Shedding Light on the PE field

STUDIES INTO 'HOT MARKET' OUTLINE DEALS

BY PAUL MCLAUGHLIN

DIGGING INTO THE DATA from studies into the "very hot" Private Equity market in Canada, some interesting nuggets emerge — US financial buyers closed 79 deals in Canada in 2017, a new record, with large-market transactions perhaps playing a bigger role over the past few years than expected.

Blake, Cassels & Graydon LLP's inaugural *Canadian Private Equity Deal Study* — an internal examination of some 150 PE deals the firm had signed from 2014 through 2017 — found that more than 20% had a purchase price of $500 million or more, according to Kurt Sarno, co-leader of Blakes' Private Equity group, who authored the study with senior associate Rory ffrench. Eight per cent of its M&A transactions involved deals valued at more than $1 billion.

And a Bennett Jones LLP commissioned market analysis being conducted by Acuris has found that deal flow in Canada was not just fueled by domestic players but especially by "an influx of US financial buyers seeking reasonably priced targets amid heated competition globally. The 79 inbound deals to Canada counted by Acuris in 2017 set a new record."

The interest in gathering intelligence on the Private Equity market in Canada is perhaps a result of it being "very hot," says Matt Tevlin, chair of the business law group at the mid-size firm Torkin Manes LLP. "There's a lot of pent-up demand. A lot of PE funds have raised a lot of money and there's considerable dry powder still out there."

Samantha Horn, a partner in the Mergers & Acquisitions and Private Equity Groups at Stikeman Elliott LLP, concurs. "There are a lot of transactions in Canada," she says.

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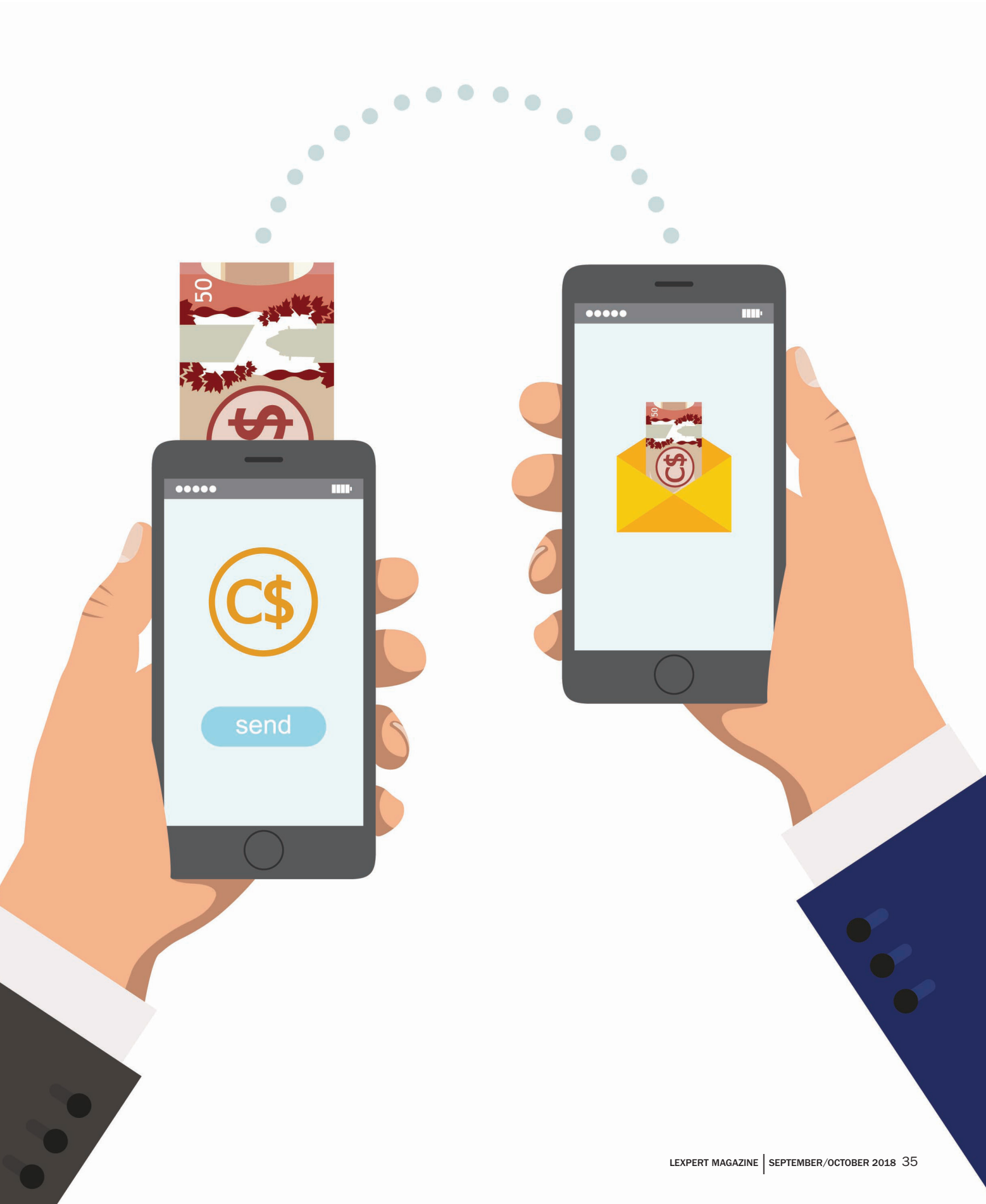
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"The M&A market is very busy and robust. The last time I looked at it we tend to do more transactions than any other firm [but many] are mid-market, which my practice is focused on."

