quickly become one of the biggest players in the North American waste sector through its investments in many of the industry's top companies.

ADAM REDLING

PUBLISHED AUGUST 27, 2019

Macquarie Infrastructure and Real Assets (MIRA), the New York-based division of Macquarie Asset Management, has been a leading infrastructure and real asset investment and management company for nearly a quarter-century. While MIRA started out investing in global infrastructure assets like toll roads, bridges, airports, and water and power utilities, the company made the strategic decision to turn its attention to the global waste sector in the early 2000s.

Today, MIRA-managed funds own companies that provide municipal solid waste (MSW) and construction and demolition (C&D) collection, transfer, treatment, recycling and disposal, as well as waste-to-energy (WTE), both in the U.S. and abroad.

To help identify, acquire and then manage waste infrastructure investments in this new segment, MIRA tabbed long-time industry veteran Paul Mitchener. Mitchener, who currently serves as senior vice president and managing director at MIRA, became a part of the company's U.S. operations in 2005 after 25 years working in Europe, Asia and the Americas for companies like Hong Kong-based Swire Pacific, Houston-based Browning–Ferris Industries, and Paris-based Suez Environment and its waste arm, SITA.

According to Mitchener, MIRA originally made the strategic decision to enter the waste sector because of its complementary nature to the industries the company was familiar with.

"In the early 2000s, MIRA identified that certain parts of the solid waste management business—particularly vertically integrated businesses with disposal assets, such as landfills and waste-to-energy facilities—have very similar characteristics to many of its other infrastructure businesses," Mitchener says. "The waste business provides an essential service to customers, with volumes that correlate to population and gross domestic product (GDP) growth. These disposal assets are often capital- intensive, with long-dated useful lives.

WCA, GFL Environmental and Wheelabrator are among the high-profile waste companies Macquarie has invested in in recent years.

"More specifically, we like the essential service characteristics of these businesses that generate stable performance and predictable cash flows," Mitchener adds. "We also like that these businesses are highly regulated and have significant ongoing capital requirements that create barriers to entry. The vertically integrated business model, from collection to disposal, can create lasting competitive advantages, which are attractive to an infrastructure investor. A high degree of fragmentation still exists in the waste industry, which continues to create opportunities for accretive growth and synergies via tuck-in acquisitions. More recently, the use of technology and the investment that goes along with it has increased sophistication in the industry, which, in turn, is resulting in increased efficiency. As a long-term investor, this is a particularly attractive opportunity for us."

The majority of MIRA's solid waste investments to date have been in North America through its Macquarie Infrastructure Partners (MIP) series of funds. Since 2007, this represents more than $2.4 billion of equity invested and encompasses some of the largest companies occupying the space.

Beyond its North American activity, MIRA has also invested in waste assets in China, Korea, the United Kingdom and Germany during this period, and Mitchener says the company is actively looking for additional investments in other parts of the world, including South America and Australia.

Sound strategies

Mitchener says MIRA's history of successful investments in the waste space have been predicated on proper due diligence during the analysis phase.

"There are two key items that we look for in an acquisition: First, we want to partner with good, honest and hardworking management teams and employees," Mitchener says. "This is critically important to ensure our investments are successful. Fortunately for us, we have been able to find those people in all of the businesses we have invested in to date, and I am very pleased to say that the people in Tunnel Hill and Wheelabrator are proving to be the same. Together with this, we look for high-quality assets [that] are environmentally and socially sound with strong underlying fundamentals in the regions or markets where these companies operate."

By focusing on investing in quality people, Mitchener says MIRA has been able to strike partnerships with businesses that foster successful and safe company cultures.

"Our people are our most important assets," Mitchener continues. "They are what really drive our businesses, and protecting their health and safety is absolutely key to us and is part of our MIRA culture. Safety is the first thing we look at when evaluating companies and the first thing we prioritize post-close. It is the first subject we discuss at any management or board meeting, and it is a key performance indicator (KPI) for all of our people, including the MIRA asset managers who provide oversight for the investment. Over time, our efforts have resulted in considerable improvement in the safety metrics of our portfolio companies and improved the quality of the lives of our people, which is something I am particularly proud of over my nearly 40-year career."

