

A photograph of three business professionals in a modern office lobby. An older man in a dark suit and tie stands on the left, looking towards a woman in a dark suit and high heels in the center. A younger man in a dark suit stands on the right, looking towards the woman. They are standing near a large window with a view of greenery. In the foreground, there are several potted plants in white containers. The scene is brightly lit, suggesting daytime.

# M&A Trends in Canada

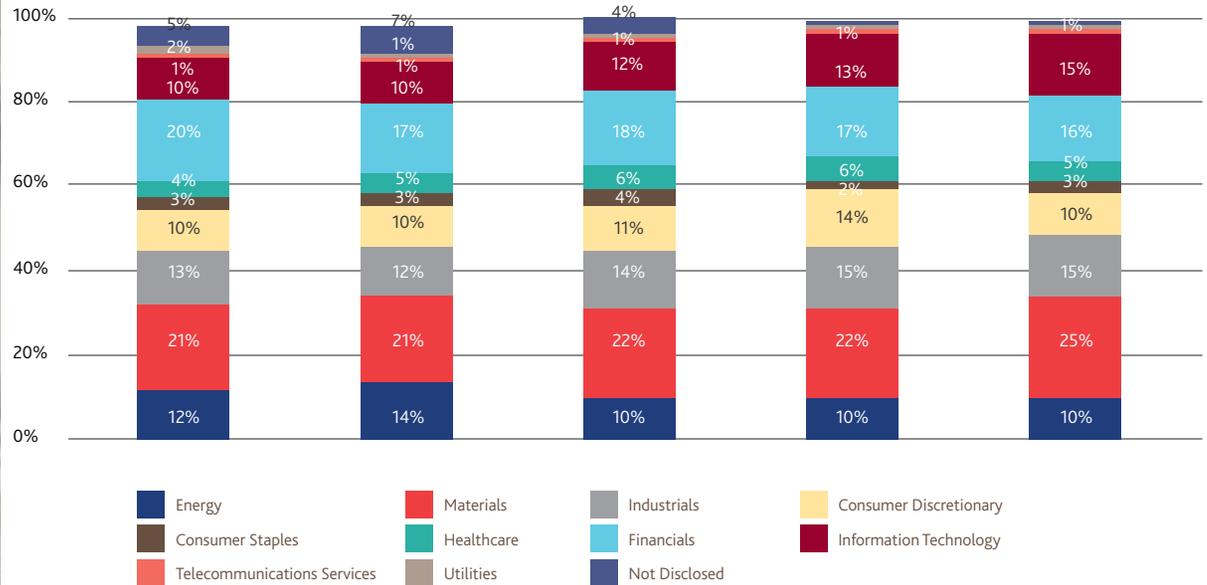
Q1 2016

## Canadian M&A Environment

After a record-setting 2015 in global deal making, M&A activity in Canada has started off strong in Q1 2016, with announced transaction value totalling \$26.4B CAD and almost doubling the transaction value from the same period in 2015 of \$13.5B CAD. This was a divergence from our American counterparts who experienced a decline in Q1 M&A activity. In Canada, M&A deal volume was similar quarter over quarter, but dollar value increased significantly due to a handful of larger deals including Lowe Companies Inc.'s acquisition of Rona Inc. for \$3.1B CAD, and Corus Entertainment's acquisition of Shaw Media for \$2.6B CAD. McKesson Corp also announced the acquisition of the 470-store Rexall Health chain for \$3.0B CAD, which still requires approval from the Competition Bureau of Canada and is expected to close in late 2016.

Similar to what we saw throughout 2015, the Materials, Financials, Information Technology and Industrials sectors continue to represent the lion's share of M&A activity in Canada, making up 70% of the total transactions by deal volume in the first quarter of 2016 and displacing the Energy sector as a traditional workhorse of Canadian M&A activity. Strategic or corporate buyers continue to dominate the M&A landscape, accounting for almost 85% of transactions in Q1, well above the 74% average over the past five years. This was a surprise to some as expectations of increased private equity or financial buyer activity failed to materialize and these funds continue to hold record amounts of cash. A strong appetite for acquisition from corporate buyers combined with a rebounding Canadian economy, low interest rates and elevated levels of corporate and private equity cash signal a continued sellers' market for business owners in Canada.