The majority (48%) of the transactions analyzed by Blakes had values totaling less than $100 million. The next largest group, those with values of $100 million to $500 million, accounted for 31% of the deals.

The number of large transactions was more than expected.

"Canada is a middle-market country, so if we start talking about Private Equity deals over $500 million, there just aren't that many of them," says John Mercury, who leads the Private Equity practice group out of the Calgary office of Bennett Jones LLP. "Only a couple a year [are more than] a few billion."

Blakes began work on the study in early 2016, involving "dozens of lawyers across the firm," says Sarno. The resulting 50-page document outlines data exclusively sourced from transactions in which Blakes was involved as lead or Canadian counsel.

Sarno says Blakes initiated its study "because we noticed there was an absence of market data in this area." He agrees that Blakes' numbers likely reflect his firm's experiences and are not applicable across the board. He cites what he says is the only comparable study — the American Bar Association's *Canadian Private Target M&A Deal Points Study* (it had deals under $100 million at 63%) — that was released in late December 2016 and was based on transactions signed in 2014 and 2015.

At Stikeman Elliott, Horn has seen US interest in doing Private Equity deals in Canada become "bigger and bigger over the years." One reason, she says, is that, "Private Equity tends to like doing deals in what I would call their own backyard," and Canada, to many of them, falls into that category. She also has heard some US buyers mention that "the market in Canada tends to be less competitive than the US marketplace. The ideal transaction for any PE player is to find a deal that isn't a competitive auction for probably obvious reasons: better price and negotiations. When you have a competitive process, you're probably going to pay more and perhaps not get all the terms you'd like."

MATT TEVLIN
TORKIN MANES LLP

"A lot of founders are now in their late 60s or early 70s ... They're probably saying, 'Well, I've got five or 10 years left so it probably makes sense to cash out my chips now.' "

Mercury agrees that Canada's proximity to the US is a big factor in driving PE money northward. "Going from New York to Toronto or Montréal is not a very difficult exercise," he says, adding that he spent a decade in New York, mostly as an investment banker.

"We're basically another state to [the Americans]. Nor can you underestimate the human relationships here. There are lots of Canadians working in New York or LA working on these funds. That has only grown in the last 10 or 15 years, where you have even more Canadians migrate to the US and when coming back here, those bonds are even tighter."

