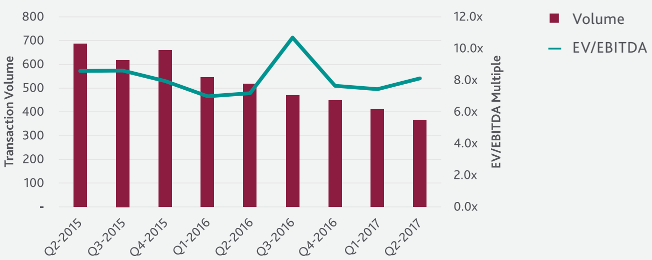
ADVISORY
M&A Update

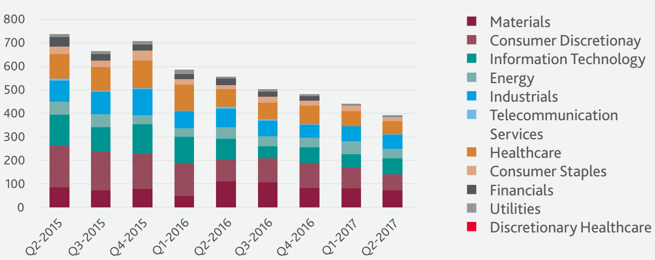
In Q2-2017, North American deal values continued their decline since peaking in Q4-2015. Aggregate value decreased 2.6% over last quarter and declined 28.6% from Q2-2016. This is partly due to US corporations continuing to delay acquisitions in the hopes of the President's promised corporate tax cuts and revised capital repatriation policies. Additionally, high valuations across US equity markets have led to a decrease in large scale transactions, as companies have been unwilling or unable to overpay for transactions. Although overall North American deal value has decreased, total Canadian deal value has grown significantly, increasing 33% over Q1-2017. This is attributed to a positive overall outlook on the Canadian economy and increased activity in energy assets. Although M&A activity is currently below its historical levels, there are many positive factors signaling an upturn could soon occur. Some of these factors include dry powder held by PE firms to fund acquisitions, interest rate hikes that could reduce inflated valuations, strong projected growth in both Canada and the US as well as US policy changes that will be beneficial to businesses.

NORTH AMERICAN OVERVIEW - PRICE VS. VOLUME



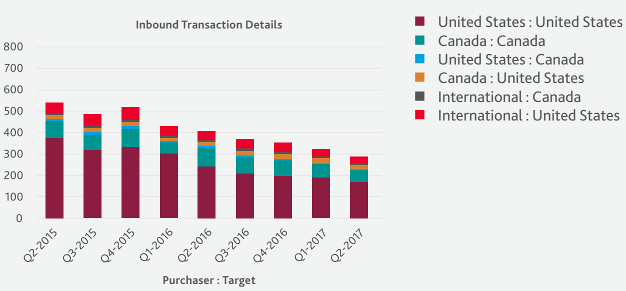
Once again, the total volume of North American transactions declined, dropping 11.2% over last quarter and 29.6% lower than Q2-2016. From this time last year, both Canadian and US total volumes dropped 35.9% and 27.5% respectively. The decrease was largely due to reasons noted above (i.e. political change, high valuations etc.). Mid-market transaction pricing appears to have broadly increased, with the average EV/EBITDA multiple growing by 9.3% over Q1-2017 and 13.1% over Q2 last year.

TRANSACTION BY INDUSTRY



The table on the left shows the North American transaction volume by industry. In this quarter, the top 5 sectors accounted for 82.4% of all deals. Materials is the most active sector with 18.7% of total deals in this quarter. This is largely due to the dominance of material deals in Canada, which accounted for 47.6% of the country's mid-market deal activity, 9.4% above the combined 2015 and 2016 average for Canada. This is due to increased activity in the Canadian energy market, where international investors are exiting their investments due to the high expenses required to develop Canadian reserves. Additionally, private equity and pension funds with large amounts of dry powder are eager to acquire domestic assets. Of all sectors, the least active was financials, accounting for only 0.3% of total deals.

CROSS BORDER TRANSACTIONS



The table to the left dissects the quarterly transactions according to the geography of the buyer and the target. Although most transactions consist of US firms acquiring targets in the US, this trend is becoming less prevalent, with activity in this category accounting for 5.4% less than it did on average during 2015 and 2016. This change is largely driven by an increase of Canadian investments in international assets, which has moved up by 3.5% over its two-year historic average. This has been driven by the recent decline in commodity prices, paired with the large amounts of cash Canadian companies and institutions have on hand, pushing them to seek higher growth and varied opportunities in alternative markets. US acquisitions of Canadian firms was also at its lowest level in the last 9 quarters, accounting for only 1.1% of transactions.

