Q4 2017
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TECHNOLOGY IN CANADA: MARKET UPDATE

Macro-economic indicators: Canada

During Q4 2017, several of Canada's broad indicators yielded mostly positive results, pointing to a relatively strong economic environment that bodes well for businesses, as well as M&A activity.

- In October the Bank of Canada maintained its policy interest rate at 1.00%. Conversely, in December, the U.S. Federal Reserve increased its target interest rate by 25 basis points to 1.25%-1.50%.
- Expectations for real GDP growth in Canada for 2017 were increased to 3.1%, according to the Bank of Canada's most recent October Monetary Policy Report, up from the 2.8% forecast published in July.
- The S&P/TSX Composite Index rose to 16,209.13 by the end of the fourth quarter of 2017, a 3.7% increase since the close of Q3 2017.
- In the month of December, the Canadian economy added 79,000 net jobs. This increase followed net job gains of 79,500 and 35,300, respectively, in November and October. In total, over 420,000 jobs were created in 2017 compared to 214,000 in 2016, an increase of 93%. This included over 390,000 full-time positions.

Looking at 2017, employment rose by 2.3%, reaching a pace not seen in a calendar year since 2002, and the unemployment rate declined to its lowest mark in more than 40 years. Not only did the unemployment rate fall, but Canadians are working more hours. Growth in the average number of hours worked dipped earlier in the year, but grew 3% on a year-over-year basis. Considered together, Canada's economic outlook continues to appear relatively favourable for the near future.

Sources: Bank of Canada, Capital IQ, Federal Reserve, Statistics Canada

Trends Driving Tech M&A and an Outlook for 2018

The Tech Trends Driving M&A

As another year closes and 2018 begins in earnest, we review some of the latest trends driving the tech M&A market. Subsectors such as augmented and virtual reality, and cybersecurity, are expected to continue to expand significantly, and we expect to see acquisitions and consolidation. Further, we expect that some established players in the market will acquire new technologies and capabilities to stay current or find competitive advantages. Below, we highlight three of the biggest tech trends that we expect to drive industry activity as well as M&A in 2018:

1. ***Internet of Things:*** Artificial Intelligence (AI) continues to be a prominent industry buzzword and an important concept. In 2018, we will see more and more devices become connected and capable of speaking to each other. We will also likely see further refinements in AI—such as deep structured learning, natural language processing, and neural-network driven decision-making—which will help AI understand not only us but other AI as well.

   With bigger companies like Google, Amazon and Apple getting involved, we would expect to see some major developments in this area during 2018. For the moment, Amazon and Google appear focused on smart speakers (with Amazon Echo and Google Home, respectively). These smart speakers act as virtual assistants by providing different ways to access digital controls scattered throughout the home (for such uses as lighting, security and heating).

2. ***Mobile Augmented Reality/Virtual Reality (AR/VR):*** 2017 wasn't the year of AR/VR as was initially predicted. Facebook (Oculus Rift) and HTC (Vive) had numerous issues at launch, Samsung's Galaxy Note 7 caught fire from overheating batteries, and Magic Leap never achieved its 2017 release despite significant industry speculation (it will likely be released this year).

   However, there were a number of successes, with Pokémon Go outperforming expectations and delivering over USD$1bn in mobile AR revenue.[1] Sony had an impressive launch of Playstation VR with revenue rising swiftly towards the end of 2017.[2] Google also found relative success with the launch of its Daydream View mobile VR headset/controller and first Tango mobile AR phone. The momentum created by several impressive debuts in the AR/VR market and the recent developments from Apple and Snapchat, amongst others, position 2018 to be the biggest year yet for the AR/VR market.

3. ***On-Demand Services:*** Brands like Uber, Netflix, Skyscanner, EBay and others have made it the norm for people to consume products and services on-demand via mobile apps. The B2C market has become saturated with numerous food, travel and accommodation apps. As such, we would expect that in 2018 other industries will develop or expand their on-demand market channels. We would also expect that on-demand services would filter further into the B2B market (e.g., on-demand legal advice, on-demand shipping).

Outlook for 2018 Tech M&A

The volume of tech deals in recent years has formed a significant portion of the total global M&A activity, growing faster than the overall M&A market.[3] Despite a number of consecutive years of strong performance, tech industry M&A activity is likely to continue in 2018. As technology continues to change our way of life and the way we do business, M&A transactions involving tech companies are likely to reach across many different sectors as business leaders manage their companies in a rapidly changing ecosystem.