He adds that the US Funds have "dollars under management that dwarf anything else going on around the world." With all that "dry powder," the funds are under "intense pressure to deploy capital in a manner that results in attractive valuations."

Blakes found that the largest number of its transactions, by a wide margin, involved founders selling to Private Equity (47%), followed by strategic to Private Equity (26%) and Private Equity to strategic (16%). The first statistic did not surprise Tevlin. "Founders to Private Equity? No doubt. That's certainly what I'm seeing both on the buy and sell side."

Many of the founders are baby boomers, he says. "I think the demographics are right. A lot of founders are now in their late 60s or early 70s, a time when [many] are prepared to enter transactions. They're probably saying 'Well I've got five or 10 years left so it probably makes sense to cash out my chips now.' "

Horn has a similar sense as to why so many founders are selling. "I'm just postulating here," she notes, "but we hear a lot about the fact that there are these entrepreneurs selling out of, I can't remember how many trillions of dollars of value, that we expect to change hands in the next, say, 10 or 15 years, as the baby boomers, many of whom are business owners, decide it's time to do their succession planning."

Although Pascale Dionne, a partner in the Montréal office of Borden Ladner Gervais LLP, sees deals involving founders to Private Equity, she says it's not as prevalent in Québec. "There are a lot of inbound transactions here. There are many specialized funds in Québec, so a lot of pension funds or consortiums between certain financial institutions [occur]."

The majority of deals conducted by Blakes involved industrial goods and services (25%), followed by technology and media (17%) and life sciences (12%). Those rankings did not catch Sarno off guard. "It's a large, broad categorization," he says, "but it goes to what has been a focus of Private Equity investors, at least in Ontario, for a long time. Technology and life sciences — those two sectors have garnered a lot of attention in the recent past."

Tevlin agrees that, "industrials are big. A lot of my clients are bricks-and-mortar type companies. And definitely technology. But life sciences? That's a hit or miss kind of thing. Some make it big and others fizzle out."

In Québec, says Dionne, "the market is ramping up, especially in the technology

ANALYSTS' FOUR INDUSTRIES TO WATCH IN 2019*

Consumer goods: **24%**
Industrials and chemicals: **22%**
Technology: **14%**
Oil & Gas: **14%**

*Acuris analysis for Bennett Jones

PRIVATE EQUITY DEALS, IN VALUE*

$100 million or less: **48%**
$100 million to $500 million: **31%**
$500 million plus: **20%**

*Blakes Canadian Private Equity Deal Study

TRANSACTION TYPES*

Founders selling to PE: **47%**
Strategic to PE: **26%**
PE to strategic: **16%**

*Blakes Canadian Private Equity Deal Study

sector." She attributes that to Montreal's growing reputation as "one of the capitals for AI, so that's why we see a lot of investment and activities in that sector."

That reputation helped lure Facebook to open a research lab in Montreal in September 2017, becoming another of numerous technology companies setting up in that city. As Eric Lalanne, president of De Grandpré Chait LLP, put it, AI in Montreal feels like a "gold rush."

Of particular note in the Blakes study was that only 8% of its transactions took place in the Oil & Gas sector. "In the recent past, we would have categorized the public market as being very energy Oil & Gas focused," says Sarno. "What Private Equity is focused on versus what our public markets represent is interesting."

The Acuris study commissioned by Bennett Jones found that 14% of its respondents named Oil & Gas as one of the four key industries they would prioritize in the coming 12 months. Consumer goods (24%), industrials and chemicals (22%) and technology (14%) were the other three. "These responses should come as little surprise, given that these four sectors have had the greatest reported deal value in Canada from Private Equity buyouts and buy & build transactions over the last five years," the study concluded.

