The outlook for Canadian M&A in 2018

Reaching New Heights

The outlook for Canadian M&A in 2018
## Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreword</td>
<td>3</td>
</tr>
<tr>
<td>Key takeaways</td>
<td>4</td>
</tr>
<tr>
<td>Part 1: The M&amp;A landscape</td>
<td>6</td>
</tr>
<tr>
<td>Part 2: Regional and sector trends</td>
<td>16</td>
</tr>
<tr>
<td>Feature: Special partners</td>
<td>26</td>
</tr>
<tr>
<td>Spotlight on U.S.-Canada M&amp;A</td>
<td></td>
</tr>
<tr>
<td>Part 3: Deal financing</td>
<td>30</td>
</tr>
<tr>
<td>Conclusion</td>
<td>32</td>
</tr>
<tr>
<td>About us/Contacts</td>
<td>34</td>
</tr>
</tbody>
</table>

### Methodology

Citi commissioned Mergermarket to interview 50 senior Canadian M&A practitioners in the second half of 2017 to gain insight on their predictions for Canadian dealmaking in 2018. All responses are anonymous and the results are presented in aggregate.
The year 2017 was doubtlessly one for the history books. A series of unprecedented events shook global affairs, and no one active in Canadian mergers & acquisitions could ignore the political rumblings coming from Canada's big neighbor to the south, as newly-elected U.S. President Donald Trump set about reordering America’s international role with unpredictable consequences.

Yet at the same time, Canada's economy went from strength to strength, posting the best first half growth since 2002 amid strong consumer spending, higher exports and fiscal stimulus introduced by Ottawa. Notably, the economy boomed even though oil prices remained well below the highs reached in mid-2014.

Against this backdrop, it is little wonder that many believe the fortunes of Canadian M&A in 2018 depend greatly on macro trends in both global affairs and economics. Enormous questions loom about the fate of U.S.-Canada ties and the direction of oil markets.

As of this writing, the future of NAFTA remained uncertain. As talks over the free-trade agreement closed in Mexico City between negotiators from the U.S., Canada and Mexico in late November, The New York Times reported that “tensions were still simmering.”

Developments in the oil patch will provide crucial context for decision-makers in 2018, just as they did last year, when the prospect of lower-for-longer crude prices prompted big international players like ConocoPhillips and Royal Dutch Shell to pull out of non-core oil sands investments. Their operations were sold to local investors for billions in some of the largest deals of the year.

The price of crude, which fell so precipitously in 2014, appeared to be firming as 2017 drew to a close. In November, the U.S. Energy Information Agency forecast Brent spot prices would average $56 per barrel in 2018, a slight increase from the first-10-month average of $53 per barrel in 2017.

Meanwhile, the OECD in September held its forecast for Canada’s economic growth in 2018 steady at 2.3%. In the context of economic expansion, Prime Minister Justin Trudeau’s Liberal government has seen fit to raise spending and to seek to transfer more wealth to low-income citizens.

Of course, Canada is not the only country that has enjoyed a season of economic growth, relative market stability, buoyant asset prices and low unemployment. As the International Monetary Fund said in late 2017, “the global upswing in economic activity is strengthening.” The U.S. in particular saw many positive signs last year, including a more than 20% gain in equity prices and a tax reform law expected to increase the country’s attractiveness for both domestic and foreign businesses.

Indeed, Canada in 2018 – like other nations in the Western world – may now be faced with the challenge of how to manage and sustain growth, rather than how to spark it.

Foreword
Five key takeaways for those pursuing Canadian M&A in 2018:

• Watch the economic winds – amid economic expansion, acquirers must still closely track interest rates, consumer spending and the outlook for growth
• Prepare for fierce competition – a shortage of quality targets may be contributing to a slump in outbound M&A and private equity buyers are more numerous and active than ever
• Be aware of sector shifts – natural resource industries still remain critical in Canadian M&A, but technology, consumer and financial services are making inroads as the economy evolves
• Monitor geopolitical events – uncertainty over NAFTA negotiations and U.S. foreign policy more broadly will play an outsized role in Canadian dealmaking, as companies gauge the impact on their businesses of any change in direction
• Look to Asia for growth – dealmakers predict that Asian countries will have the most cross-border targets for Canadian acquirers, and the most buyers of Canadian assets, as the region continues its upward trajectory
Respondents in this survey overwhelmingly expect Canadian M&A activity to rise over the coming 12 months amid rosy economic prospects, cash-rich corporate balance sheets, firming oil prices and strong consumer spending.

“The total number of deals will significantly increase in 2018,” said one M&A legal advisor at a Canadian law firm. “Deals will increase not only in number but also in size. Valuations have gone up. We are expecting a good rise in the domestic market due to the robust economy.”