Similar to 2017, we believe that many company leaders will look to acquisitions of digital business models as the instrument of choice to bring in needed technologies, capabilities and products to close innovation gaps, forming a driving force behind M&A activity for the coming year. However, it is important to note that deals involving technology targets differ in many respects from M&A in more traditional industries. Corporate leaders need to consider and review each facet of deal making, including strategy, valuation and post-merger integration, with the added twist of acquiring an asset that is perhaps outside their comfort zone.

2018 will also likely see acquisitions involving some of the largest firms, such as Amazon and Apple. With rumours already emerging about a potential deal between Amazon and Target,[4] it is possible that the American electronic commerce and cloud computing company will purchase a large store retailer sometime in 2018 in order to grow its presence in the brick-and-mortar retail channel. While Apple is rumoured to be considering the purchase of Netflix in the coming year, we believe an acquisition is unlikely. However, many analysts believe that Apple will soon acquire companies in the augmented/virtual reality industry due to the performance of the AR/VR market in 2017. With this in mind, we may see a number of larger firms, including private equity funds and private-equity backed businesses, participating in large deals during 2018.

Finally, it is important to highlight the potential impact of the NAFTA negotiations on both the tech and general M&A markets in North America. Given NAFTA's potential effect on supply chains and free-flowing data between the U.S., Canada and Mexico, the tech industry has a definite interest in the outcome of the trade pact. With a number of provisions currently being negotiated that will affect the tech industry, such as data sovereignty and Canada's de minimis threshold, any development will be closely watched. If any one issue has potential to create drag in tech industry M&A, this could be it, due to either a disadvantageous outcome, or merely the uncertainty surrounding discussions.

Sources:

1. *Venturebeat - Pokémon Go passes $1.2 billion in revenue and 752 million downloads*
2. *Road to VR - Pressure Mounts for Xbox's Missing VR Strategy as PSVR Rakes in $700M in Hardware Alone*
3. *Boston Consulting Group - The 2017 M&A Report: The Technology Takeover*
4. *Mediapost - Amazon Could Acquire Target, Experts Predict*

Selected Q4 2017 – Canadian Tech Transactions

In Q4 2017, a total of 88 technology-related transactions were closed or announced. Eight selected deals have been highlighted below.

1. ***ESC Corporate Services Ltd. acquired AVS Systems for CAD$25 million on December 21, 2017.***

   AVS Systems Inc. provides automation services to facilitate lending, leasing and issuing activities and is based in Vernon, British Columbia.

   ESC Corporate Services Ltd. provides online corporate record due diligence and filing services for new business owners. The company is based in Toronto, Ontario.

2. ***Datametrex AI Limited (TSXV:DM) entered into an agreement to acquire Ronin Blockchain Corp. for CAD$10 million. The deal was announced on December 15, 2017.***

   Ronin Blockchain Corp. is engaged in industrial blockchain mining activities and is based in Vancouver, British Columbia.

   Datametrex AI Limited (TSXV:DM) offers plug-and-play solutions to collect big data from retail point of sale terminals. The company is headquartered in Toronto, Ontario.

3. ***eBay Inc. (NasdaqGS:EBAY) has entered into an agreement to acquire Terapeak (Canada) Inc. The cross-border deal was announced on December 13, 2017 and no financial information was disclosed.***

   Terapeak (Canada) Inc. develops predictive analytic software to service the e-commerce market. The company is based in Victoria, British Columbia.

   eBay Inc. (NasdaqGS:EBAY) operates a commerce platform to connect various buyers and sellers across the globe and is based in San Jose, California.

4. ***GAR Limited (CNSX:GL) entered into a definitive share exchange agreement to acquire Netcoins Inc. for CAD$10 million. The deal was announced on November 20, 2017.***

   Netcoins Inc. develops software to facilitate the exchange of Bitcoins and is based in Vancouver, Canada.

5. ***Data Transfer Solutions LLC was acquired by SNC-Lavalin Group Inc. (TSX:SNC) on October 30, 2017 for US$45 million.***

   Data Transfer Solutions LLC provides digital asset management, geographic information systems and transportation planning solutions to the public sector and transportation industry. The company is based on Orlando, Florida.

   SNC-Lavalin Group Inc. (TSX:SNC) provides engineering and construction services worldwide and is headquartered in Montreal, Quebec.