Concerning Oil & Gas, it noted: "The sector is emerging from an undeniably tough period. Foreign direct investment in Canadian Oil & Gas fell 12.2% in 2017 — the steepest drop in nearly two decades. In addition to the global slump in oil prices that struck in 2014, Canada is dealing with a deficit of pipeline capacity that forces producers to seek other, more expensive means of transport. But with oil prices up, some respondents believe this is the moment to seek opportunities ..."

JOHN MERCURY
BENNETT JONES LLP

"My main message is that Canada will remain an attractive jurisdiction for US capital regardless of what happens with NAFTA and US Tax reform and all that."

Transactions in the Oil & Gas sector do still take place, says Mercury, and when they do, they tend to be big. He points, as an example, to the announcement in early July that Enbridge Inc. sold its Canadian natural gas gathering and processing business to a group led by Brookfield Asset Management Inc. for $4.31 billion.

While the low numbers for Oil & Gas deals were unexpected, Blakes was not surprised that its study revealed growing popularity of representation and warranty insurance.

"This is obviously a very hot topic now," says Sarno, whose study devotes three pages to data collected from "rep and warranty brokers and carriers, who provided it and referenced their contributions. We've seen rep and warranty insurance used more and more in the last 12 to 18 months and now it is becoming almost a staple," especially when there's an auction.

Michael Caruso, a partner in the Toronto office of Norton Rose Fulbright Canada LLP, whose expertise includes M&A insurance, says he has definitely seen a dramatic rise in the use of R&W insurance.

"Our involvement goes back four or five years when there were few insurers and the product was really in its infancy," he says. "Since that time, and particularly in the last 18 to 24 months, [its] use has escalated significantly. We've seen 200%, 300% an-

nual increases in respect to mandates over 2016 and fiscal year 2017 and I would expect we will see those percentages in 2018 and in the next number of years. The Canadian market could be looking at 100 to 150 overall annual deals this year."

He characterized those increases as "staggering," but added that the sudden, extensive growth in its popularity in Canada is not mirrored in the US, where the product has been available and utilized for a much longer period.

Caruso says having representation and warranty insurance can often speed up the conclusion of a transaction, "which is extremely important these days. We see it increasingly as a requirement by a seller in a seller auction, for example, and is connected to exits. In competing bids, buyers tend to see this as a way to distinguish their bid from the others."

Sellers also find the insurance attractive because it helps to close the door on a deal once it has been concluded. "A fund has a lifetime of say 10 years," notes Tevlin. "Let's say in Year Nine they're selling for $100 million and they distribute the funds to the limited partners. Once they've done that, they don't ever want to call the money back because, say, they just got a $20 million claim against them. Once all the funds are dispersed, they want to wind up the fund and be done with it."

Initially quite expensive, the insurance, which can indemnify transactions, typically in the range of 10% to 25% of the purchase price, is more affordable than when it was first offered in Canada.

The reason the cost has lowered, says Mercury, "is that the market has now matured. Whenever you develop a new insurance product, history shows that you need time to for the provider of the product to have enough data to properly appraise the risk."

While the accumulation of data about the PE market in Canada is obviously beneficial, it can't be examined without considering a potentially influential element that is, at the moment, beyond the reach of the researchers to assess. Namely, the possible effect of what's happening in the US. Issues such as US Tax reform, the renegotiation of NAFTA and the imposition of trade tariffs could all play a role in the flow of private equity capital into Canada.

Dionne says she has yet to see any negative repercussions from what is happening with the issues emanating out of the US "but, down the road, maybe. It could impact the revenue streams and expenses of industries and, for sure, it could have an impact on the price of investments."

Mercury, whose practice is intricately linked to what happens south of the border, says he is "a bit defiant" about any consequences from a rejigged set of trade rules.

"My main message is that Canada will remain an attractive jurisdiction for US capital regardless of what happens with NAFTA and US tax reform and all that," he says. "I think that notwithstanding all those issues, our economies are so inexorably tied and rooted that I think it's inevitable that continued integration is going to occur."

Paul McLaughlin is a writer and playwright based in Toronto.