> "In the early 2000s, MIRA identified that certain parts of the solid waste management business have very similar characteristics to many of its other infrastructure businesses." –Paul Mitchener, senior vp and managing director, MIRA

"We leverage our years of experience and expertise developed from past waste investments to analyze new opportunities. We know what items to zero-in on and what questions to ask as we conduct our due diligence. We also leverage third-party advisors in engineering, IT, human resources, etc. to ensure that we have the full picture of the assets and companies we're investing in."

"We develop detailed transition plans for the companies we invest in to ensure that they adopt the best practices and pursue the key initiatives necessary to drive improved operational and financial performance," Mitchener says. "We also focus on opportunities to improve performance across other areas, such as health and safety and sustainability. After acquisition, we then actively partner with our management teams to build and grow these companies to ensure we're delivering the best outcomes for both our investors and the communities we operate in."

"MIRA's global platform allows us to incorporate best practices from overseas waste investments into our North American companies. For example, technology is advancing and service requirements are becoming more comprehensive in other countries, particularly in Europe. We believe investing in companies in these markets has, and will continue to, help us drive change for the better in our investments in North America," Mitchener says.

The joint statement also highlights Macquarie's commitment to provide 'long-term and flexible access to capital' to support Renewi's innovation-led growth. This approach acknowledges Renewi's competitive advantages while recognising that its current earnings growth has the potential for acceleration.

This investment-driven growth strategy means Macquarie's interest will be less dependent on Renewi's current performance, focusing instead on the potential unlocked by new capital provision.

As a well-established asset manager overseeing £474 billion[39], Macquarie also exemplifies the type of scaled, mature acquirer we seek. Their institutional structure likely exhibits elements of the decision-making rigidity characteristic of large organisations, reducing the probability of their acquisition thesis shifting during due diligence.

Finally, Renewi matches criteria consistent with a low probability of rejection by the target company

While Renewi's takeover has not been initiated by a controlling nor activist shareholder, Macquarie has secured irrevocable commitments from 15% of shareholders, including historically activist investors such as Avenue Capital Management (though not publicly activist in this case)[40].

These irrevocables suggest indicate Macquarie's determination to complete the deal by securing shareholder support, and their potential concern about competing bidders – a scenario that would also benefit shareholders. Significantly, the irrevocables are voided if competing proposals emerge, suggesting their signatory shareholders also recognise that Renewi's valuation might attract additional bidders now that a formal sale process is underway.

Conclusion

The white paper has reviewed the non-binding precursor to the merger arbitrage opportunity, a precursor which we refer to as the *Pre-Deal Opportunity*. Whilst most merger arbitrageurs typically eschew non-binding deals as a result of their generally higher speculative characteristics and lack of legal enforcement, our contention is that there is, within the *pre-deal opportunity* set, every year a handful of situations offering highly predictive characteristics.

The white paper has put forward and reviewed the criteria that raise the probability of the path to success, represented by the *green box* in Figure 3, being achieved. The criteria are presented as grouped into three categories. The first is that the takeover proposal is public, friendly (i.e. has been welcomed by the target company), and due diligence has commenced. The next two criteria exhibit restrictive properties with the aim of significantly lowering the probability of the takeover leaving the path to success. The first restrictive criteria is the existence of conditions that result in there being a low probability of the acquirer withdrawing, the second restrictive criteria is conditions that result in a low probability of antagonism or rejection from the perspective of the target company.

When these conditions align, they create a pathway to deal completion that, while not legally binding, becomes comparable in its predictive characteristics due to the institutional and behavioural forces at work. The outcome is close in equivalence to *enforcement*, and normally associated only with a legally binding construct. As such, our target form of *pre-deal opportunity* is defined.

This framework is presented as a tool for merger arbitrageurs to identify the small subset of non-binding deals that may be worth pursuing, while still avoiding most pre-deal situations which will remain speculative.