Around three-quarters of our respondents expect Canadian M&A activity to increase in 2018, both in terms of volume (78%) and value (74%). No one predicted that dealmaking levels will fall.

Yet, to be sure, many respondents said they expect the rise to be moderate. Only a fifth (18%) said they anticipate a significant increase in the number of deals, and one-in-ten (10%) said they expect a significant increase in the overall value of the Canadian M&A market in 2018.

Respondents said geopolitics and macroeconomics will provide a critical backdrop to Canadian dealmaking, as executives watch the headlines and game out the impact of changes for their businesses.

Economically, executives are asking how long the good times can last. Politically, the relationship with the United States is at center stage — including the policy direction and political stability of the White House. Will U.S. President Donald Trump’s administration successfully bring down barriers to doing business, or be swept up in chaos and intrigue?

And what will be the impact on Canada of the White House’s “America First” agenda and promise to reset America’s trade relationships? Canada’s business elite are watching how Prime Minister Justin Trudeau will react, and how these two incredibly different leaders will resolve some of the biggest challenges to the U.S.-Canadian relationship in memory.

Domestically, the election of Trudeau’s Liberal government in October 2015 was seen as an endorsement of his youthful optimism over the age and experience of his competitors. Indeed, Trudeau’s Liberal government has been emboldened to raise spending and to seek to transfer more wealth to low-income citizens as strong economic growth helps lower budget deficits. In October 2017, the government reduced its deficit projection for the fiscal year ending March 31, 2018, to C$19.9bn from C$28.5bn, while introducing C$7.7bn in new spending over the coming six years.
What do you expect to happen to Canadian M&A activity in terms of the total number of deals in 2018?

- 18% significantly increase
- 60% somewhat increase
- 22% remain the same

What do you expect to happen to the overall value of Canadian M&A activity in 2018?

- 10% significantly increase
- 64% somewhat increase
- 26% remain the same
Global vectors

Outbound dealmaking from Canada is expected to increase in particular in 2018, according to survey participants. No less than 96% said outbound deal activity will rise, and four-in-ten (42%) said they expect it to grow significantly. Almost the entirety of the remainder said they expect activity to rise moderately (54%). Only a sliver (4%) expect outbound activity to be unchanged.

If this prediction holds true, it will represent a reversal from 2017, when the total value of outbound dealmaking declined. It fell in one direction in particular: the United States.


The numbers in 2016 were, however, propped up by a small number of very large energy investments by Canadian firms, including Canada’s Enbridge buying Houston-based Spectra Energy in a deal valued at US$41.4bn.

Yet the overall number of Canadian outbound deals actually increased in 2017, driven partly by a jump in private equity activity (see page 10 for details). There were 333 outbound transactions last year, compared to 287 in all of 2016.

“I think the number of outbound deals will rise substantially, because there are targets in sectors with high potential in other countries but with less competition and at more reasonable prices,” said the CFO at a Calgary-based oil and gas company.

A full 82% of respondents said they think domestic dealmaking will increase in 2018, with just 2% predicting it will decrease somewhat. Meanwhile, 74% said they expect inbound activity will rise, although a quarter (26%) said it will simply remain the same.
What do you expect to happen to the volume of Canadian M&A activity in the following areas over the next 12 months?

- **Domestic**
  - Somewhat decrease: 24%
  - Remain the same: 58%
  - Somewhat increase: 16%
  - Significantly increase: 2%

- **Inbound**
  - Somewhat decrease: 10%
  - Remain the same: 64%
  - Somewhat increase: 26%

- **Outbound**
  - Somewhat decrease: 42%
  - Remain the same: 54%
  - Somewhat increase: 4%

Canadian M&A volume + value, 2013-2017

- **Domestic value (in US$m)**
- **Inbound value (in US$m)**
- **Outbound value (in US$m)**
- **Domestic # of deals**
- **Inbound # of deals**
- **Outbound # of deals**
Buyouts on the rise

The total value of Canadian private equity dealmaking reached an all-time high in 2017 with US$32.8bn worth of buyouts, according to Mergermarket data. This record was driven in part by a dramatic increase in the value of Canadian assets purchased by foreign PE players. Inbound dealmaking from foreign PE firms soared to US$11.7bn, nearly four times the 2016 figure of US$2.8bn.

Highlights included US buyout firm Vista Equity Partners’ US$3.4bn acquisition of Canadian financial technology company DH Corporation. In another significant deal, Starwood Capital Group, the investment firm headquartered in Connecticut and managed by Barry Sternlicht, purchased Milestone Apartments REIT for US$1.7bn. Milestone was listed on the Toronto Stock Exchange, even though its physical assets were located primarily in the U.S.

