Trading Day, CTV globemedia
January 2, 2008

Merger Mania 2008
Interview with Michael Hainsworth

Michael Hainsworth: Merger mania? A thing of the past, according to a new report by Torys LLP. The law firm says tighter credit will quell M&A activity in 2008. To talk about this, Philip Brown, partner at Torys, joins us now. Phil, thanks for joining us.

Phil Brown: Nice to meet you, Michael. How are you?

Michael Hainsworth: How much of a role will the credit crunch play in the squelching of M&A activity?

Phil Brown: I think significantly—in certain sized deals. I think what you'll see is a cutback on debt. I think debt will be more expensive for companies to take on. I think covenants will be tighter. I think banks will do more due diligence, and I think they'll be less reluctant to put on as much leverage as in the past. I don't think that will close down the M&A market though—I think it will slow down the bigger deals.

Michael Hainsworth: Would this mean that we would see more companies using their stock as currency, as opposed to just going to the debt market?

Phil Brown: It's a good point. I think in cases where you're not looking at private equity, you may have strategics that increase the number of deals that they otherwise would have done. I think that it will be more attractive for them to do deals because prices will come down, because private equity won't be quite as competitive as they were before, at least for the larger deals, and put strategics in a much better position because they can rely on synergies to pay more.

Michael Hainsworth: What is the most attractive form of a merger, for those who are investing in those two companies? I can imagine you want to see as little debt as possible, but at the same time you wouldn't want to see dilution on equities.

Phil Brown: No. I think there's a balance and it just depends on the company and the particular industry that you're in. There's no real limit on the amount of debt other than what the banks think the deal will support, and that depends on the balance sheet of the particular company involved.

Michael Hainsworth: So as far as the credit crunch goes, you say certain sized deals are going to be affected more than others. What is that size?

Phil Brown: I think if you're looking at the larger deals, north of $10 billion, for example, you'll see very few of those. The point though I would make, is last year in Canada, even though there was some frenzy, there were very few deals that were that large.

Michael Hainsworth: Right.

Phil Brown: Particularly led by private equity which are the deals that are impacted the most. The market that's most affected by that is the United States. So the deal flow in Canada should slow down, but the deal sizes that have always been done in Canada should continue. I think what you'll see is a more normalized market.

Michael Hainsworth: I can imagine, as well, when you get into those levels of $10 billion plus, particularly here in Canada, you're talking primarily resource-related companies and we seem to be running quite, quite out of them, lately.

Phil Brown: Right, you are talking commodities-based industries, you're talking telecom. You're talking banking and the financial industry probably.

Michael Hainsworth: Resource sector, as I say, saw a lot of M&A activity last year. What sector do you expect to dominate in 2008?

Phil Brown: I think infrastructure would probably be one of the leading areas. I think there's a huge amount of work to do in Canada in infrastructure with roads and airports and the like—hasn't been a ton of money put in, in the last few years. They tend to be businesses with consistent cash flow. They can support a lot more debt than other companies, and therefore, they are attractive businesses right now for acquirors.

Michael Hainsworth: And we seem to have a broad swath of those types of infrastructure plays in this country. You've got your SNC Lavalins at the top, your Stantecs sort of in the middle of the road, to the lower end of things. Does that mean that Canadian companies are expected to be the acquirors, or will they be picked up by large foreign players?

Phil Brown: I think that what you'll see for the most part is Canadians picked up by foreign players. We've seen an increased interest from companies (acquirors) in Russia, India and China in particular, and they're not as subject to the debt markets because they've got a ton of cash and their economies are all very strong.

Michael Hainsworth: Right.

Phil Brown: Strong balance sheets, and more likely to come in and do larger deals.

Michael Hainsworth: What role does the Canadian dollar play in all this? I can imagine you know the at-par buck is burning a hole in a lot of CEOs' pockets.

Phil Brown: I think it could have a huge impact for Canadian companies looking south. What we expect as one of the trends is that Canadian companies will do more deals in the United States in the next year. It does depend a little bit on what happens with the Canadian dollar. Volatility is not good, usually, because boards are reluctant to do deals when the dollar is moving too much. But if you get some stability this year, we expect to see more deals in the United States by Canadian acquirors.

Michael Hainsworth: And are you expecting that in light of a lot of talk about $0.98 to a $1.03—this seems to be the range the loonie will trade in through 2008.

Phil Brown: I think any of those rates would be attractive for Canadian companies, particularly if you look at it on a historical basis over the last five to ten years.

Michael Hainsworth: So what will Canadians be buying south of the border?

Phil Brown: I think a wide range of industries. I think you could see a fair bit in healthcare, telecommunications and other diverse industries.

Michael Hainsworth: Those are industries that seem to be faltering in the United States right now—is that an accurate assessment?

Phil Brown: Some of them are faltering and that's what makes them attractive to Canadians. You know a lot of the Canadian companies haven't been as affected by the debt crisis as the American companies. They should be in attractive positions. That, coupled with the Canadian dollar, should make it very attractive for them to look at companies that are faltering in the United States.

Michael Hainsworth: Are you seeing a sense of throwing the baby out with the bathwater in the United States, as far as valuations of companies goes?

Phil Brown: Not yet.

Michael Hainsworth: Not yet?

Phil Brown: Not yet.

Michael Hainsworth: What do you mean by not yet?

Phil Brown: Well we haven't. I don't think we've seen a large dropoff in values yet. That's probably the next thing to come, I would have thought, as targets get used to the fact that the prices that were paid in the last six or six months ago, for example, are not likely to continue. But there'll be a little bit of time before that sets in, I imagine.

Michael Hainsworth: So acquirors won't need to pay the premium that they have in the past?

Phil Brown: That's my guess.

Michael Hainsworth: Fascinating stuff, Phil. we appreciate your time. Thank you so much.

Phil Brown: Thank you Michael.