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Economic uncertainty threatens to stall M&A activity

Jeffrey Jones
Alexandra Posadzki

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Unpredictability on the trade and economic fronts threatens to temper Canadian merger and acquisition activity in 2019, as corporate buyers reassess the risks of making big deals.

The deal flow hit a record in the third quarter of 2018, and there is still keen interest in corporate purchases, with more than US$1-trillion in private capital seeking opportunities globally. However, some deal-making veterans question how much support public markets in Canada have for major transactions, in the form of putting up capital, after a year in which major stock indexes declined.

"M&A is driven by confidence and the greatest enemy of M&A is uncertainty," said Peter Buzzi, co-head of mergers and acquisitions at Royal Bank of Canada.

The S&P/TSX composite index fell 12 per cent in 2018 on a host of factors, including rising interest rates and concern over trade disputes between China and the United States, as well as tensions between Ottawa and Beijing. In addition, there has been a mass exodus from Canadian oil and gas shares due to weak prices and protracted regulatory and legal delays to pipeline projects. Meanwhile, U.S. economic data have recently shown cracks that indicate slower growth ahead.

"So I think people are starting to wonder if this is the beginning of the end of the long economic bull-market cycle we've been in," Mr. Buzzi said.

For much of 2018, Canadian markets dealt with uncertainty as talks toward a new North American trade deal dragged on amid warnings about potential negative effects on Canadian manufacturing and other sectors. There has also been no shortage of friction with China, after Ottawa quashed the $1.5-billion takeover of construction firm Aecon Group Inc. by China Communications Construction Co. Ltd., citing security concerns. In December, Canada's arrest of Meng Wanzhou, the chief financial officer of Huawei Technologies Co. Ltd., prompted tit-for-tat detentions of Canadians in China.

"We are a very trade and foreign investment-sensitive country and sometimes the political headwinds, trends, vicissitudes around us have an outsized impact on the M&A market," said Jake Bullen, a Toronto-based lawyer who specializes in deals and private equity at Cassels Brock & Blackwell LLP. "Even before the Huawei arrest, we were seeing a tail-off in

Chinese investment." He noted that some of that had to do with factors taking place in China, including currency controls.

Still, deal activity was brisk for much of last year. In the third quarter of 2018, Canadian deal-making hit a record 881 announced transactions, according to advisory firm Crosbie & Co. The overall value declined by $6-billion from the previous quarter to $68-billion, owing to a drop in the number of very large takeovers. In the first nine months of the year, the number of deals totalled 2,541, a 15-per-cent increase from the same period in 2017.

Some sizable transactions included Brookfield Asset Management's US$6.8-billion acquisition of Cleveland-based Forest City Realty Trust and Barrick Gold Corp.'s US$6-billion takeover of Randgold Resources Ltd. In the fourth quarter, Ensign Energy Services Inc. won a $470-million hostile takeover bid for Trinidad Drilling Ltd.

Domestic mid-market-size deals were hot in 2018, and that should play out next year, Mr. Bullen noted. Despite the political and trade risks, Canada is still seen as a stable place for such activity, especially privately-held targets. "I think we've still got a lot of companies performing very well in their sectors, from tech to advanced manufacturing to consumer products. And I think the exchange rate continues to entice U.S. buyers," he said. Energy and mining firms have been largely absent from raising capital in public markets over the past year due to depressed commodity prices and lagging valuations, but Roman Dubczak, head of global investment banking for CIBC World Markets Inc., said the bank remains committed to the sectors.

For example, CIBC advised NuVista Energy Ltd. on its $625-million acquisition of natural gas assets in northwestern Alberta from Cenovus Energy Inc. – a deal that took place under "really tough market conditions," Mr. Dubczak said.

"In the old days, that would have just been a phone call and a bought deal," he said. "Now, it required a bit of work. And the deal went well. Everyone was happy. But you really have to become an adviser to your clients and devote quite a bit of time and creativity to getting stuff done."

Companies with cash reserves, as well as private-equity buyers, will have good buying opportunities in 2019 as stock markets roil, said Geoff Barsky, head of M&A Canada & International at BMO Capital Markets. Another factor that may loom large is activist investors looking to boost value at lagging public companies, he said.