Furthermore, despite the overall decline, 2017 did witness some notable outbound activity. In April, Montreal-based builder SNC-Lavalin Group Inc announced an agreement to acquire British-based WS Atkins Plc for a total of US$3.1bn. Funding for Canada’s biggest engineering and construction company’s largest-ever takeover came in part from Canadian pension fund manager Caisse de dépôt et placement du Québec, one of SNC’s largest shareholders.

Canada’s Restaurant Brands International also executed a PE-backed acquisition of the iconic American fast-food chain Popeye’s Chicken for US$1.8bn.

Overall, respondents expect the pace of private equity buyouts to accelerate in 2018. Indeed, in July, Toronto-based private equity firm Onex Corporation raised US$6.5bn for its fifth flagship private equity fund.

Yet this survey also found more optimism about the prospects for domestic and outbound activity than for the likelihood of foreign buyers snapping up of Canadian assets. Half (50%) of respondents said they expect inbound activity to increase, while a large minority (38%) said they expect the same amount of interest from abroad as last year.
What do you expect to happen to the level of private equity activity in Canada for the following areas in 2018?

- **Domestic**
  - Somewhat decrease: 32%
  - Remain the same: 62%
  - Somewhat increase: 4%
  - Significantly increase: 2%

- **Inbound**
  - Somewhat decrease: 6%
  - Remain the same: 44%
  - Somewhat increase: 38%
  - Significantly increase: 12%

- **Outbound**
  - Somewhat decrease: 30%
  - Remain the same: 66%
  - Somewhat increase: 4%

---

**Canadian private equity buyout volume & value, 2013-2017**

- **Domestic value (in US$m)**
  - US$0bn: 0
  - US$5bn: 10
  - US$10bn: 20
  - US$15bn: 30
  - US$20bn: 40
  - US$25bn: 50
  - US$30bn: 60

- **Inbound value (in US$m)**
  - US$0bn: 0
  - US$5bn: 10
  - US$10bn: 20
  - US$15bn: 30
  - US$20bn: 40
  - US$25bn: 50
  - US$30bn: 60

- **Outbound value (in US$m)**
  - US$0bn: 0
  - US$5bn: 10
  - US$10bn: 20
  - US$15bn: 30
  - US$20bn: 40
  - US$25bn: 50
  - US$30bn: 60

- **Domestic # of deals**
  - 0
  - 10
  - 20
  - 30
  - 40
  - 50
  - 60

- **Inbound # of deals**
  - 0
  - 10
  - 20
  - 30
  - 40
  - 50
  - 60

- **Outbound # of deals**
  - 0
  - 10
  - 20
  - 30
  - 40
  - 50
  - 60
Drivers of growth

Respondents focused on four key factors expected to drive Canadian M&A in the coming year:

**Inorganic Growth:** Half of respondents (50%) said domestic activity will be primarily underpinned simply by the drive for inorganic growth, which was also seen by a sizable minority (32%) as a significant draw for dealmakers seeking assets in Canada from abroad.

**Technology:** Tech looms large in the minds of Canadian dealmakers, especially when it comes to cross-border activity. Respondents in this survey said they expect Canadian firms to seek out foreign tech acquisitions—and for buyers from abroad to purchase Canadian tech as well. Roughly a third said inbound (32%) and outbound (38%) activity would be driven by technology.

**Accumulated Cash:** Canadian corporations have socked away tens of billions of dollars, and almost half of respondents (46%) believe domestic activity in 2018 will be fueled by accumulated cash stockpiles at domestic companies.

At the end of 2015, the combined Toronto Stock Exchange-listed companies held some US$40bn in cash on their balance sheets. A fifth (22%) of respondents also said that inbound activity will likewise be driven by the sheer amount of cash available for purchases. S&P Global Ratings calculated that cash and investments held by its rated U.S. non-financial corporate issuers rose by 10% to $1.9 trillion in 2016.

**New Markets:** A majority of respondents (58%) said Canadian outbound acquisition will be primarily spurred by the drive by corporates to enter new markets. Canadian buyers are especially interested in Asia and Latin America, as discussed in Part 2 of this report (see page 16).
What will be the greatest drivers of domestic, inbound and outbound Canadian M&A in 2018?

