

# DEALS WEST

WESTERN CANADA'S CORPORATE TRANSACTION QUARTERLY



## Q2 2016 Mid-Market M&A Review

### MID-MARKET TRANSACTIONS IN NORTH AMERICA

North American mid-market M&A activity in Q2 2016 increased 2% by volume (760 deals in Q2 2015 to 773 in Q2 2016) while the total value of transactions increased by 15% compared to Q2 2015. The increase in deal value was driven primarily by higher M&A activity in the real estate sector, with almost half the transactions in North America occurring in this sector alone.

On a quarterly basis, mid-market M&A activity in North America remained relatively flat in terms of volume and increased by 5% in total value relative to Q1 2016.

On a rolling twelve month basis, M&A activity in the North American mid-market continues at a robust level, with deal value in the last twelve months totalling over \$370 billion. Overall, transaction activity continues to be driven by low interest rates and an abundance of capital.

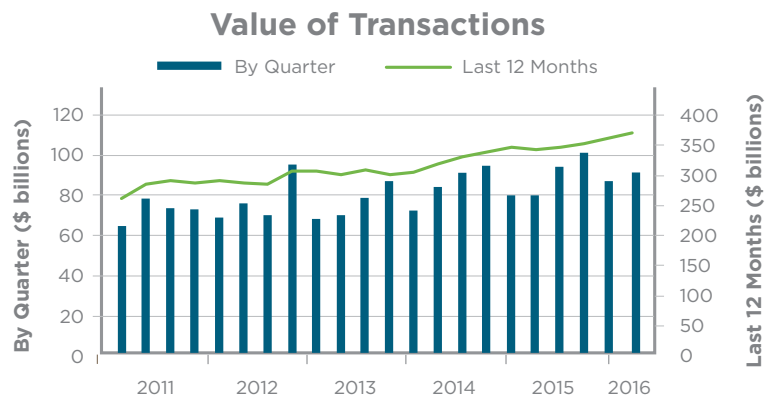
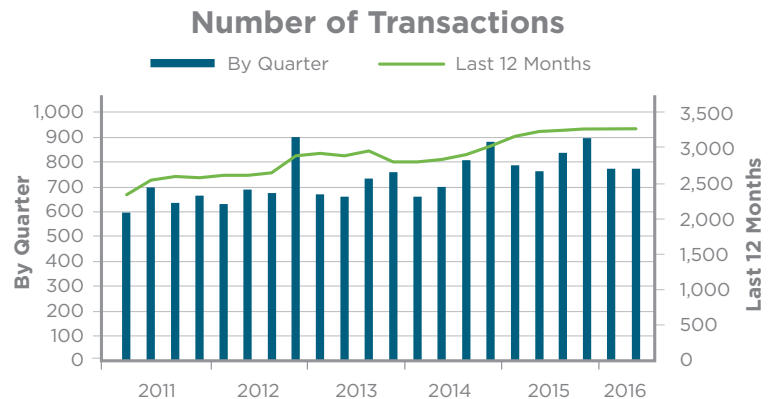
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Mergers & Acquisitions Review (continued)

## MID-MARKET ACQUISITIONS IN CANADA (\$25 million - \$500 million)

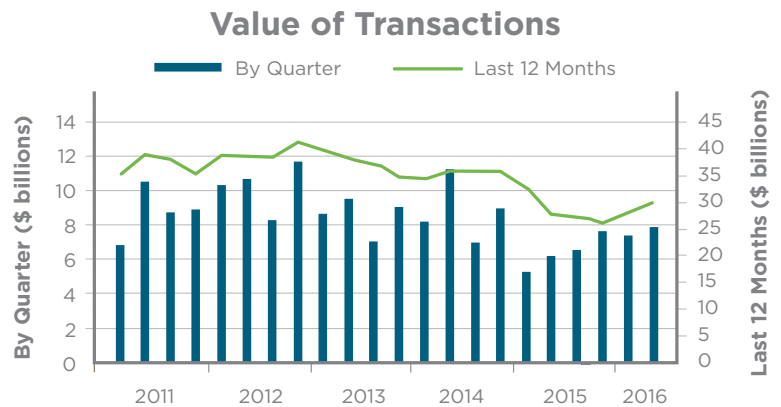
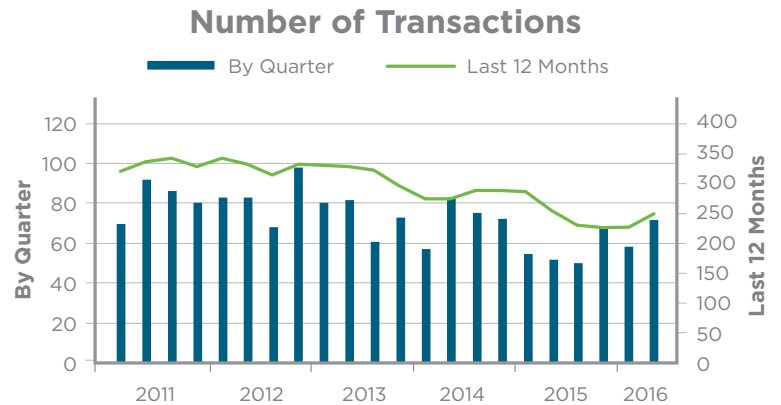
### MID-MARKET TRANSACTIONS IN CANADA

Compared to Q2 2015, mid-market activity in Canada increased 39% by volume and 25% in value in Q2 2016. A rise in deal activity in the industrials & materials, real estate, and tech, media & telecom sectors accounted for the majority of the increase. Total deal value in the real estate sector rose from \$1.4 billion in Q2 2015 to \$3.1 billion in Q2 2016.

