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M&A Activity Breaks Record, but Slows in Q4

By: Bryan Borzykowski

Despite a slowdown in the fourth quarter, Canada's mergers and acquisitions activity broke records in 2007. Crosbie & Company reports that the M&A market saw \$370 billion worth of deals, up 44% from 2006's total of \$257 billion.

"The new record was posted on the back of some of the largest deals in Canadian M&A history," says Crosbie & Co. in its quarterly M&A report.

The biggest deals of the year were the \$51 billion acquisition of BCE and the \$40 billion deal for Alcan, but 2007 also saw 60 transactions worth more than \$1 billion, of which there were only 51 in 2006.

As good as these numbers are, the M&A market wasn't immune to the credit crisis that occurred in the last few months of the year. In Q4, 425 transactions, worth \$52.5 billion, were announced, which is the lowest level of M&A activity since the third quarter in 2005.

Ian Macdonell, Crosbie & Co.'s managing director, says while the overall activity levels are strong, "growing concerns about the economic outlook together with the ongoing credit crunch are certainly hurting the M&A market."

He adds that the main issue is "what happens to the economy in the first half of 2008 and whether the negative trend in M&A activity continues."

The credit crunch has hit the leveraged buyout sector especially hard. Buyouts by financial groups such as private equity and pension funds accounted for \$85 billion in the first half of 2007, but only \$10.7 billion in the second part of the year.

"We expect to see few large buyout transactions for at least the first half of 2008 as the market digests the backlog in buyout loans," says Macdonell. "However, we should continue to see financial groups play an active role in transactions below \$100 million, where leverage is less of a factor."

Sector-wise, financial services saw the most activity in Q4, led by TD Bank's \$8.5 billion acquisition of Commerce Bancorp and Royal Bank's \$2.2 billion purchase of RBTT Financial.

One aspect of the M&A market that is reporting positive results is cross-border activity. It accounted for 58% of deal value in the fourth quarter and 78% for all of 2007. Most of the cross-border activity involved trades with the U.S.

Since the 10 biggest transactions of the year dealt with international companies, cross-border dollar volume increased 43% to \$290 billion over 2006, while the number of deals jumped 6% to 778.

As for Q1 2008, Macdonell says it's likely we'll see similar activity to last year's fourth quarter, which is actually a surprise to him as he thought activity in the first month and a half of this year would be down.

"I was expecting that we might have seen a significant further decline relative to Q4, but we're not seeing that yet," he says. "The first quarter so far seems to be tracking towards a similar level activity to what we saw in the fourth quarter."

He says the year as a whole really depends on how well the economy does. "If the economy continues to deteriorate, we'll see a further slowdown; if things stabilize, the sector will recover and we could have a reasonably active year."

Before robust M&A activity can resume, though, companies need to get their own financial houses in order. Macdonell says businesses are waiting to see if there will be a downturn in performance due to economic conditions, so they're being cautious about moving forward on acquisitions.

However, market downturns are often good times to purchase companies, and, Macdonell says, we could see some bargain hunting from strategic buyers. He says the Microsoft bid for Yahoo in the U.S. is a promising sign that the M&A market is still alive and well.