- Companies seeking inorganic growth
- Accumulated cash stockpiles on corporate balance sheets
- Private equity demand
- Rise in consumer spending
- Business diversification
- Technology acquisitions
- Easy access to financing
- Energy prices
- Strength of Canadian dollar
- Expansion into new markets by corporates
- Dry powder held by pension funds and PE firms
- Lack of domestic targets
- Increasingly global nature of business
Navigating risks

Regulatory hurdles stand out as the single biggest challenge for Canadian dealmaking in 2018, underpinned by anxiety about the future trade and investment relationship with Canada’s biggest trading partner, the United States.

Indeed, the top three answers respondents gave to the impediments of 2018 are intertwined: after regulatory hurdles (44%) came geopolitical and macroeconomic risk and U.S. government policy (42%), followed by uncertainty over the results of NAFTA negotiations (40%).

Trump’s anti-NAFTA rhetoric, “America First” governing philosophy and talk of a border-adjustment tax have all raised questions in the minds of Canadian dealmakers.

“The results of NAFTA negotiations will affect trade, the market, other policies, and so on, and all these factors directly affect M&A deals,” said the CFO of a Calgary-based oil and gas company. “The uncertainty leads to a lot of high-end risks.”

Yet the United States isn’t the only factor underpinning unease about regulations.

“Canada has policies that are investment-friendly but the regulations can be a real pain at times,” said an executive vice president at a Canadian media company. “The rigidity of the system can slow things down.”

In the context of rising activity between Canadian and Asian players, national security reviews of deals have become increasingly complex in recent years in Canada. And in May 2016, the Canadian Securities Administrators introduced major amendments to the Canadian takeover bid regime that represented the most important changes in well over a decade. Among other changes, new rules require non-exempt takeover bids to remain open for a minimum deposit period of 105 days, as opposed to the previous 35-day minimum. Overall, the rule changes aimed to make hostile takeovers more difficult.
What do you perceive as the greatest challenges to Canadian M&A in 2018? (Select top two)

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory hurdles</td>
<td>44%</td>
</tr>
<tr>
<td>Geopolitical and macroeconomic risk / U.S. governmental policy</td>
<td>42%</td>
</tr>
<tr>
<td>Uncertainty over results of NAFTA negotiations</td>
<td>40%</td>
</tr>
<tr>
<td>Valuation levels</td>
<td>26%</td>
</tr>
<tr>
<td>Competition for quality targets</td>
<td>24%</td>
</tr>
<tr>
<td>Interest rate expectations</td>
<td>14%</td>
</tr>
<tr>
<td>Energy prices</td>
<td>10%</td>
</tr>
</tbody>
</table>
The Asia-Pacific region is front and center for Canadian dealmakers – both as a destination and as a source of incoming bids.

About two-thirds of respondents (66%) said they expect Asia to be among the top-two regions targeted by Canadian buyers. Only slightly fewer said they expect buyers from Asia-Pacific to be among the top-two regions generating bids for Canadian assets (62%).

Indeed, in one of the biggest inbound deals of 2017, Hong Kong-based CK Asset Holdings agreed to buy Canadian heating, ventilation and air-conditioning firm Reliance Home Comfort for US$3.6bn.

“Some companies from Asia and Europe that are looking to invest in the North American market are slowly shifting investments to Canada as the U.S. has become more restrictive to foreign deals,” said a managing director at a Canadian bank.

Mergermarket data indicate that the number of cross-border deals between Canada and Asia-Pacific countries continues to rise. The value of Asian investment into Canada also
increased in 2017, though the value of Canadian investment heading to Asia fell to a fraction of what it was the year before. Overall, there were 60 deals valued at US$18.3bn between Canada and Asia-Pacific nations in 2016, compared to 56 transactions worth US$10.9bn last year.

After Asia, Latin America (46%) was also picked as a prominent destination for Canadian acquirers. In 2017, Paper Excellence Canada Holdings splashed out US$4.3bn to acquire 81% of Brazil-based pulp production company Eldorado Brasil Celulose SA. In another major deal, investment manager and private equity firm Caisse de dépôt et placement du Québec joined Mexico-based investment trust CKD Infraestructura Mexico to purchase a combined 80% stake in Enel Green Power S.p.A., a portfolio of eight wind and solar assets, for a total of US$340m.

Survey participants also predict that U.S. (60%) and European and U.K. (58%) acquirers will actively seek out Canadian targets.

In one of the biggest inbound European deals of 2017, Refresco Gerber BV, the Netherlands-based bottler of fruit juices and soft drinks, bought Mississauga, Canada-based Cott Corporation’s traditional beverage manufacturing businesses for US$1.25bn. The transaction included Cott’s operations in North America, the U.K., and Mexico.

THE OLD AND THE NEW
Canada’s energy sector continued to dominate deal activity in 2017, and with good reason. Natural resources make up 16% of the country’s GDP, according to official statistics. And in 2016, natural resource firms accounted for almost 40% of total non-residential capital investment in Canada, worth C$90bn.

