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M&A Activity on the Rebound

By Steven Lamb

Merger and acquisition activity strengthened in Canada over the third quarter, reinforcing the notion that financial markets have stabilized. It was the second consecutive quarterly increase in M&A activity, according to investment bank Crosbie & Company Inc.

There were 221 deals announced in Q3, according to the *Financial Post Crosbie: Mergers & Acquisitions in Canada* database, a 12% increase in volume over Q2. Total deal value was \$30.2 billion, up 27% from the prior quarter.

"As a result of strengthening conditions, we have we seen a return of many of the market participants that were sitting on the sidelines," said Colin Walker, managing director of Crosbie & Company Inc. "It is now apparent that many industry sectors and companies were well positioned to weather the downturn, providing good ingredients for transactions."

He goes on to suggest this level of activity may represent a "new normal" for Canada. While there has been a significant improvement from Q1, it is still a far cry from the 300 to 400 deals-per-quarter seen before the recession.

"Although many suppliers of capital to M&A transactions that emerged relatively recently have exited the market, we believe that the current activity level is stable and sustainable," Walker says.

The M&A market could see even more activity in the near future, according to a executive survey of by Ernst & Young.

"History has shown us that the period following a downturn often polarizes markets, as some companies struggle to keep up with those moving full-steam ahead," says Tony Ianni, leader of Ernst & Young's mergers and acquisitions practice.

"We expect Canada will be no exception, particularly with respect to oil and gas, and oilfield services in Alberta and Saskatchewan, as well as the core manufacturing belt in Ontario."

The recession created no shortage of distressed companies, but determining the value of a takeover target remains an obstacle to reaching a deal, say 65% of respondents. Insufficient financing, another result of the recession, was cited by 62%, while 60% cited investor caution.

Much of the recent Q3 activity has come from strategic buyers who have been taking out mid-market competitors. These accounted for 88% of deals, according to the Crosbie report.

There was also a return of the mega-deal, however, with nine transactions in excess of \$1 billion being announced. These totaled \$16.3 billion in value, compared to \$9.7 billion in the prior quarter, when only two mega-deals were announced.

The merger of Petrobank Energy and Resources' Canadian business unit with TriStar Oil & Gas to create PetroBakken Energy was easily the biggest deal, worth \$5.6 billion. The oil and gas sector saw the most activity, with 65 deals worth \$10.7 billion.

The industrial products sector saw 38 transactions, with a combined value of \$3.7 billion.

There were 90 cross-border deals made in Q3, representing 41% of all deals. Canadian firms were the acquirers more often than not, by a margin of 2.2 deals to 1. But many of these were smaller deals, and Canadian-led transactions accounted for only 45% of cross-border deal value.

Globally, the Ernst & Young survey found 63% of respondents saw their domestic markets as having the most attractive acquisition opportunities.

The ability to strike quickly could determine whether a company is an acquirer or a target, and many companies are shedding underperforming assets to ensure they are nimble enough to be a buyer.

Just over one-third of Canadian respondents (36%) reported being positioned to act quickly and exploit acquisition opportunities.

"Companies should conduct ongoing proactive screening of distressed targets and establish corporate governance tailored for accelerated acquisitions," Ianni says, pointing out there are alternatives to an outright purchase. "They should also look at joint venture, strategic alliance and alternative deal structures to more effectively manage scarce capital and increased risk."