Cross-border M&A: The View from Canada

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Canadian M&A by the Numbers

As sharp as the drop in M&A was in Canada in 2020, the rise in the final quarter of 2020 and the first three months of 2021 has been even more intense. Rarely has there been a year when the story of deal activity has to be told on such a quarter-by-quarter basis.

On the whole, though, the covid-19 pandemic still made 2020 the slowest year for M&A in Canada since 2011. Crosbie & Company reports that total deal value was US$163.3 billion, down almost 50 per cent from 2019. The number of transactions in 2020 declined to 3,136 from 3,227, although this was less of a drop than one might have expected standing on the precipice in April 2020. The quarters with the greatest divergence in 2020 were the second and the fourth. This is a shared experience in many jurisdictions worldwide. Q2 saw total deal value of US$14.2 billion, a six-year low and down 70 per cent from the first quarter of the year. The month of April 2020 saw 168 deals worth only US$700 million, a result of mass disruption in the global economy in mid-March. On an industry level, the precious metals and the metals and mining sectors were standouts in the second and third quarters in deal activity. Together, those related groups accounted for almost one-third of total transactions in Q2 and 29 per cent of all deals in Q3. Precious metals led total deal value in Q2 2020 at US$4.53 billion, nearly double the second-highest group.

Broader deal activity picked up in the third quarter and total value was up modestly, but it was in Q4 2020 when the behind-the-scenes efforts of dealmakers over the prior quarters showed up to be counted in announced deals, and the pace has continued to be visible since then as well. In fact, more than half of the announced deal value in all of 2020 came in Q4 at US$85.5 billion, a near record for the highest quarterly amount. A new Canadian market record for the number of transactions was set at 935. The momentum has carried into this year, and Bloomberg reports that between 1 January and 20 April 2021, companies from Canada have been involved in transactions with a total value of US$184 billion, including agreed deals and preliminary proposals. This is up 198 per cent on the same point in 2020 and the most for any corresponding period on record.

When it comes to mega-deals in 2020, the fourth quarter was the story. Crosbie & Company reports there were 16 transactions with values above US$1 billion in Q4 worth a total of US$58.7 billion. This was the third largest total value in the past four years and, not surprisingly, well above the combined value for the 12 mega-deals in first three quarters of 2020 (US$43.4 billion). The value of the 16 mega-deals in Q4 was more than one-third of the total value of all deals in FY 2020.

Political events

Canada saw mostly positive developments with its largest trading partner in the past year, but some areas of concern continue to exist in US relations. On the trade front, the United States–Mexico–Canada Agreement (USMCA) entered into force on 1 July 2020, bringing a close to four years of negotiations and uncertainty about the future of the North American trading relationship. Politically, Canada's relationship with the US is expected to improve under the Biden administration and be more predictable, which is positive for Canada's most common forum for cross-border M&A. A growing US economy is also beneficial to Canadian businesses, and to start 2021, the US had the biggest first-quarter increase in growth since 1984. However, US protectionism continues to have strong support in both the Democratic and Republican parties, and Canada appears unlikely to be spared by President Biden's 'Buy American' policies. While the decision was not unexpected, the President revoked the permit for the 2,000km long Keystone XL oil pipeline between Canada and the US on his first day in office, rendering a blow to efficient Canadian oil export plans.

The strategic rivalry between the US and China continues to create uncertainty in the global economy and shape its future. Tensions between the two countries persist under President Biden, and the first face-to-face meetings between US and Chinese officials got off to a tense start. The tariffs against Chinese-made goods put in place by former President Trump remain in place, and President Biden has stated that America is in direct competition with China for economic and geopolitical superiority.

Canada's political relations with China have continued to be challenged as the extradition hearings for Meng Wanzhou, Huawei's chief financial officer, continue, and Canadians Michael Kovrig and Michael Spavor remain in custody in China. These circumstances have now lasted more than two years. In addition, in March 2021, Canada imposed new economic sanctions against four Chinese officials and one entity, based on Canada's assessment of their participation in human rights violations in the Xinjiang.