This survey indicates that energy’s prominent position in the M&A league tables may grow in 2018. Two-thirds of respondents (68%) believe energy will be among the sectors with the biggest increases in domestic and inbound deals in 2018.

Looking at sector data from 2017, energy towered over the landscape in all three geographical categories, while the related sectors of utilities and industrials & chemicals also came up strong.

In one of the biggest Canadian deals of 2017, Calgary-based power and gas supplier AltaGas agreed in January to spend US$6.7bn to buy WGL Holdings, an American holding company with natural gas, electricity, green power and energy services throughout the U.S.

Yet respondents also expressed enthusiasm about the outlook for consumer deals, especially in the domestic market. More than a quarter (26%) picked the consumer sector as among the top two most likely to experience growth in domestic deal activity in 2018. Canada’s rapid economic grow has been fueled by a consumer-spending binge, as Canadians benefit from a strong jobs market and rising home values.

And while several of Canada’s biggest deals in 2017 took place in energy or utilities, large retail acquisitions made headlines as well. In October, for example, Canada’s third-biggest retailer, Metro Inc, announced it would purchase pharmacy chain Jean Coutu Group for US$3.47bn.
Which sectors in Canada do you think will see the biggest increases in M&A activity in the following areas next year? (Select top two for each)
What’s more, activity in Canada’s energy sector wasn’t driven primarily by foreign interest in Canadian assets. In 2017, Canada’s mighty energy sector received less inbound M&A activity than either the country’s consumer or technology sectors.

Looking to 2018, respondents said they expect technology, media & telecoms (TMT) companies in Canada to draw the most attention from foreign buyers. Indeed, Vista Equity Partners’ US$3.4bn acquisition of Canadian financial technology company DH Corporation may be a sign of things to come.

Consider, for example, Element AI, the Montreal-based platform and incubator for companies incorporating artificial intelligence into their business models. The firm raised US$102m in 2017 in one of the largest-ever funding rounds for an AI-focused firm.

Interestingly, a plurality of our survey participants believe Canada-based purchasers looking for deals abroad will be primarily drawn to the TMT sectors, followed by industrials & chemicals (40%) and consumer (36%).
In 2017, a bear market for crude prompted some big international players to depart from Canada’s oil sands, leaving local companies to snap up their assets. Those deposits are considered to be among the most technically difficult and therefore most expensive in the world to develop, and the prospect of lower-for-longer oil prices sent international players in search of easier returns elsewhere.

In March, U.S. oil giant ConocoPhillips agreed to sell oil sands and western Canadian natural gas assets to Canada’s Cenovus Energy for US$13.3bn, in the single largest deal of the year. That acquisition doubled Cenovus’s total output to 588,000 barrels per day.

Weeks earlier, Royal Dutch Shell agreed to sell most of its Canadian oil sands assets for US$8.5bn to Canadian Natural Resources in the second-largest deal of the year.

What will 2018 bring for Canada’s oil patch? In October 2017, the Petroleum Services Association of Canada predicted that Canadian oil and gas drilling activity will climb 5% in 2018 as firmer, marginally higher oil prices spark cautious optimism among producers. The group forecast that 2018 will be the busiest year for drillers in Canada since prices collapsed in 2014.

In this survey, a majority of respondents said that the current oil price – which hovered around US$52 per barrel (WTI) at the time of the poll – was having either a significant positive impact (14%) or somewhat positive impact (48%) on Canadian M&A. The price reached a two-year high in November 2017 amid threats to global supply and a possible deal to reduce output by OPEC.

A minority of respondents (14%) said the current price – and, more specifically, the near-term unpredictability – is instead having a somewhat negative effect on deal activity.

“There is a lot of uncertainty surrounding global oil prices,” said a managing director at a Canadian bank. “Some Canadian oil companies have targeted investments in other regions to help create a buffer against the possibility of falling prices and higher costs for some assets. These investments haven’t been substantial but are on the positive side.”

Of course, fossil fuels aren’t the only form of energy in Canada. Renewables have made enormous strides in recent years.

In May, the country reached a big milestone: renewable energy supplied two-thirds of the country’s electricity, according to the National Energy Board. Indeed, within energy, mining and utilities, alternative energy made up the second-largest sub-sector in terms of M&A activity in 2017, thanks in large part to three deals in the segment valued at US$1bn or more. In the most significant of these, Toronto-based asset manager Brookfield Asset Management raised its stake to 51% in TerraForm Power, a large-scale, diversified portfolio of solar and wind assets located predominantly in the U.S., in a transaction valued at US$4.2bn.

