Mergers & Acquisitions: Trends To Watch In 2016

An unusually strong third quarter bolstered Canadian M&A activity, making 2015 the most active year in Canadian deal making since the 2007 market bubble. Here are some of the developments and trends we can expect to see impacting Canadian M&A in 2016.

The value of Canadian deals announced to date in 2015 (all figures as of December 1, 2015) totalled approximately C$374.1-billion (US$293.5-billion), reflecting a 51 per cent increase over 2014 on an annualized basis. Deal volume also broke a 10-year record, reaching 2,749 announced transactions.

The clear leaders in cross-border deals were Canada and the United States. Canadian buyers acquired more U.S. businesses than any other country in 2015. Similarly, Canada was the target country of choice for U.S. buyers in terms of both volume (673 deals) and value (C$167.5 billion).

Headline-making Canadian deals in 2015 included:

- Element Financial Corporation's C$8.9-billion acquisition of the bulk of General Electric's (GE) fleet business
- Canadian Pension Plan Investment Board's (CPPIB) C$17.8-billion consortium acquisition of Cablevision Systems Corp.
- CPPIB's C$12-billion acquisition of GE Antares Capital Corp.
- The launch of Emera Inc.'s C$10.2-billion acquisition of TECO Energy Inc.

Here are some of the developments and trends we see impacting Canadian M&A in 2016.

POLITICAL CHANGE WILL CREATE INVESTMENT OPPORTUNITIES

Following the ouster of Alberta's provincial Conservative party in favour of the left-leaning NDP, Canadians also elected a new federal government in November. Led by Prime Minister Justin Trudeau, the Liberal party secured a majority government and mandate for political change. For nearly a decade, former prime minister Stephen Harper's Conservative government prioritized, among other goals, curbing government spending and the promotion of Canada's natural resource economy. In securing its new majority government, the Liberals ran on campaign promises of greater public support for renewable energy, increased taxes on high-income earners and planned deficit spending for three years to spur economic growth.

With the new government now at the helm, the Canadian business community is readying itself for Liberal policymaking and some initial reactions have not been favourable. A recent KPMG survey of Canadian top executives indicated that almost 60 per cent of surveyed executives, and particularly those in Western Canada, feel the election of the new Trudeau-led government is negative for business. Contributing to this negative attitude are concerns over potentially drastic changes being made during a weak economy, running deficit spending and the ability of Canada's oil and gas industries to remain competitive under an environmentally focused government.

A number of possible effects of the change in government on M&A include:

- **Slow start to 2016:** Many expect M&A activity to be slower out of the gate as, among other factors, the market adjusts to the regime change and possible tax implications
- **Lower loonie:** Uncertainty surrounding new government policies and the proposed deficit spending may continue to put downward pressure on the Canadian dollar
- **Energy shift:** The renewable-energy sector will receive a boost from the government's stated commitment to phase out fossil fuel subsidies, beef up the approval process for energy projects and implement new climate change regulation
- **Infrastructure opportunities:** With government spending on infrastructure poised to increase by C$5-billion annually, investors will look to capitalize on new Canadian projects

TAKE-OVER BIDS: JUST SAY "SLOW"

Available defences to hostile bids are expected to change in 2016. While Canadian boards are empowered to implement shareholder rights plans (poison pills) to ward off unsolicited offers, Canadian securities commissions have historically cease-traded rights plans after 45–60 days in order to permit shareholders to tender to a hostile bid.

In March 2015, the Canadian Securities Administrators published proposed amendments to Canada's take-over bid regime:

- All bids will be required to remain open for at least 120 days (an increase from the current 35 days), unless the target voluntarily shortens the period (to not less than 35 days)
- All bids must be subject to a minimum tender condition of at least 50 per

cent of the outstanding securities of the class that are subject to the bid (not including those held by the bidder)
- Following the satisfaction of the minimum tender condition, all bids must be extended for an additional 10-day period

The changes are intended to provide target boards with more time to respond to unsolicited take-over bids and avoid the need for a rights plan. Shareholders will be assured an opportunity to gauge whether a bid is successful before tendering, as the 10-day extension will be mandatory. The 50 per cent minimum tender condition is intended to prevent partial (or “creeping”) bids to ensure all shareholders can share in a control premium from the buyer.

While no effective date has been announced, market participants expect the amendments will be implemented during the first half of 2016.

THE LOONIE: HOW LOW CAN IT GO?