Number of M&A Transactions in Canada by Sector



Source: S&P Capital IQ

# Favourable Trends Moving Forward for Canadian Mid-Market M&A

## Canadian Economy Expected to Recover in Q3

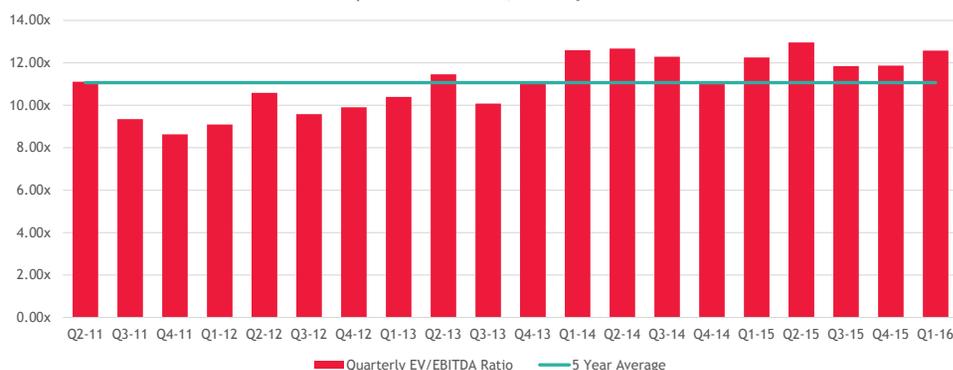
The Bank of Canada estimates that real GDP growth increased by 2.8 percent in the first quarter, however it expects output to contract in Q2 as the economic impact of the devastating Alberta wildfires is felt. The economy is expected to rebound in Q3 when oil production in the affected areas resumes. The Bank of Canada's long-term real GDP forecasts in April for 2017 and 2018 of 2.3 percent and 2.0 percent, respectively, are not expected to be revised downwards at this time.

The market reacted positively to the release of the Trudeau government's budget in March with large planned deficits in the next two years to spur growth, and then easing the deficit down over the following three years. The loonie rebounded back from a 13-year low of \$0.6865 CAD/USD in January 2016, benefitting from recovering crude oil prices, and even tested the \$0.80 CAD/USD level in early May and has recently settled in around the \$0.75 CAD/USD level. Given the current condition of the energy sector and its overall impact on the economy, other sectors will need to make up the slack, especially non-resource exporters whose growth is being aided by increased US demand. The expected recovery of the Canadian economy in Q3 should increase M&A activity heading into the last quarter of 2016, as firms will begin to feel comfortable pursuing growth through acquisition opportunities again to stay competitive and gain market share.

## Strong Valuation Multiples

The S&P/TSX Composite Index is currently showing strong valuations with EV/EBITDA multiples trading near five year highs. Strong public equity multiples have a trickle down effect on private M&A as premium public valuations are a common deciding factor when contemplating a sale of a business. Vendors try to time the market and cash in on premium pricing and this in turn leads to more new deals coming to market.

S&P/TSX Composite Index - Quarterly EV/EBITDA Ratio



Source: S&P Capital IQ

## Low Interest Rate Environment

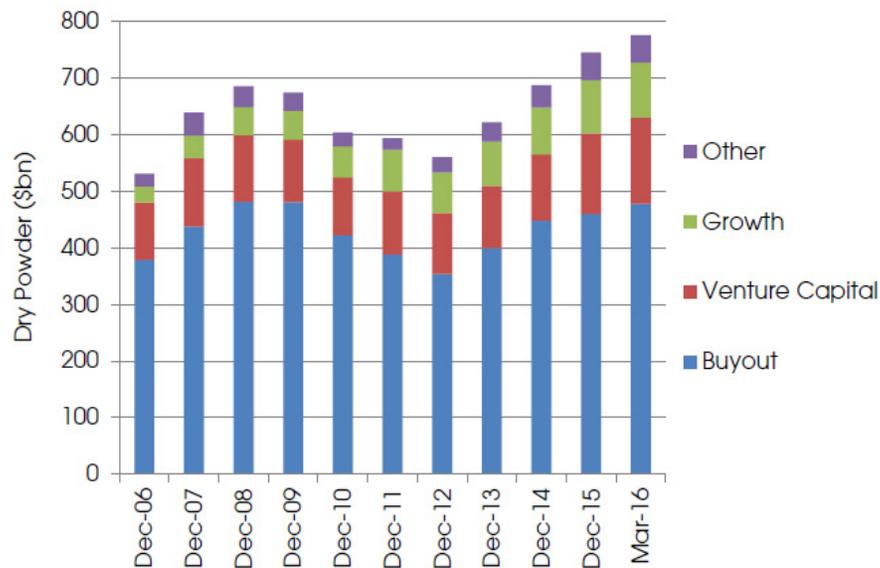
After the events in Alberta, the Bank of Canada announced on May 25, 2016 that it will maintain the overnight rate at 50 basis points. Given these circumstances, no rate hikes are expected in the short to intermediate-term. As the Canadian economy recovers, lower yields on cash and short-term investments can benefit business owners looking to sell as this incentivizes firms and funds to seek more effective uses of capital, provides for cheaper financing and increases demand for acquisitions.