Back at home, Canada is bolstering its renewable power generation as well. A decade ago, Canada produced almost no solar power, but by 2015, solar generated more than 3,000 gigawatt hours. Thanks to generous financial incentives, Ontario is home to some 98% of all Canadian solar production.
How are current oil prices impacting Canadian M&A?

- 14% Significant positive impact
- 48% Somewhat positive impact
- 14% Somewhat negative impact
- 24% No material difference

How are current metals prices (for gold, copper, aluminum, zinc and others) impacting Canadian M&A?

- 12% Significant positive impact
- 58% Somewhat positive impact
- 4% Somewhat negative impact
- 26% No material difference
Nonetheless, respondents called wind energy (42%) the clear choice to become the top alternative segment for deal activity in 2018, followed by hydropower (24%) and nuclear (22%).

Canada ranks fourth globally in renewable energy generation behind China, the U.S. and Brazil. The country is also the second-biggest producer of hydro power after China, and the seventh-largest producer of wind power.
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil and gas exploration and production</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Alternative energy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electrical power generation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Metal ore</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other utilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exploration and drilling services and equipment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electrical power transmission</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Water, sewage and other systems</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-metallic ores</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other utilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Integrated utilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The economic relationship between the U.S. and Canada is nearly unique around the world in its scale and depth. The neighbors exchanged US$627.7bn worth of goods and services in 2016, making the U.S. Canada’s largest trading partner and Canada the U.S.’s second-largest partner behind China. Increasingly, M&A has become a key component of the two countries’ ties as well. Over the last five years (2013-17), there have been 765 deals for American targets by Canadian companies, with a total value of US$310bn - the highest number and largest value of deals from any inbound country into the U.S. over that period.

With the change in U.S. political leadership in late 2016, a note of uncertainty entered the relationship. This was caused in no small part by U.S. President Donald Trump’s determination to renegotiate the landmark North American Free Trade Agreement (NAFTA) that came into force in 1994. Negotiators from the two countries and Mexico hit roadblocks throughout the fall of 2017, and the outcome of talks remained unclear as of this writing.

When it comes to U.S.-Canada M&A, however, the impact of changes to NAFTA may not be monumental. Some of the sectors that could be most affected by new trade conditions, such as the agriculture and automotive industries, see minimal cross-border deal activity as it is. There would also likely be a transition period if a settlement regarding NAFTA proves elusive - which could allow the U.S. and Canada to forge a new bilateral trade agreement instead. In early December, Prime Minister Justin Trudeau said Canada would consider one-on-one talks with the U.S. if no consensus is reached on changes to NAFTA.

**IMPACT OF U.S. TAX REFORM**

The U.S. push to overhaul its trade relationships is not the only policy change that could have a major effect on M&A activity in the two countries next year. The tax reform bill passed by the
U.S. Congress in December contains measures that could add substantial amounts of cash to U.S. corporate balance sheets, one natural use for which would be to make acquisitions.

The main contributor is expected to be the reduction in the rate at which American multinationals pay taxes on foreign profits held overseas, from the former 35% to 15.5% or less. Many observers believe the lower rate will cause companies to repatriate some of the estimated US$3tn in foreign profits held abroad. In addition, the new 21% top corporate rate is expected to boost profits at many U.S. companies.

The tax reform effort is likely one reason that most of our survey respondents are optimistic about the effects of U.S. policy on U.S.-Canada M&A in the year ahead. Fifty-six percent said they think it will have a positive effect on deal activity between companies in the two countries.

**COMMODITY PRICE REBOUND**

Another reason for a positive outlook on transactions in 2018 is the upswing in the value of many natural resources, especially oil and gas. The energy, mining & utilities sector typically has the most cross-border M&A investment between the U.S. and Canada, and this held true in 2017, when there were 40 deals valued at US$26.5bn. (This represents a steep decline in value from 2016, when the sector had cross-border deals worth US$75bn - but US$64.7bn of that amount came from just three mega-
Which sectors do you expect U.S. buyers to target most in Canada over the next 12 months? (Select top two)

Energy
Technology, media & telecoms
Consumer/Retail
Mining
Industrials & chemicals
Healthcare
Financial services
Infrastructure/Utilities
Leisure
deals, headlined by Enbridge’s US$41.4bn acquisition of Spectra Energy in September 2016.)

After several challenging years for the mining industry, improved prices for metals such as gold and copper have buoyed expectations for financing and deals. U.S. buyers made several major acquisitions in Canada’s mining sector in 2017, including Gryphon Enterprises’ US$750m purchase of magnesium and gold properties owned by Calgary-based West High Yield Resources. If commodity prices hold firm or rise further, expect increased targeting of exploration companies as mid-sized and large miners look to refill their production pipelines.

