Canada’s merger deals continued to slide during the third quarter

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Deal making activity slowed further in Canada during the third quarter, continuing a downtrend trend driven by rising interest rates and volatile market conditions, though experts are counting on a rebound in 2023.

A total of 684 merger and acquisition transactions were announced between the start of July and the end of September, according to the latest Canadian M&A report from specialty investment bank Crosbie & Co. released Wednesday, representing the third straight quarterly decline. Transactions fell by one-third from the recent high achieved in the first quarter of 2021, when more than 1,000 deals were announced, although the latest decline in transactions was offset by several mega-deals worth more than $1-billion.

Aggregate deal value increased to $63-billion in the third quarter, up 16 per cent from the second quarter, largely as a result of 14 mega-deals announced during the latest period. Fully one-third of that total came from just two transactions: refining giant Phillps 66′s proposed takeover of pipeline operator DCP Midstream LP, which also involves Enbridge Inc., in a complex deal Crosbie & Co. valued at more than $13-billion; and Waterloo-based Open Text Corp.’s purchase of Micro Focus International PLC for $8.4-billion.

Fairfax Financial Holdings Ltd. also closed a $1.5-billion deal to privatize Recipe Unlimited Corp., parent company of restaurant chains such as Swiss Chalet, Harvey’s and The Keg, during the third quarter. Strip away those billion-dollar transactions, however, and lawyer John Clifford said a true slowdown in the Canadian M&A market is revealed.

“When it comes to Canadian M&A deal activity, from my perspective what happens in the middle market is what really matters and that is where there still is a continuing decline there,” said Mr. Clifford, M&A partner and chief operating officer at McMillan LLP. “When you lump in the big deals, on aggregate it is going to maybe smooth the impact, but it does mask the fact that in the heart of the Canadian M&A world, deal numbers and values are still going down.”

The Crosbie & Co. report found middle market transactions – those valued less than $250-million – totalled 251 during the third quarter. That size segment represented 12 per cent of the aggregate value of all deals announced during the quarter, the report found, and led the overall decline, falling 8 per cent from the second quarter.

Rising interest rates are the main domestic driver of the slowdown, Mr. Clifford said, as higher deal financing costs "will cause folks to pause a bit and be more careful in their assessments," though he also says it is important to remember 2021 was a "record-shattering year" for Canadian M&A.

"I'm not sure that anyone would have expected 2022 to be as strong as 2021," he said. "Frankly, most people were surprised at how robust 2021 was, but I think coming off a banner year when you have these headwinds in the marketplace, a decline is not surprising."

Domenic Marino, national deals leader for PwC Canada, said 2021 was "an anomaly year" and that global deal values and volumes for 2022 are trending above the average from 2014 through 2019.

Higher interest rates, while currently a headwind for M&A activity, could also lead to a rebound of deal making activity in 2023.

"Increasing interest rates are making it more expensive for companies with their debt servicing costs rising, so they are going to have to make tough choices," Mr. Marino said. "Our clients are saying they are going to double down on their core assets and look to potentially sell assets that are not as core to the business."

While McMillan's Mr. Clifford said he "would not be surprised" to see further declines in the fourth quarter, "the reality is people are always talking about there being lots of dry powder out there that is still available."