The case study of Renewi illustrates how these theoretical principles manifest in practice. While each situation will have unique characteristics, the fundamental criteria we have identified provides a blueprint that can be applied across markets to successfully identify our form of *pre-deal opportunity* where market scepticism is also co-incident with predictable outcomes.

> *"The intelligent investor is a realist who sells to optimists and buys from pessimists."*
>
> Ben Graham, writing in The Intelligent Investor, 1949[41]

Just as index investors who buy at any price misunderstand the fundamental principles underpinning the *indifference* or *enforcement* aspects driving successful investment outcomes, merger arbitrageurs who categorically avoid all pre-deal situations may also be missing opportunities where the risk-reward proposition is compelling.

The key is not to abandon prudence, but to develop frameworks that allow us to identify specific circumstances where the rigid application of conventional wisdom by others allows the successful isolation of individual opportunities at what may remain highly attractive pricing.

Footnotes

1. Peter Fenton, Benchmark Partners, interview by Jeannette zu Fürstenberg, 2022 [link]
2. Warren Buffett, writing in Buffett Partnership letter, 1964 [link]
3. Peter Fenton, Benchmark Partners, public comments, source: GA-Courtenay research archive
4. Charlie Munger, public comments, 2008 [link]
5. Ray Dalio, Principles: Life and Work, 2017 [link]
6. Warren Buffett, writing in Buffett Partnership letter, 1964 [link]
7. Peter Fenton, Benchmark Partners, public comments, source: GA-Courtenay research archive
8., 9. See, GA-Courtenay white paper, A Unified Framework for Capital Allocation [link]
10. Figure source: GA-Courtenay research
11. The UK Takeover Code [link]
12. Figure source: GA-Courtenay research
13. See, GA-Courtenay white paper, The Activist Opportunity Type within Merger Arbitrage [link]
14. Source: GA-Courtenay letter in situation exhibiting conflicts of interest, company names redacted
15., 16. See, GA-Courtenay white paper, The Activist Opportunity Type within Merger Arbitrage [link]
17. Peter Fenton, Benchmark Partners, interview by Jeannette zu Fürstenberg, 2022 [link]
18. See, GA-Courtenay white paper, How Far Away to Berkshire Hathaway [link]
19. The Psychology of Human Misjudgement - Charlie Munger, 1995 [link]
20. Thomas Kuhn's 1962 The Structure of Scientific Revolutions [link]
21. Renewi rejection statement of Macquarie offers, October 2023 [link]
22. Macquarie statement of intention not to make an offer for Renewi, October 2023 [link]
23. Rule 2.8 of the UK Takeover Code [link]
24. Renewi rejection statement of Macquarie offers, October 2023 [link]
25. Joint Statement Regarding a Final* Possible Cash Offer for Renewi by Macquarie, November 2024 [link]
26. Australia's Macquarie offers to buy UK-listed waste management firm Renewi for £700m, The Guardian [link]
27. See, Renewi investor presentation, June 2024 [link]
28. Source: Bloomberg and Capital IQ consensus estimates
29. See, Renewi investor presentation, June 2024 [link]
30. Source: GA-Courtenay research
31. Source: Bloomberg and Capital IQ consensus estimates
32. See, Renewi investor presentation, June 2024 [link]
33. How Macquarie became one of waste's most influential companies, August 2019 [link]
34. Macquarie Asset Management completes acquisition of DTG Recycle, December 2022 [link]
35. Veolia Announces an Agreement to Sell Suez's UK Waste Business to Macquarie for €2.4bn, August 2022 [link]
36. Macquarie Asset Management completes investment in Coastal Waste & Recycling, June 2023 [link]
37. Joint Statement Regarding a Final* Possible Cash Offer for Renewi by Macquarie, November 2024 [link]
38. How Macquarie became one of waste's most influential companies, August 2019 [link]
39. Joint Statement Regarding a Final* Possible Cash Offer for Renewi by Macquarie, November 2024 [link]
40. Ben Graham, The Intelligent Investor, 1949 [link]

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