Recent Canadian M&A Developments and Outlook for 2022 – Will the Party Continue?

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Canada experienced a record run of M&A activity in 2021, with an aggregate value of announced deals reaching $437.6 billion, easily eclipsing the previous $330 billion record set fifteen years ago in 2007. The free-for-all was driven by robust economic fundamentals, low interest rates and strong debt and equity markets, which created an attractive financing environment for buyers, enticing valuations for sellers and excess capital reserves that companies and private equity (PE) investors had stockpiled during the first year of the pandemic. This robust M&A environment was broad-based across multiple business sectors, transaction size ranges and geography. And while, in keeping with historical trends in Canada, mid-market deals (in the $100 million to $500 million range) represented the bulk of transactions, there were a handful of mega-deals, particularly in the transportation and telecommunications sectors with Canadian Pacific Railway's US$26.7 billion purchase of Kansas City Southern and Rogers Communications' $19.5 billion acquisition of Shaw Communications.

Vigorous competition for acquisition targets pushed some traditionally conservative PE funds to adopt more aggressive private M&A transaction structures in 2021. PE sponsors were more willing to forego the customary indemnification provisions that supplement representation and warranty insurance coverage and propose "public-company style" deals with no recourse to the sellers post-closing. While such seller-friendly structures were not unheard of in larger deals, 2021 saw this trend accelerating in the mid-market space. While the "public-company style" approach can expedite the drafting and negotiation of private acquisition agreements, it places increased reliance on due diligence procedures that are already under pressure from increasingly compressed timeframes. Fortunately, the pandemic-induced shift to virtual or desk-top due diligence has lead to more streamlined and efficient due diligence strategies in M&A deals.

Use of earn outs also increased in private M&A transactions in 2021 as a means of bridging valuation gaps or pandemic-related business uncertainties. Such earn out structures allowed PE funds to deliver above-market valuations while maintaining some degree of linkage to operational performance at the top end of the valuation range.

The robust M&A environment also led to unexpected pressures on public transactions, with an atypical number of topping bids from third party interlopers driving up the ultimate purchase price in several deals, such as Canadian National Railway's topping bid for Kansas City Southern and Pembina Pipeline Corporation's white knight bid for Inter Pipeline Limited. M&A-focused shareholder activism campaigns also occurred in record numbers in 2021, establishing a new high water mark for successful dissident campaigns against announced public transactions. While some of these activist campaigns outright opposed M&A deals, others succeeded in obtaining sweetened offer prices (a practice known as "bumpitrage").

Not all Canadian M&A in 2021 was in pursuit of growth strategies. Perhaps influenced by increasing investor scrutiny, many companies engaged in spinoffs and divestiture transactions to re-focus on their core businesses, while utilizing proceeds to return value to shareholders or fund acquisitions more aligned with their long-term strategies – such as George Weston Ltd.'s sale of its fresh and frozen bakery businesses in two transactions for aggregate consideration of $1.57 billion.

2021 was not without significant legal developments in the Canadian M&A sphere. As the pandemic disrupted many business sectors and M&A transactions in 2020, some transaction participants aggressively tested the bounds of material adverse effect, termination and interim operating covenants, by threatening to terminate or outright walking away from their signed deals. In 2021, Canadian courts provided guidance in two such noteworthy "busted deals": Fairstone Financial Holdings Inc. v Duo Bank of Canada and Cineplex Inc. v. Cineworld plc. These cases held that the bar to rely upon such clauses to abandon transactions is high, and that: (i) absent express language to the contrary, a buyer of a business generally accepts forward-looking systemic risks associated with that business between signing and closing; and (ii) interim operating covenants should be read as a whole and interpreted consistently with the rest of the agreement, and not be interpreted to preclude a target from responding to systemic risks. These decisions underscore the importance of carefully crafting such clauses and will be important reference points for future M&A participants considering termination of a deal.

Looking forward to 2022, three Canadian M&A trends bear scrutiny. Firstly, expect companies to continue to look towards M&A deals to augment their technological capacity to transform or buttress their business models. Secondly, the need to shore up supply chains may bring more vertical integration deals, both upstream to secure key raw materials and components and downstream to build greater resilience into distribution channels. Finally, environmental, social and governance (ESG) factors, while nascent, are increasingly being taken into account in M&A decision-making and strategy to both assess risk and identify value creation opportunities. With increasing commitments being made to reduce carbon emissions, expect to see increased M&A in industries pivoting to greener business models.

The elevated pace of Canadian M&A activity is expected to continue into 2022, notwithstanding headwinds from inflation, interest rate increases, supply chain disruptions, tight labour markets, geo-political tensions, volatile equity markets to start the year and of course the continuing pandemic. While 2022 may not be the record year that 2021 was, many of the key drivers which propelled the frothy deal market in 2021 remain in place. There is plenty of M&A to come.

By

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