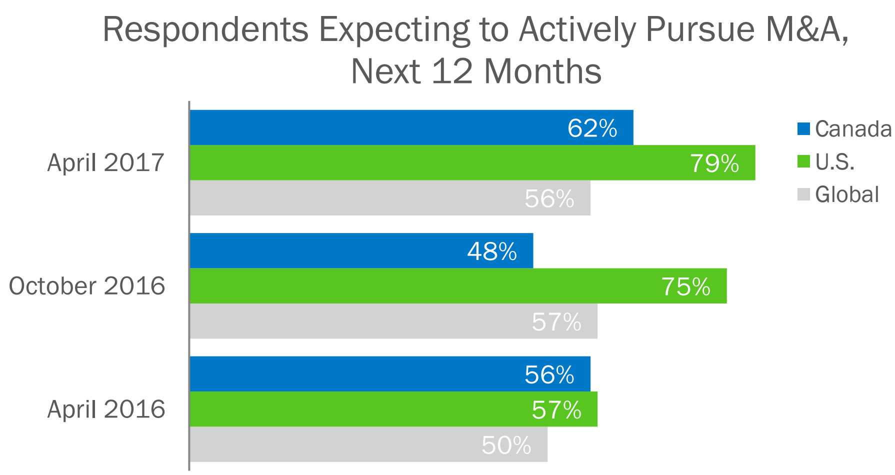
Valitas Insights: Pursuit of Cross-Border Deals in the Face of Geopolitical Uncertainty

In the recently released EY Global Capital Confidence Barometer, the following question is posed:

Can complex geopolitical uncertainty and a healthy, active M&A environment co-exist?

The simple answer is yes, based on survey results reflecting the expectations[1] of 2300 executives in 43 countries including Canada, which is where we will focus. While geopolitical uncertainty is regarded as a significant risk factor, there is an overriding focus on other drivers (including, paradoxically, an interest in cross-border transactions) that are likely to fuel M&A activity.

Canadian sentiment, as expressed in the survey, was positive on all measures, with expectations up from October 2016[2]. More than 50% of respondents expected improvement in the domestic and global economies (up from, respectively, 39% and 19%). In addition, 62% expected to actively pursue a merger or acquisition in the next 12 months, compared to 48% in the previous survey. This is above the global level of 56%, and well above the Canadian historical average of 47%.



Moreover, and more tangible than expectation, Canadian respondents have deep deal pipelines, with 45% currently looking at multiple acquisitions, and 90% seeing their pipelines improving or staying the same. Additionally, adding an extra layer of momentum to the

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[1] Expectations have proven to be predictive of M&A activity, but the predictive power weakens over a relatively short period. For example, see "Can Business Expectations predict Merger Activity?"
[2] The date of the previous EY survey.

Canadian M&A market, Canada ranks as one of the top five countries where global respondents will actively pursue acquisitions. The global theme is further reflected in Canadian expectations, with 78% of respondents looking at cross-border deals to secure market access and expand their customer base. Given this focus on geographical expansion, it is not surprising that geopolitical uncertainty and emerging government policy concerns were perceived as the greatest risk to growth.

With a robust M&A environment, high valuations, and heated competition for quality targets, Canadian dealmakers are being prudent. Almost 60% indicated that they have walked away from a deal, most often the result of an issue uncovered during due diligence.

Positive management expectations, higher levels of M&A due diligence and our own experience at Valitas lead us to feel optimistic about the latter half of 2017. We continue to see deal activity escalate with buy and sell-side mandates. In addition, we are working with several companies to assess their strategic alternatives.

Current market conditions provide further compelling support for an active M&A environment through 2017. There is abundant cash on corporate balance sheets, and credit terms remain favourable. Management will continue targeting acquisitions to “future proof” their companies in response to challenges posed by new innovations and disruptors. And finally, despite the geopolitical uncertainty, cross-border transactions will contribute significantly to deal activity with Canadian companies involved as both buyers and sellers.