

MERGERS *unleashed*

Canadian Acquirers Flex Their Muscle

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Over the last two years, companies based north of the U.S. border have been increasingly acquisitive toward their once-dominant neighbors to the south as the Canadian dollar — often called the "loonie" for the bird that adorns Canada's \$1 coin — has gained strength against American currency.

"We're seeing a lot more Canadians looking into buying in the States," says **Allison Dent**, co-founder and managing partner of Montreal's **Synergis Capital**. "The U.S. is on sale," she adds, noting that the deal flow of Canadian companies considering U.S. acquisitions has not slowed early into 2008.

In fact, over the past two years, the deal flow has increased, with a modest climb in volume and a tremendous leap in overall value. In 2005, Canadian acquisitions of U.S. companies totaled 375, according to Thomson Financial, a number that grew to 490 in 2007. The overall value of deals going north to south, however, climbed more than 340% during the same time period, moving from \$13.6 billion in U.S. dollars to \$60.1 billion. Of course, the Canadian dollar appreciated 17.6% during the same period against the U.S. dollar, accounting for a portion of that increase, but the balance of the jump likely comes from the improved buying power of Canadian companies (also directly related to the improving exchange rate).

The 2007 acquisition of California-based ATI Systems International by Canada's Garda World Security was an example of the country's growing power over stateside targets. The company paid \$341 million (C\$393 million) for the cash-handling company, giving Garda a reach into 35 separate U.S. states. The company, according to Reuters, now controls an 18% market share in the U.S., which exceeds the company's 15% share in its home Canadian market. Also, through the deal, Garda became the number two provider of cash logistic services in North America.

Another instance of Canuck muscle, mentioned by Dent, was the acquisition activity of Alimentation Couche-Tard, an operator of convenience stores. It had acquired the Circle K operations of ConocoPhillips back in 2003, and during the past three years has been using the platform to snap up hundreds of properties in the U.S. Last year, it notched two separate deals within weeks of each other in March that added 80 new gas station/convenient stores under its Circle K umbrella, and this past March, added another 15 locations in the Midwest through a deal with Speedway SuperAmerica.

While the declining value of the U.S. dollar does provide buying power for Canadian acquirers, some argue that buyers aren't necessarily drawn in for that reason. According to **Eric Shube**, who heads the U.S. M&A practice at law firm **Allen & Overy**, the declining U.S. dollar can put off Canadian buyers, depending on the sector and scale of the business, since revenue of the

target will have a commensurately lower value to the buyer. With that said, he acknowledges that in some circumstances, the exchange rate can stimulate M&A activity.

"[I]n order for the currency difference to matter from an economic point of view, you have to be planning to use or extend the U.S. assets outside of the U.S. following the acquisition," he says.

Another perspective

Just as Canadian buyers are enjoying a position of strength, the exchange rates has made U.S.-based buyers looking to make M&A plays in Canada cautious. The rapid movements of the exchange rates, has also added a level of complexity to dealmaking, which in some cases has extended the time it takes to close a deal.

Joseph Carson, managing director with **Western Reserve Partners**, a Cleveland investment bank, cites one example he ran into last fall, when his firm served on a buy-side mandate in which a British Columbia-based company was sold to a U.S. buyer. The exchange rate between the loonie and the American dollar increased from about \$0.95 to \$1.09 from September to November of last year all while Carson and both parties involved in the deal were trying to iron out the details to the buyer's letter of intent. The deteriorating dollar, however, caused a 10% to 15% slide in the profitability of the target, since it was selling into the U.S., and dealing with costs and expenses that were calculated in Canadian dollars. At the same time the purchase price, calculated in U.S. dollars, had to be upwardly adjusted to account for the currency fluctuations.

Carson noted that the deal didn't actually close until February, when the Canadian and U.S. dollars traded at near parity. "Thankfully, the company's performance and end-markets remained strong," he notes, adding, "That really helped offset the currency impact."

However, if there's a light at the end of the tunnel for U.S. buyers interested in Canadian companies, it's that the stateside capital markets and cross-border M&A activity does have an impact on valuations in Canada. So even though the American dollar is sinking, purchase price multiples may also soften.

Clay Horner, a partner at **Olser, Hoskin & Harcourt LLP** in Toronto says that while multiples are indeed falling off, it is not a widespread trend, yet. Rather, at the moment, it's more sector specific, he says.

Focused on U.S.

Canadian businesses, however, aren't concerned at the moment about how they're perceived by potential U.S. acquirers. The opportunity today, they argue, is to build out in the U.S. Dent points to sectors including mining, energy and retail as having the most sought after U.S. assets for Canadian acquirers. Others pointed toward energy delivery systems as likely targets, as well as some infrastructure plays.

"The truth is U.S. acquisitions have become cheaper than they historically were," Horner says. But he adds one caveat, noting that despite the growing number of M&A deals over recent years and the loonie's rise of nearly 18% compared to the dollar, the Canadian market is also being impacted by the debt market collapse, though not as acutely as its U.S. neighbor. As

opposed to shutting down the deal market, the prevailing financial climate has instilled "a general sense of caution in the market."

Along with the debt crash, experts point out that some potentially acquisitive companies may continue to hold off on U.S. buys, hoping for a continuing downturn in the economy — and valuations. They likened the current situation facing the American market to the bursting of the dot-com bubble eight years ago. And while it presents opportunities, experts cite that it will be difficult to maintain the breakneck deal pace established during the past few years.

"In 2008, the value of transactions will be lower," Horner says, but there has "never been a better time" for Canadian companies to make mid-market buys in the U.S.

Meanwhile, other roadblocks remain for Canadian acquirers looking to the U.S. **Heller Ehrman's Wesley Fredericks**, a shareholder in the law firm's corporate practice group, says that the regulatory system in the U.S. has grown increasingly complex, to the point that it's serving as a deterrent to possible acquisitions in the States.

"I've gotten complaints about that," **Mark Peters**, an M&A attorney with **Dykema**, confirms. But, he notes that despite the red tape, the proximity of the two nations means that "Canada has always been at the top of foreign buyers into the U.S."

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