Similarly, the energy sector is likely to see more deals over the coming 12 months if oil and gas prices maintain their steady climb begun in late 2017. Canadian majors such as Suncor Energy and Canadian Natural Resources posted strong financial results in Q3 2017 that were helped in part by acquisitions, and private equity capital in the space continues to grow. For instance, Houston-based EnCap Investments announced in December that it had raised US$7bn for one of the largest energy-focused funds of the years.

**FUTURE FORCES**

Beyond the natural resources sectors, two influential factors are set to make an impact on U.S.-Canada M&A over the coming year: private equity and technology sector deals. Both of these categories are seeing substantial growth in North America, as they are around the globe. In 2017, there were 68 cross-border PE deals between the countries valued at US$18.7bn, which is 21 more transactions and an 80% increase in value year-over-year. The tech segment saw even more impressive growth with 85 deals worth US$7.2bn, which is 24 more than in 2016 and a 53% jump in value.

One factor contributing to the growth in technology M&A is the gradual development of sub-sector niches in Canada. For instance, Canadian fintech companies now employ an estimated 60,000 people as the burgeoning industry gains support from the country’s mature banking system, including in the form of corporate venture capital investments. Last year, the biggest deal from the U.S. to Canada was the US$3.4bn acquisition of payments provider DH Corporation, one of Canada’s largest fintech companies, by PE firm Vista Equity Partners.

In the private equity arena, funds are raising record amounts of capital, spurring them to seek out larger targets, as the deal for DH demonstrates. In November 2017, Canada’s largest buyout firm, Onex, announced that it had gathered US$7.15bn for its latest fund, exceeding its original US$6.5bn target. And another one of the top five deals from the U.S. to Canada last year involved a PE buyer – the Carlyle Group, which paid US$723m for packaged ice distributor Arctic Glacier Holdings in March 2017.

**THE YEAR AHEAD**

Market conditions and macroeconomic forces suggest that U.S.-Canadian dealmaking is set for another strong year in 2018. Two major wild cards exist in the impact of U.S. policy changes and the direction taken by energy prices over the coming year, but structural factors suggest that cross-border M&A will almost certainly ramp up in specific categories. Investors and dealmakers should have a busy year evaluating the ample opportunities against a backdrop of not insignificant risks.
PART 3: DEAL FINANCING

How will Canadian acquisitions be financed in 2018? According to this survey, the cash firms have piled up on their books will do most of the heavy lifting. A majority of respondents (56%) think cash on balance sheets will be among the top sources of financing for M&A deals in 2018, along with asset sales (46%) and private debt (42%).

Respondents also envision private debt becoming an increasingly common form of financing: 90% said they expect its availability to increase either significantly (36%) or somewhat (54%).

In 2017, non-investment grade bonds rallied amid a record year for Canadian high-yield issuance, supported by firming oil prices. New high-yield issuance reached a year-to-date record of US$2.3bn by November 1, according to data compiled by Bloomberg.

Yet few respondents (10%) think high-yield debt will be among the most accessible forms of funding for Canadian dealmaking in 2018. Nearly half (46%) think its availability will remain the same as the year before.

Strategic deals (72%) and mega-deals (44%) are the two deal types expected to see the biggest increases in activity next year. Last year had the fewest inbound, domestic and outbound mega-deals (defined as transactions valued at US$4bn or more) since at least 2014 with just seven, compared to 11 in 2016, 10 in 2015 and nine in 2014. Six of the seven Canadian mega-deals in 2017 were for energy, mining & utilities companies.
Which types of financing will be most accessible to fund Canadian acquisitions in 2018? (Select top two)

<table>
<thead>
<tr>
<th>Type of Financing</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategic deals</td>
<td>72%</td>
</tr>
<tr>
<td>Mega deals (US$4bn+ in value)</td>
<td>44%</td>
</tr>
<tr>
<td>Bolt-on acquisitions</td>
<td>32%</td>
</tr>
<tr>
<td>PE buyouts</td>
<td>30%</td>
</tr>
<tr>
<td>Joint ventures</td>
<td>22%</td>
</tr>
</tbody>
</table>

What will happen to the availability of financing in Canada in the following areas in 2018?

