

ANNUAL REVIEW

Mergers & acquisitions

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CANADA

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Q WHAT DO YOU CONSIDER TO BE THE MAJOR TRENDS SHAPING M&A ACTIVITY IN CANADA OVER THE LAST 12 MONTHS? WHAT FACTORS ARE DRIVING DEALS IN THE CURRENT MARKET?

YALDEN: Cash-rich corporate balance sheets, low financing costs and a strong US economy have contributed to vibrant Canadian M&A markets. These factors continue to drive activity at the top end of the market, as well as remarkable levels of mid-market activity. The last year also saw a surge in outbound M&A, as Canadian companies remained active internationally, particularly in the US, where Canada was the leading country with respect to the number of inbound deals. Blockbuster Canadian M&A activity was driven by acquisitions of non-Canadian targets across a range of sectors, notably financial services, energy and technology. Canadian pension funds also continued to be active in striking larger deals abroad, particularly for global utilities and infrastructure assets. Hostile bids remained part of the equation and 'deal activism', seeking to interfere with board supported M&A transactions, has also become an increasingly frequent transaction dynamic.

Q DO TRANSACTIONS SEEM TO BE CONCENTRATED IN PARTICULAR SECTORS, OR IS THIS ACTIVITY SPREAD ACROSS A RANGE OF INDUSTRIES?

YALDEN: Canadian M&A activity touches a wide range of sectors, but the most active sectors have remained largely the same. For the fifth year in a row, the most active sector by deal count was real estate. However, the energy sector was by far the most active sector by deal value, due in part to several mega deals that reveal an appetite for strategic expansion into the US, such as Enbridge's C\$61bn acquisition of Spectra Energy and Transcanada Pipeline's C\$18.2bn acquisition of Columbia Pipeline. Activity levels were also driven by a wave of consolidation in Canada's domestic energy market. Activity in the industrials sector declined in the final quarter of 2016 after an otherwise strong year, which featured several notable transactions, including the C\$24bn merger between agri-product heavyweights Agrium and Potash Corporation of Saskatchewan. Other sectors that saw meaningful M&A activity include the technology, mining and consumer discretionary sectors.



Q WHAT TRENDS ARE YOU SEEING IN TERMS OF VALUATIONS AND TRANSACTION MULTIPLES? IS THERE OFTEN A GAP IN PRICE EXPECTATIONS BETWEEN BUYERS AND SELLERS?

YALDEN: North American private equity acquirers are paying higher multiples for larger companies and those exhibiting above average profit margins. While there are no signs of an impending correction, it is unclear how long current multiples will be sustainable. Valuation multiples are in-line with long term averages for companies in the \$10m to \$25m range – at 5.7 times EBITDA. But average multiples of 9.0 times EBITDA for companies in the \$50m to \$250m range remain significantly higher than their longer term average of 7.8 times EBITDA. There are times when valuation gaps arise and these do affect deal activity. For example, valuation gaps help explain why mid-market M&A activity slumped in Canada in 2015. Valuation gaps were, in part, due to overheated expectations on the part of sellers, driven by widespread publicity surrounding lucrative M&A deals. Valuation gaps have also been an issue in highly speculative industries, such as the technology and life sciences industries.

Q HOW WOULD YOU DESCRIBE GENERAL LIQUIDITY LEVELS FOR M&A FINANCING? TO WHAT EXTENT IS DEBT AVAILABLE TO SUPPORT M&A ACTIVITY?

YALDEN: Canadian pension funds and the alternative lending arms of global private equity firms remained significant sources of capital in 2016 and early 2017. Importantly, Canadian pension funds have become Canada's most significant participants in global private equity investing, as well as in direct investing in infrastructure and real estate assets. Interestingly, as Canada's outbound M&A volume has grown, so too has the role of global investment banks providing financing to Canadian acquirers. In 2016, four of the top five M&A advisory firms in Canada were foreign investment banks. In general, Canadian credit markets continued to be relatively robust due to low interest rates, especially for investment grade debt issuers, with the result that acquisition financing is generally readily available. Moreover, Canadian public equity and debt capital markets remain reliable sources of financing for large M&A transactions.



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Q WHAT STEPS SHOULD A BUYER TAKE TO MINIMISE TRANSACTIONAL RISK IN A DEAL? IS THOROUGH DUE DILIGENCE AN INDISPENSABLE PART OF THE PROCESS?

YALDEN: One of the most effective ways for acquirers to minimise transactional risk is to be strategic about the internal team that they select to spearhead the transaction. External advisers benefit immensely from the perspective of those on the acquirer’s team with deep industry experience who understand the target company’s business well enough to ascertain the challenges that it faces. With the benefit of that perspective, external advisers are better able to identify and manage transactional risks, both by ensuring that diligence is well focused and by designing deal structures that address those risks. Indemnity packages, reps and warranties and escrow provisions are, of course, typical contractual tools used to manage risk. In recent years, however, parties to Canadian deals have started using rep and warranty insurance – notably where US private equity is bidding as part of an auction process – to give a vendor comfort that proceeds of sale will not be clawed back.

Q HOW IMPORTANT IS LOCAL MARKET KNOWLEDGE WHEN IT COMES TO CLOSING DEALS?

YALDEN: Obtaining advice from local legal experts is always important in order to ensure that one understands market practice with respect to deal terms. But it is absolutely crucial for transactions that trigger merger review. Canada has a pre-merger notification regime that requires the Competition Bureau to approve transactions that exceed prescribed thresholds. Canada also has a mandatory review process under the Investment Canada Act for certain large transactions that confer control over Canadian businesses to non-Canadians. It is therefore important for foreign acquirers to consider their strategies for dealing with different government bodies that will take an interest in the impact of a transaction on particular regions or industries in Canada. Understanding local market dynamics and political sensitivities can make all the difference to whether or not a deal ultimately closes, particularly where flagship domestic companies are being acquired by foreign interests.

Q WHAT IS YOUR ADVICE TO BUYERS ON PLANNING FOR POST-DEAL INTEGRATION? HOW IMPORTANT IS THIS PROCESS IN UNLOCKING FUTURE VALUE?

YALDEN: Designing and implementing an integration plan is fundamental to the success of any deal. Dealmakers must have a clear vision as to how the integration process will unfold. Appointing a team from the outset that is dedicated to managing the integration process can make an enormous difference and a leading practice in larger M&A deals is for boards to appoint a subcommittee that is dedicated to the task. Because integration presents challenges across the organisational spectrum – from capturing synergies to transitioning workforces to retaining customers and merging cultures – it is critical to involve functional experts within the combining companies. Aligning acquisition strategy and integration strategy undoubtedly complicates negotiations when parties are eager just to get the deal done, but it is essential for parties to consider integration challenges early on as they assess how best to allocate deal risk and what obligations each party will have to discharge in the run up to closing.

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