The analysis above presents the last 9 quarters of Canadian and American mid-market merger and acquisition activity. Mid-market has been defined in this analysis as transactions with enterprise values under $100 million CAD. The information for this analysis was obtained from Capital IQ's transaction database on July 4th, 2017 and is intended to represent overall trends as the information but may not be 100% complete.

Understanding your exit alternatives

You've been focused on building your company for years, or maybe decades, and are now thinking about crystalizing the equity value you've built. You may have been approached by a competitor in the past regarding a sale, or perhaps thought about a management buy-out (MBO), but have you really considered all the options available in today's market? As you think about your ownership succession and retirement plans, exploring the wide world of exit options can be a valuable exercise.

Three options most commonly considered by owner-operators include: i) passing the business to a younger generation (perhaps completing an estate freeze for tax purposes), ii) a MBO, or iii) selling to a strategic buyer (i.e. an operator in the same or adjacent industry). The first two may be scuttled by a lack of children or management team that are willing and able to participate, and the third can sometimes present competitive, cultural, or other challenges that make it too risky or impractical. In the past few decades a growing number of alternative exit strategies have emerged through the evolution and differentiation of financial buyers (e.g. private equity firms and alternative financing providers). With firms and lenders coming in all shapes and sizes, specializing by industry, geography, deal size and deal type, understanding the world of exit opportunities represented by financial buyers can be a daunting but important undertaking.

Let's take a step back and walk through some of these options:

Minority and Majority Equity Investment: Private equity (PE) firms typically need an owner to stay with the business for a post-transaction period, but the length of this period can vary widely. Some firms and circumstances require an owner to remain involved for only a transition period, while others require owners to remain involved and invested much longer, and ultimately exit together with the PE fund years later. This tactic aligns the interest of both shareholders and provides an opportunity for sellers to benefit from company growth achieved after the initial transaction. Mid-market PE firms predominantly prefer to make majority investments as this provides them with control of the business, but depending on the size of the business and goals of the seller, some may be open to make a minority investment.

Family Office: When we speak about family offices in the arena of private equity, we refer to an asset management firm that has a mandate to invest the wealth of one or a small group of high net worth families. Certain family offices consider private equity investments as a means to achieve diversification, and potentially higher return profiles. These investments are typically smaller than those mid-market private equity firms may make.

Dividend Recapitalization: Dividend recapitalizations are accomplished by taking on a conservative amount of debt. The debt raised is used to pay out a dividend to the business' owners, and the future cash flows of the business are used to repay the loan. The approach allows owners to pull cash out of the business, without giving up ownership control, and can be an effective means of capital diversification in advance of a divestiture.

Search Funds: Search funds are investment vehicles that provide seasoned professionals with the opportunity to raise capital from private investors for the purpose of purchasing and operating a business. Contrary to a private equity investment firm, search funds typically look for only one business to acquire and operate at a time. Transaction structures, management transition timelines, and preferred investment holding periods can vary widely, but search funds may offer an interesting exit alternative.

The universe of financial buyers and lenders is large and diverse. Firms vary in terms of industry focus, deal structure, preferred holding period, deal type (e.g. minority, majority, or 100% buyout), valuation range, and other factors. This diversity can make finding the right option an intimidating venture, but it also means that finding just the right fit is increasingly possible.

The options listed above are but a few of the many possibilities that exist when it comes to thinking about retirement or selling your business. Whether retirement is knocking on your door or still many years away, BDO's expertise in areas such as succession planning, mergers & acquisitions, tax planning, wealth management and others can help you make sure you've considered all of your options.

TO LEARN MORE, CONTACT:

Bruno Suppa
Partner
Tel: 416 369 3103
Email: bsuppa@bdo.ca

Adam Mallon
Director
Tel: 780 643 6192
Email: amallon@bdo.ca

Jamie Windle
Managing Director, Diligence
Tel: 416 809 1096
Email: jwindle@bdo.ca

Sunil Sharma
Director
Tel: 416 775 7816
Email: ssharma@bdo.ca

Ryan Farkas
Managing Director, M&A
Tel: 416 775 7804
Email: rfarkas@bdo.ca

Cameron Percy
Associate Vice President
Tel: 416 369 3931
Email: cpercy@bdo.ca

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