After reaching a high of US$1.09 in 2007, the value of the Canadian dollar has undergone a precipitous decline in recent years. At the time of this publication, the loonie had fallen to US$0.72.

Falling commodity prices, combined with the weaker Canadian dollar, are presenting compelling investment opportunities for foreign buyers looking to call the bottom.

With the Canadian dollar showing no immediate signs of a quick rebound in 2016, we expect foreign buyers to scoop up Canadian assets at bargain prices.

DEPEND ON DE-SPACing

The special-purpose acquisition corporation (SPAC) market has been thriving in recent months. Since the first Canadian SPAC, Dundee Acquisition Ltd., went public in April 2015, seven additional SPACs have closed initial public offerings (IPOs) or filed preliminary prospectuses.

SPACs raise public funds by offering investors units (typically one share plus a half warrant for an additional share), with the net proceeds held in escrow. Sponsors of the SPAC then have a period of time, typically 21 months, to find a “qualifying acquisition” to present to shareholders and purchase with the escrowed funds; a de-SPACing. If a qualifying acquisition is not completed within the prescribed timeframe, the SPAC must return the escrowed proceeds to investors. We expect to see robust M&A activity by SPACs in 2016.

CONTINUED TUMULT IN THE OIL PATCH

Global oversupply and weak demand for oil over the past 12 months has stalled new investment in the energy industry. This global trend has had a particular impact on Canadian markets, which are highly invested in oil and gas.

This year saw, for the first time in recent memory, the energy sector dethroned as the most active in M&A (in terms of deal value) by real estate and financial services. Nevertheless, market participants expect 2016 to be a robust year in energy M&A as both strategic and financial acquirers take advantage of undervalued Canadian assets.

Of particular importance will be sales of assets and cash-flow streams by distressed companies trying to reduce debt levels or raise capital for maintenance or expansion of existing projects.

PRIVATE EQUITY IS SHOPPING

Canadian private equity (PE) deal volume and value were robust in 2015, with Q3 showing a dramatic increase over the prior period in 2014. Despite market difficulties, key sectors of interest continue to include mining and natural resources. Cross-border sponsor activity by U.S. funds is most prevalent, accounting for over half of all PE transactions in 2014 and will likely reach similar levels in 2015.

Both private equity and domestic pension plans are focused on midstream oil infrastructure assets, such as pipelines and storage tanks, to capture long-term cash flows with less direct exposure to oil prices. For example, in late 2014, Encana Corp. sold gas pipelines and plants to U.S. private-equity firm KKR & Co. L.P. and Canadian energy infrastructure group Veresen Inc. for C$461-million.

We expect targeted PE activity, especially in the oil and gas services sector, to continue in 2016.

TPP MAY SPUR MORE ASIAN INVESTMENT IN CANADA

The Trans-Pacific Partnership (TPP), an accord that will reduce tariffs on many goods and provide duty-free trade on others among the 12 partner countries, will reduce Industry Canada’s oversight of foreign take-overs of Canadian companies by TPP signatories under the Investment Canada Act. The Investment Canada review threshold, currently C$600-million, would increase under the agreement to C$1.5-billion in respect of deals involving companies from countries that are TPP signatories. The TPP is expected to come into force in 2017, if ratified by Parliament, once all approvals are granted.

While cultural businesses and some key Canadian companies, like Air Canada, will be excluded from the application of the increased threshold, diminished Investment Canada review may boost interest by foreign buyers in Canadian assets.

INCREASED FOCUS ON FOREIGN CORRUPT PRACTICES DILIGENCE

The interactions of Canadian businesses with foreign governments will be under greater scrutiny next year with this year’s enactment of new legislation, the Extractive Sector Transparency Measures Act (ESTMA), a new debarment regime for government procurement, and the laying of corruption charges against a prominent Canadian engineering firm.

Larger Canadian oil, gas and mineral development companies are now subject to ESTMA, which is designed to reduce international corruption by requiring public reporting of payments made to foreign and domestic governments and government officials (eventually including aboriginal governments). The federal government also introduced a new Integrity Regime for all federal government procurement, which can result in a supplier being debarred from doing business with the government for 10 years if it has committed an integrity-related offence, including one arising from foreign corruption issues. Enforcement actions also received a boost from charges laid by the Royal Canadian Mounted Police against a large Canadian engineering firm. These factors will prompt potential purchasers to undertake more robust diligence efforts with respect to a target's overseas activities.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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