

# THE GLOBE AND MAIL

AUGUST 29, 2007

## **An M&A Shopping Spree Before the Calm**

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GLOBE AND MAIL UPDATE

The value of mergers and takeovers in Canada soared to a record high in the second quarter of 2007, a frenzied period of multibillion-dollar deals that may well be remembered as the storm before the calm.

“This market may be looked back upon as the ultimate seller's market,” said Colin Walker, managing director of Crosbie & Co., a boutique investment bank that tracks corporate unions, willing or otherwise.

The value of mergers and acquisitions soared to a record \$202-billion in the second quarter, up from \$69-billion a year ago and well above the previous high of \$89-billion set in the third quarter of 2006, according to the Crosbie report. The second quarter would still be record even without two of the three largest domestic deals ever at BCE Inc. and Alcan Inc., which account for a combined \$88-billion of the total.

Alcan has since rejected Alcoa Inc.'s bid in favour of teaming up with Rio Tinto Ltd. for nearly \$40-billion, a deal that will be reflected in Crosbie's next quarterly numbers.

There were 520 deals announced in the April to June period, down from 536 a year ago but up from 516 in the previous three months.

Crosbie is sticking with its forecast that M&A activity will break new ground this year. Despite the current uncertainty facing markets, Crosbie says the stellar recent quarter will ensure that 2007 will still be a record.

“The subprime mortgage situation and disruption in credit markets will certainly have some impact on M&A, although the full extent remains to be seen,” Mr. Walker said.

Concerns about the meltdown in the U.S. subprime market and a global credit crunch have pummelled North American equities since July, signalling that the record-setting period of merger and acquisition activity is drawing to a close.

Mr. Walker says the economics of securing financing have shifted in recent weeks, particularly for large deals.

“There is a chance that some deals that looked good a few weeks ago may get withdrawn or renegotiated. The closing risk is higher with larger deals involving private equity sponsors – these are more vulnerable because they tend to use more leverage and their cost of money has gone up,” he said.

In the second quarter, before the market turmoil took hold, capital markets were friendly towards M&A deals, providing financing terms and capital at an attractive cost to buyers. This allowed private equity groups to aggressively target and price larger deals, which improved valuations for buyers.

There were 25 transactions valued at more than \$1-billion – or mega-deals – in the second quarter, accounting for 86 per cent of the overall quarterly value of transactions. By comparison, the value of all the mega-deals announced in 2006, a record year, was \$172-billion.

Mid-market transactions – those under \$500-million – were also strong, with 477 announcements.

The deals were spread among the industries, with transactions of more than \$5-billion reported in each of seven sectors. Communications and media was active with 27 deals worth \$83-billion, followed by industrial products with 100 deals worth \$53.8-billion, real estate with 84 deals worth \$31.2-billion and consumable fuels with 118 deals worth \$20.6-billion.

The income trust sector, once written off as dead, rebounded in the second quarter with 62 deals valued at \$12.2-billion, up from 32 deals in the first quarter and an average of 45 deals per quarter in 2006.

Of the 25 mega-deals unveiled in the second quarter, 18 involved an international player. On a year-to-date basis, 39 per cent of the activity and 83 per cent of deal values involved transactions between Canadian and international parties.

In terms of who is buying whom, Canadian companies announced 278 cross-border transactions worth \$27.8-billion while there were 129 foreign acquisitions of Canadian companies valued at \$155-billion. Nearly half of the foreign purchases in the second quarter were by U.S. buyers.

Financial sponsors played a significant role in the second quarter's M&A activity. Deals by financial groups during the second quarter include the acquisition of BCE Inc. by a consortium of buyers including Ontario Teachers' Pension Plan and its U.S. private equity backers Providence Equity Partners and Madison Dearborn Partners; the sale of Thomson Learning Assts to Apax Partners and OMERS Capital Partners; General Motors Corp.'s sale of its Allison Transmission commercial and military business to Carlyle Group and conglomerate Onex Corp.; and the purchase of UE Waterheater Income Fund by Alinda Capital Partners.

The Crosbie report maintains that changing credit realities have shifted the environment for heavily leveraged buy-out deals by financial groups.

“These changes are the result of losses in the U.S. sub-prime mortgage market which have impacted credit spreads and the liquidity of credit markets. It remains to be seen what the impact will be on M&A activity both in the U.S. and Canada.”