The IMAA reports that total value of M&A transactions from China and Hong Kong into Canada fell to US$570 million in 2020. This is well under half of what it was in 2019 and the lowest annual value since 2004. This latest drop in 2020 follows year-over-year declines since 2016, when US$8.12 billion of inbound deals were announced. M&A from Canada into China and Hong Kong was under US$800 million for the fourth year out of the last five. The exception was 2018, when US$2.3 billion worth of deals was announced.

Canada's federal government released its first budget in two years in April 2021. It proposes to extend business and income support measures through to the autumn and includes new spending measures to support the country's economic recovery. As with elsewhere in the world, a full recovery will require the near full vaccination of the Canadian population, and the vaccine rollout is under way.

Industry matters

MAE clauses

The pandemic brought to the fore 'material adverse change' or 'material adverse effect' (MAE) clauses in M&A deals in 2020. These clauses typically allow a party to walk away from a transaction where a material adverse change has occurred between signing and closing. It is, however, under Canadian law an uphill battle for buyers to walk away from deals using an MAE clause. Canadian case law on this issue is sparse, but an Ontario Superior Court of Justice (Commercial List) decision in December 2020, Fairstone Financial Holdings Inc v Duo Bank of Canada, helped establish some Canadian jurisprudence in this area. In its decision, the court concluded that there was no MAE as defined by the deal's share purchase agreement because the emergency, industry change and projection carve-outs all applied, and the plaintiff was not reasonably expected to be disproportionately affected relative to others in the market or industry. The decision provided a clear analysis of the principles Canadian courts will consider in future cases.

Environmental, social, governance (ESG)

Factoring ESG concerns into the M&A matrix is not new, but the rapid acceleration of its importance is clearly being felt in deal making, and the pandemic has only intensified this phenomenon. Aspects of M&A affected by ESG include financing, valuations, identifying and evaluating partners, governance and integration, communicating with shareholders and stakeholders and insurance. A company's executives and boards need to examine how a transaction will impact stakeholders beyond shareholders and be able to explain their decision-making internally and externally. ESG strategies are critical for private companies as well as public ones. If a private company is considering going public or putting itself up for sale in the future, ESG will be an important part of determining its market value. Canada has a unique framework when it comes to ESG, and the legal foundation for ESG-based decision-making by corporations is set out in legislation as well as the common law.

Canadian energy sector

The shockwaves that Canada's oil & gas industry felt at the start of the pandemic continued in 2020, and even saw the benchmark price for US oil dip into negative prices in late April for the first time ever. The Canadian industry received some welcome news in July 2020 when Canada's Supreme Court dismissed an appeal over the federal government's approval of the expansion of the Trans Mountain pipeline from Alberta to tidewater in British Columbia. The decision effectively ended the years-long legal battle over the project and will allow Canadian oil to be delivered more efficiently to international markets. In October 2020, Canadian companies Cenovus Energy Inc and Husky Energy Inc announced a transaction to combine in an all-stock transaction valued at US$23.6 billion. The deal closed in early January 2021.

As the Canadian energy industry maximises the value of its current resources, it is also continuing to develop new lower-carbon sources of energy, including hydrogen. The opportunities to produce and export the fuel in Canada are immense, and in December 2020, the federal government released its Hydrogen Strategy for Canada. A key goal of the strategy is for Canada to become the world's hydrogen supplier of choice.

SPACs

Special purpose acquisition company (SPAC) activity in Canada was limited in the past year, with only two of the blank-cheque companies being formed in 2020. This is a far cry from the dizzying growth of SPACs in the US, but interest has been building in Canada and more activity is expected in the rest of 2021. In particular, US SPACs are showing a growing interest in looking to Canada for potential targets to invest in. Studies have shown that the most recent wave of US SPACs look for targets in many sectors of the economy where Canadian companies excel, including energy, renewables, high tech, fintech, clean tech, cannabis, ESG-focused, industrial and leisure.

M&A resilience and adaptability

The surge of deals in the final quarter of 2020 and the first quarter of 2021 showed a resilience in the Canadian M&A market that bodes well as it moves through the rest of this year and into a post-pandemic world. For their part, Canadian M&A lawyers have adapted quickly to the realities of deal-making in a pandemic and are racing forward.