

MAY 25, 2006

M&A Pace Nearly Doubles

by Roma Luciw

The torrid pace of mergers and acquisitions that swept through Canada last year has carried on into 2006, with the year getting off to its most active start in more than a decade.

According to a report from Toronto-based investment banker Crosbie & Co., there were 424 transactions during the first quarter of 2006, compared with 264 in the same period last year. The value of the corporate unions reached \$25-billion in the quarter, compared to \$26-billion in the first quarter of 2005.

The fourth quarter of last year - which tends to be seasonally stronger than the first quarter - saw a record 463 deals worth \$61.9-billion, the report said.

Ed Giacomelli, Crosbie's managing director, said the "outstanding showing" in the first quarter suggests this could be another blockbuster year.

"Based on the start we have had to the year, our expectation is for another hot pace of activity," he said in an interview. "I think we could do as well as last year, if not better."

The Crosbie report noted that Canadian acquisitions of foreign companies outnumbered foreign purchases of Canadian corporations by a ratio of nearly 3 to 1, countering the perception that it is always Canadian companies that are being bought.

Mr. Giacomelli said that Canadian companies often make smaller purchases, which don't tend to make headlines and fall below people's radar screens.

"When deals are above \$1-billion, that catches everyone's attention," he said. "The reality is that there are a lot of Canadian companies out there fighting it out internationally but the transactions are of a size that you just don't realize what they are up to."

While in the second half of 2005 the M&A activity was focused on mega-deals valued at more than \$1-billion, this year's early action was concentrated in the mid-market, where deals range from \$1-million to \$500-million, the report said.

Mid-market activity accounted for \$12.5-billion or 50 per cent of all transactions, up from \$8.7-billion or 34 per cent a year ago.

Of the four mega-deals that did take place during the first quarter of this year, all of them featured a global player and three of them involved the purchase of a Canadian company by foreign one.

“Of the foreign takeovers, they are more likely to be large, established Canadian companies,” Mr. Giacomelli said. “They tend to be public companies, so it is played out on a much more visible arena.”

The single largest transaction reached in the first quarter of 2006 was outside of the resource sector, when Kingdom Hotel Investment and Colony Capital LLC agreed to buy Canada's Fairmont Hotels & Resorts Inc. in a deal valued at about \$4.5-billion.

The second-largest involved EnCana Corp., which sold its natural gas storage business to a pair of American private equity funds for \$1.5-billion (U.S.).

The red-hot pace mergers and acquisitions are indicative of a strong economy, liquid financial markets, and a still-favourable interest rate environment, Mr. Giacomelli said.

“There is no question that this is a good time to sell a business,” he said. “There is a better valuation opportunity with smaller private companies than with larger public companies,” he said, noting that in a situation, there is always the danger that an offer can be trumped with a higher one.

As expected, most of the Canadian merger and acquisition activity in the first quarter was focused in the resource sector, which has been riding the boom of skyrocketing commodity prices.

Companies with oil, gas, base and precious metals components accounted for 38 per cent of the transactions and 42 per cent of the dollar volume compared with 23 per cent of the transactions and 31 per cent of the dollar volume in the same period last year.

Mr. Giacomelli said he expects the resource sector will continue to lead the charge in this arena, with many showing a willingness to pursue aggressive merger and acquisition strategies.

There are a number of factors that could slow this year's buying and selling frenzy, including a continued fall in equity markets, a major drop in commodity prices, a sharp rise in interest rates, an economic recession, and a real estate crisis.

Something fairly “dramatic” would have to happen to derail the market in the near-term, Mr. Giacomelli said. “However, if we head into a six-month decline on the TSX, that is something that could dampen M&A activity.”