THE GLOBE AND MAIL

Mergers and Acquisitions Activity has Exploded. Here's Why – and the Reasons it will Continue for the Foreseeable Future

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Many Canadians are in lockdown. Canadian companies, however, are on the road in the pandemic, launching takeovers at a record-setting clip and creating a deal-making boom that's seeing domestic firms emerge as international players.

There has never been more mergers and acquisition activity - or more megadeals worth more than $1-billion - and the M&A rapid pace is expected to continue for the foreseeable future. As CEOs, bankers and lawyers prep for the next big deal, there's also surging interest in one of Bay Street's favourite games - spotting the next takeover target. Hedge funds and analysts are working flat out, and taking stakes in companies that could see their shares soar if a buyout comes their way.

The M&A surge began late last year, as corporate leaders realized ramping up vaccination programs for COVID-19 would translate into strong economic growth. Toronto-based insurer Intact Financial Corp. [IFC-T +1.81% increase], along with a Danish partner, were among the first to move, striking a $12.4-billion friendly takeover for British rival RSA Insurance Group PLC. "Market sentiment changed last fall," said John Emanoilidis, co-head of the M&A group at law firm Torys LLP. "The level of confidence surged among CEOs and boards, and that always bodes well for transformative deals."

This year, M&A activity exploded. Globally, companies launched U.S.$1.3-trillion of takeovers in the first three months of 2021. "This [is] the strongest opening period for deal making since records began," said Matt Toole, director of data service Refinitiv. Two of the five largest takeovers, worldwide, were launched by domestic companies. Canadian Pacific Railway Ltd. [CP-T +0.66% increase] bid for an American railroad at an enterprise value of US$28.7-billion and Rogers Communications Inc. [RCI-B-T +1.64% increase] made its offer for Shaw Communications Inc. [SJR-B-T +1.59% increase] at an enterprise value of $26-billion. "Many of the deals you're seeing now reflect CEOs and boards revisiting plans that were already in the works, prior to the pandemic," Mr. Emanoilidis said.

The takeover frenzy is fuelled by low interest rates, banks' willingness to lend and soaring stock market valuations. There's also confidence in the boardrooms of buyers, and realism among leaders of smaller companies that are typically takeover targets. "Potential sellers realize that valuations are pretty lofty, and M&A is cyclical, so if a board is considering selling in the next five years, they are open to offers now," said investment banker Ian Macdonell at Crosbie & Co. "Boards realize the competitive landscape is changing and it's harder to be a regional player, in North America or globally, so if they can't be consolidators, they are sellers."

The M&A party is expected to last until banks or investors take away the punch bowl. "Takeover activity will continue until the credit market tightens, the economic outlook weakens or we get a significant stock market correction," Mr. Macdonell said. For hedge funds that play takeovers, and the investment banking analysts who cater to this crowd, the question is: Who's the next target? A great deal of data-crunching, along with a dose of common sense, is generating lists of potential buyers and sellers in every sector.

For example, after Brookfield Infrastructure Partners [BIP-N +2.08% increase] made a $7.1-billion hostile bid for Inter Pipeline Ltd. [IPL-T +0.67% increase] in February, analysts at RBC Capital Markets combed the energy infrastructure sector, looking for CEOs who have signalled they are open to offers. In a report last month, analyst Robert Kwan pointed out management at AltaGas Corp., a utility with a $5.9-billion market capitalization, "is open to splitting up the company in the medium-term as a means to unlock shareholder value." Mr. Kwan also said Gibson Energy Inc., a $3.2-billion infrastructure play, is home to "a management team and board that are focused on shareholder value creation, which could include selling the business."

In gold mining, an industry widely perceived as ripe for consolidation, analysts at Scotia Capital published a report last week that contrasted the projections given by companies on key metrics, such as gold production and costs, against what the miners actually achieved. After sifting through a decade of data, Scotia found companies that consistently did what their CEOs said they would do - Barrick Gold Corp. [ABX-T +2.57% increase] and Endeavour Mining Corp. [EDV-T +5.13% increase] - enjoy premium stock market valuations. Companies that missed their stated goals - Yamana Gold Inc. [YRI-T +3.66% increase], Iamgold Corp. [IMG-T +5.35% increase] and Peru-focused Compania de Minas Buenaventura S.A.A. - trade at lower multiples, which makes them potential targets.

The forest products industry, flush with cash owing to rising lumber prices, is expected to consolidate around its largest domestic players. At the top of the food chain are companies such as Canfor Corp. [CFP-T +4.11% increase], where the management team on conference calls talks up their ability to borrow $1-billion or more. Likely targets, according to analyst Paul Quinn at RBC Capital Markets, include regional rival Interfor Corp. [IFP-T +3.07% increase] or pulp producer Mercer International Inc.

Another round of deals is also expected in the oil sands, as companies such as Suncor Energy Inc. [SU-

T +2.85% increase] and Canadian Natural Resources Ltd. [CNQ-N +2.30% increase] continue to buy out their partners on Alberta projects. In a recent report, Scotia Capital analyst Jason Bouvier predicted Suncor will spend up to $2.5-billion over the next two years to acquire minority stakes in the Fort Hills project owned by Teck Resources Ltd. [TECK-B-T +1.95% increase] and France's Total SA. Vancouver-based Teck has signalled it is open to selling Fort Hills, which analysts say would boost the mining company's valuation by making it more of a play on copper, at a time when the outlook for the commodity is bullish.

Hedge funds that invest in takeovers - an approach known as event-driven strategies - are the top performers in the industry so far this year, up 7 per cent in 2021 compared with an overall average return of 5.5 per cent, and up 25 per cent over the past 12 months, according to data service Preqin. With no end in sight to the takeover boom, fund managers are betting on the next round of big deals.