<table>
<thead>
<tr>
<th>Area</th>
<th>Significantly increase</th>
<th>Somewhat increase</th>
<th>Remain the same</th>
<th>Somewhat decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private debt</td>
<td>36</td>
<td>54</td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td>Asset sales</td>
<td>30</td>
<td>60</td>
<td>8</td>
<td>2</td>
</tr>
<tr>
<td>Cash</td>
<td>29</td>
<td>59</td>
<td>12</td>
<td></td>
</tr>
<tr>
<td>Bank loans</td>
<td>16</td>
<td>36</td>
<td>36</td>
<td>12</td>
</tr>
<tr>
<td>Equity raising</td>
<td>10</td>
<td>28</td>
<td>50</td>
<td>12</td>
</tr>
<tr>
<td>High-yield bonds</td>
<td>4</td>
<td>40</td>
<td>46</td>
<td>10</td>
</tr>
</tbody>
</table>
CONCLUSION

This survey suggests Canadian dealmaking will expand in 2018 as companies spend accumulated cash on inorganic growth, expand into new markets and make technology-focused acquisitions. Domestic activity and foreign purchases, in particular, are tipped for heightened activity, executives said.

Asia and Latin America will beckon Canadian acquirers, and private equity players will seek more opportunities both at home and abroad than they did the year before.

Yet regulatory hurdles loom large in the mind of executives, underpinned by anxiety about the uncertain future of U.S.-Canada relations under the unpredictable President Trump. The future of NAFTA, in particular, will be closely watched.

While the total value of dealmaking fell overall year-on-year in 2017, much of the difference can be accounted for by a small number of mega-deals in 2016 by Canadian buyers of energy assets in the United States.

Hopes are high for continued economic growth. The Canadian economy expanded 4% in the first half of 2017, making Canada the fastest-growing country in the G7. Solid exports, robust consumer spending, U.S. economic strength, and firming oil prices all played a part – as did fiscal stimulus introduced by Ottawa. Amid this good news, the Bank of Canada has been raising interest rates, reversing cuts implemented in 2015 in response to 2014’s collapse in oil prices.

Indeed, Prime Minister Justin Trudeau has called for Canada to “phase out” its dependence on fossil fuels, while increasing technology funding and offering fast-track visas to highly skilled workers. In March, Canada’s federal government established a new program to drive investment in growth-stage technology companies, allocating C$400m to increase venture capital available to Canadian tech entrepreneurs.

To be sure, energy remained the most important arena for Canadian dealmaking in 2017, and executives in this poll expect growth in the sector in 2018. But dealmakers also expect more domestically-sourced buying in Canada’s consumer and retail sector as the rising economic tide lifts Canadians’ spending power. Abroad, Canadian buyers will go in search of targets in technology, industrials and retail.
About us

Citi, the leading global bank, does business in more than 160 countries and jurisdictions. Citi provides consumers, corporations, governments and institutions with a broad range of financial products and services, including consumer banking and credit, corporate and investment banking, securities brokerage, transaction services, and wealth management.

In Canada, Citi is the country’s most global financial institution with roots dating back to 1919. With an unmatched global reach, the company is uniquely positioned to enable the progress of its clients.

ADDITIONAL INFORMATION MAY BE FOUND AT:

www.citigroup.com/canada

Twitter: @Citi

YouTube: www.youtube.com/citi

Blog: http://blog.citigroup.com

Facebook: www.facebook.com/citi

LinkedIn: www.linkedin.com/company/citi

Contacts

GRANT KERNAGHAN
MANAGING DIRECTOR
Canadian Investment Banking
+1 416 947 5500
grant.kernaghan@citi.com
Acuris Studios, the events and publications arm of Acuris, offers a range of publishing, research and events services that enable clients to enhance their brand profile, and to develop new business opportunities with their target audience.

To find out more, please visit www.acuris.com

Please contact:
Erik Wickman
Global Managing Director, Acuris Studios
Tel: +1 212 686 3329

About Mergermarket

Mergermarket is an unparalleled, independent mergers & acquisitions (M&A) proprietary intelligence tool. Unlike any other service of its kind, Mergermarket provides a complete overview of the M&A market by offering both a forward-looking intelligence database and a historical deals database, achieving real revenues for Mergermarket clients.
Disclaimer
This publication contains general information and is not intended to be comprehensive nor to provide financial, investment, legal, tax or other professional advice or services. This publication is not a substitute for such professional advice or services, and it should not be acted on or relied upon or used as a basis for any investment or other decision or action that may affect you or your business. Before taking any such decision, you should consult a suitably qualified professional adviser. Whilst reasonable effort has been made to ensure the accuracy of the information contained in this publication, this cannot be guaranteed and neither Mergermarket nor any of its subsidiaries or any affiliate thereof or other related entity shall have any liability to any person or entity which relies on the information contained in this publication, including incidental or consequential damages arising from errors or omissions. Any such reliance is solely at the user’s risk.