6. ***TELUS International Inc. has agreed to acquire a 65% stake in Xavient Information Systems Inc. with the right to acquire the remaining interest on or before December 31, 2020. The announcement was made on October 30, 2017 with no financial information being made available. (100% for US$250M per reports)***

   Xavient Information Systems Inc. operates as an information technology consultant in the United States and India. The company is headquartered in Simi Valley, California.

   TELUS International Inc., a subsidiary of TELUS Corporation (TSX:T), provides customer care and business process outsourcing solutions. The company is based in Vancouver, British Columbia.

7. ***Trayport Limited was acquired by TMX Group Limited (TSX:X) for CAD$928 million on December 14, 2017.***

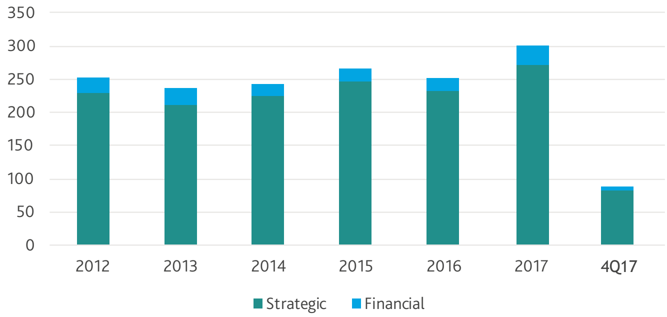
   Trayport Limited develops and delivers electronic trading and matching engine solutions. The company was previously owned by Intercontinental Exchange (NYSE:ICE). The company is based in London, UK. TMX Group Limited (TSX:X) operates exchanges and clearing houses for capital markets in Canada.

8. ***KAR Auction Services, Inc. (NYSE:KAR) has acquired a 50% stake in NthGen Software Inc. for approximately US$130 million on October 3, 2017.***

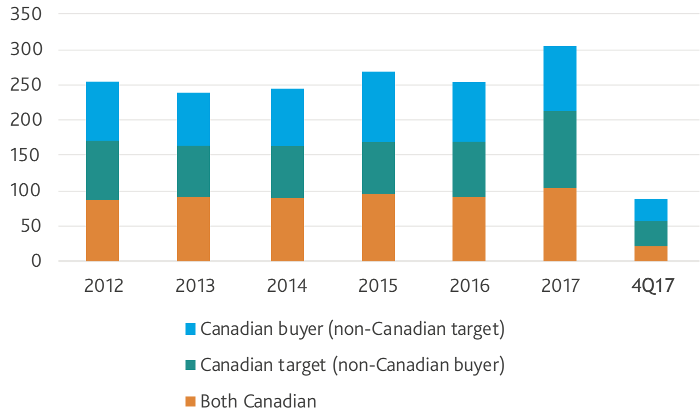
   NthGen Software Inc. develops a B2B wholesale tool for used automobile sales. The company is located in Toronto, Ontario.

   KAR Auction Services, Inc. (NYSE:KAR) provides vehicle auction services in North America and Europe. The company is headquartered in Carmel, Indiana.

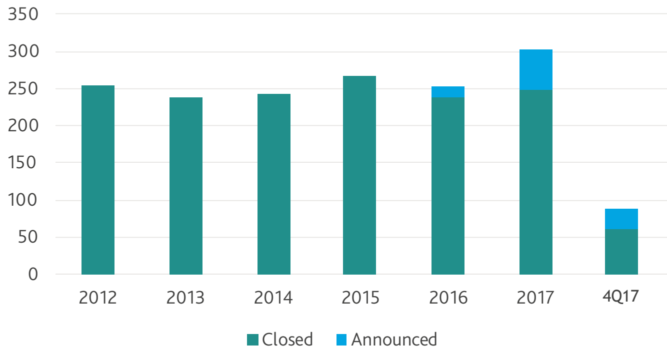
DEAL ACTIVITY
(STRATEGIC V. FINANCIAL BUYERS)



DEAL ACTIVITY
(CANADIAN TARGETS, BUYERS OR BOTH)



DEAL ACTIVITY
(INCL. LATEST ANNOUNCED BUT NOT YET CLOSED DEALS)



Note: The above deal activity charts present deals involving Canadian targets, Canadian buyers, or both Canadian target and Canadian buyer.

Source: S&P Capital IQ

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