# Favourable Trends Moving Forward for Canadian Mid-Market M&A

## Private Equity and Corporate "Dry Powder"

Private equity (PE) global "dry powder", or cash reserves, continues to remain at all time highs meaning PE funds are looking to aggressively deploy capital. As at March 2016, global private equity "dry powder" was nearly \$800 billion USD, not including real estate, mezzanine and distressed private equity. Corporate balance sheets remain strong with just over \$1.8 trillion USD of cash and equivalents on S&P 500 balance sheets at March 31, 2016. With this amount of cash available, we expect M&A demand to remain robust.

Global Private Equity "Dry Powder" by Fund Type



Source: Preqin Private Equity Online

## Business Owner Demographics

According to a report by Industry Canada, by the end of 2020 almost 350,000 small and medium sized business owners will be over the age of 55. One third of these business owners are expected to transfer control of their companies within the next five years. With baby boomers set to retire in droves, we expect significant deal supply to come to market. As a result, business owners must be well prepared to articulate what differentiates their business as an acquisition target.



# M&A Trends in Most Active Sectors by Deal Volume

## Materials

The first quarter of 2016 saw a significant consolidation trend in the Materials sector with all but three of the 104 deals completed by strategic buyers. Highlights include the purchase of Lake Shore Gold Corp., a gold mining company, by Tahoe Resources Inc., for \$895M CAD to strengthen its position in the precious metals space and establish a strong, diversified producing platform with an additional low-cost operation in Ontario.

Two out of the three largest deals by transaction value were also cross-border transactions demonstrating a high level of interest from US buyers.

## Q1 2016 Top 3 M&A Transactions in the Materials Sector by Transaction Value—Canada

Announced Date	Target	Target Business Description	Transaction Value \$M CAD	Buyers	Buyer Country HQ
8-Feb	Lake Shore Gold Corp.	A gold mining company engaging in the acquisition, exploration and development of gold properties in Canada.	\$895.44	Tahoe Resources Inc. (TSX:THO)	United States
24-Feb	InterWrap, Inc.	Manufactures coated woven packaging products and multi-layer laminated reinforced plastic substrates.	\$621.05	Owens Corning (NYSE:OC)	United States
7-Mar	Claude Resources, Inc. (TSX:CRJ)	Engages in the acquisition, exploration, and development of precious metal properties in northern Saskatchewan, Canada.	\$344.68	Silver Standard Resources Inc. (TSX:SSO)	Canada

Source: S&P Capital IQ

# M&A Trends in Most Active Sectors by Deal Volume

## Financials

In Q1 2016, there were 67 deals within the Financials sector. Three quarters of the deals were completed by strategic buyers, with the remainder owing to financial buyers.

The largest disclosed deal by transaction value was Anbang Insurance Group's, a Chinese financial services company, purchase of a 66 percent stake in the four Bentall Centre office towers in the heart of Vancouver for \$1,000M CAD. The Chinese insurance company had been looking for additional Canadian opportunities after purchasing a downtown Toronto office property from Brookfield Asset Management. This is the first ever billion dollar Vancouver real estate deal and demonstrates a continued appetite from Asian buyers in the Vancouver real estate market.

## Q1 2016 Top 3 M&A Transactions in the Financials Sector by Transaction Value—Canada

Announced Date	Target	Target Business Description	Transaction Value \$M CAD	Buyers	Buyer Country HQ
22-Feb	Bentall Centre	An integrated office complex providing a working environment for Canadian corporations.	\$1,000.00	Anbang Insurance Group Co., Ltd.	China
21-Jan	RBC General Insurance Company <sup>1</sup>	Provider of home and auto insurance products and services.	\$569.05	Aviva Canada, Inc.	Canada
18-Feb	Canadian Tire Distribution Centre <sup>1</sup>	Comprises a real estate property.	\$325.00	CT Real Estate Investment Trust (REIT) (TSX:CRT.UN)	Canada

<sup>1</sup> Announced but not closed

Source: S&P Capital IQ

# M&A Trends in Most Active Sectors by Deal Volume

## Information Technology

A total of 64 transactions took place in the Canadian Information Technology sector in Q1 2016. The majority were strategic investors, with some activity from incubation and private investment firms.

The largest disclosed deal by value in the quarter was Snapchat's acquisition of Bitstrips, an emoji creation service called Bitmoji, for just over \$130M CAD. Although Snapchat has remained silent on their intentions with the company, industry experts speculate that Bitstrip's design and keyboard provide Snapchat with several options for integration into their main platform.

Q1 also saw Kontron Canada enter into a strategic partnership with business partner Ennoconn, with a goal of becoming a leading provider of hardware and software solutions and establishing a presence in the APAC marketplace, while at the same time reducing material and production costs.

## Q1 2016 Top 3 M&A Transactions in the IT Sector by Transaction Value—Canada

Announced Date	Target	Target Business Description	Transaction Value \$M CAD	Buyers	Buyer Country HQ
28-Mar	Bitstrips Inc.	A mobile application turning the user into their own personal set of emojis, which are then shared in a chat application.	\$131.96	Snapchat, Inc.	United States
22-Jan	Kontron Canada Inc. <sup>1</sup>	Designs and manufactures OEM (Original Equipment Manufacturer) telecommunications platforms and subsystems.	\$81.10	Ennoconn Corporation (TSEC:6414)	Taiwan
5-Jan	Digital Extremes Ltd.	Develops video games, offers games for mobile phones and enables users to build their own games.	\$65.54	Leyou Technologies Holdings Limited (SEHK:1089)	China

<sup>1</sup> Announced but not closed

Source: S&P Capital IQ

# M&A Trends in Most Active Sectors by Deal Volume

## Industrials

The Industrials sector had 67 deals in Q1 2016. Similar to the other sectors, strategic buyers accounted for 87.5% of total deal volume.

The largest announced deal of the quarter was Federal Signal's \$160M CAD announced purchase of Joe Johnson Equipment, a Canadian distributor of maintenance equipment for municipal and industrial markets. The acquisition allows Federal Signal to establish a platform in Canada to grow its core business while expanding their portfolio and being able to better service customers.

## Q1 2016 Top 3 M&A Transactions in the Industrials Sector by Transaction Value—Canada

Announced Date	Target	Target Business Description	Transaction Value \$M CAD	Buyers	Buyer Country HQ
29-Feb	Joe Johnson Equipment Inc. <sup>1</sup>	Sells, rents, leases and services new and used Refuse & Recycling Collection vehicles and infrastructure maintenance equipment to municipalities and contractors.	\$160.38	Federal Signal Corp. (NYSE:FSS)	United States
24-Mar	Sanexen Environmental Services Inc.	A contractor and consultant specializing in contaminated site remediation and Water Main Rehabilitation.	\$43.80	Logistec Corp. (TSX:LGT.B)	Canada
8-Jan	H.J.R. Asphalt LP	Provides asphalt paving services to the road construction industry in Saskatchewan.	\$37.18	Westcap Management Ltd.; Golden Opportunities Fund Inc. - Class R	Canada

<sup>1</sup> Announced but not closed

Source: S&P Capital IQ

# Preparing for a transition—8 steps to success

If you are a business owner who has been contemplating selling your business, now might be the right time. Large amounts of cash on both corporate and private equity fund balance sheets, combined with relatively cheap debt financing, and difficulty in achieving organic growth may set the stage for an active acquisition market. Given the large amount of business owners retiring, it is critical to be well prepared for the sale and to alleviate as many roadblocks as possible before discussions with potential buyers. Even if a potential sale is not imminent, there are important matters to consider in preparation for the eventual transition:

## 1) Identify the key attributes of the business and make sure that you can deliver them

Often, sellers do not place enough emphasis on understanding the business attributes that are most valuable in the eyes of a potential buyer. These may include intellectual property, sales channels, customer contracts, management, machinery, processes and other unique strengths. Gaining an understanding of these attributes and ensuring you can deliver them will lead to a smoother transaction. It is also critical that you can communicate the value of the business to different prospective investors, as different buyers will value different elements.

## 2) Document the business plan and forecasting

When it comes to transactions, investors want reassurance they are investing in a company with a well thought out plan for the future, even if they have different objectives for the business. Having a history of strong business planning, budgeting, monitoring, reporting and forecasting can add to the value of your business and improve buyer confidence. Articulating plans and forecasts into formal budgets and strategic plans, then measuring financial results against them is essential if you are considering a sale.

## 3) Maximize and stabilize profits

Most investors do not want "hockey stick projections", i.e. projections where most of growth occurs next year. Instead, they look for businesses with a history of steady revenue growth over the years. A target should be set to achieve 3 years of steady growth and consistent accounting treatment prior to selling your business. It is also imperative to understand what you can do to maximize and stabilize your profitability. This will help increase the perceived value of the business in the minds of prospective investors.

## 4) Clean up the balance sheet

If you were selling your house you would want the appearance to be as neat and clean as possible, and the same can be said for a business. Before you put your business up for sale you should clean up your balance sheet. Dispose of any redundant assets, this could be land or investments that are not operational in nature. Clean up liabilities by writing off bad debt and try to settle any disputes or litigation. Also, make sure there are no potential undisclosed liabilities such as environmental claims and consider obtaining documentation such as a Phase I and/or Phase II Environmental Site Assessment (ESA) to prove it.



## Preparing for a transition—8 steps to success

### 5) Document and update contracts/agreements

Investors can't put a value on handshakes, so a lack of formal contracts can become a big issue for potential investors and negatively affect the value of your business. Make sure you update your documentation for all key relationships, whether it's with suppliers, customers, or even the related party that owns the real estate you are leasing.

### 6) Ensure transparent financial reporting

Potential buyers of a business need comfort that the information they are receiving is accurate. The best way to accomplish this is to have audited financial statements for at least the past three years, since that is usually the minimum historical period investors will want to look at. Audited financial statements give credibility to numbers you present and will reduce potential headaches when the buyer performs their financial due diligence. In addition, upgrades to IT systems that monitor key performance metrics will also add significant value to the process.

### 7) Develop a management succession plan

Very few investors are willing to buy a business knowing they have to replace the management. This is due to concerns that access to the "special sauce" which makes the business a success will be lost. Many businesses rely on the skills, relationships and expertise of the key individuals, often the owners, who add the majority of the value to the business. It is important to involve management in the sale process and transition, as investors will be interested in meeting them to ensure the business will be in capable hands going forward.

### 8) Start tax and legal planning early

Tax and legal planning is critical for a business seller to achieve maximum proceeds from their transaction. For example, family trusts can be a tax effective ownership method but need to be in place for two years before a transaction occurs. A legal advisor can ensure that corporate records are clean and up to date. These are just two examples, as there will be tax and legal situations unique to every contemplated transaction that should be discussed with your tax and legal advisors.



To learn about how BDO can help your company with these and other challenges, [contact your local BDO office](#) or:

Bruno Suppa  
Partner  
Transaction Advisory Services  
416 369 3103  
[bsuppa@bdo.ca](mailto:bsuppa@bdo.ca)

Jamie Windle  
Director  
Transaction Advisory Services  
416 865 0210 Ext. 3201  
[jwindle@bdo.ca](mailto:jwindle@bdo.ca)

Trevor Cruise  
Senior Associate  
Transaction Advisory Services  
416 865 0210 Ext. 3233  
[tcruise@bdo.ca](mailto:tcruise@bdo.ca)

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