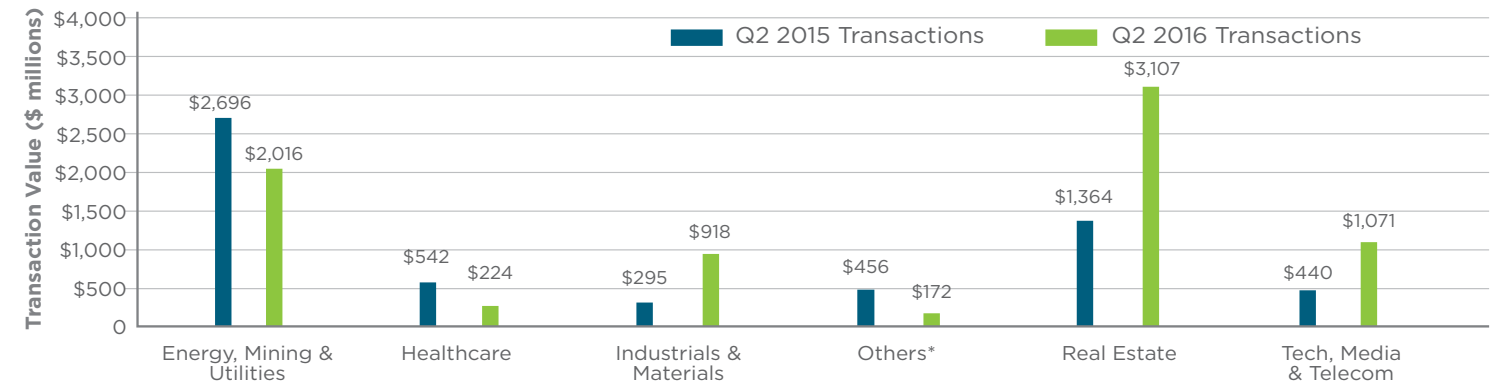
Canadian mid-market M&A activity increased 24% by volume and 6% in value in Q2 2016 compared to Q1 2016.

By industry, M&A activity in the industrials & materials sector more than tripled on a year over year basis. Deal activity in the real estate sector more than doubled from \$1.4 billion in Q2 2015 to \$3.1 billion in Q2 2016, having the highest number of deals compared to any other industry. Tech, media & telecom also saw increased deal activity in Q2.

Sectors with declining deal activity in Q2 2016 include energy, mining & utilities, and healthcare, decreasing by approximately 25% and 59% respectively.



## Q2 2016 vs. Q2 2015 Middle Market Transactions Value (\$millions)



\* Other includes Financials, Food & Beverage, Forestry & Paper Products, and Hospitality & Transportation sectors

Mergers & Acquisitions Review (continued)

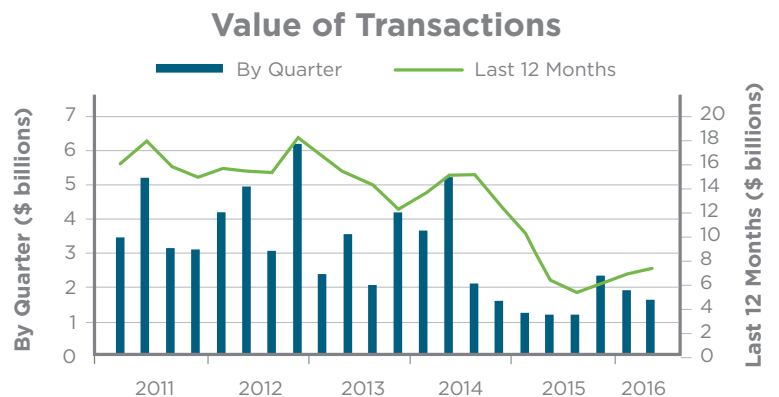
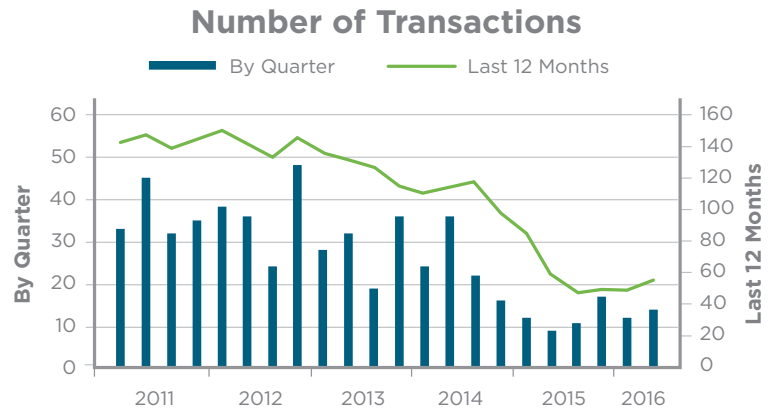
## MID-MARKET TRANSACTIONS IN WESTERN CANADA

On a year over year basis, the value of mid-market transactions in Western Canada increased 37% from Q2 2015 to Q2 2016. The number of transactions was also significantly higher compared to Q2 2015 (up 56%), driven primarily by a higher level of M&A activity in the energy, mining & utilities sector, as commodity prices improved in recent months.

Western Canadian mid-market M&A volume increased by 17% in Q2 2016 compared to Q1 2016. Despite this, the total value of deals decreased by 9% compared to Q1 2016, the result of a 26% decrease in average deal size.

The top ten M&A deals in Canada in Q2 2016 involved only a few industries: energy, mining, & utilities, and real estate being the largest contributors. A key deal in the table below from a British Columbia perspective was the acquisition of Catalyst Paper by Kejriwal Group International, a paper products company based in India that offers paper as raw material for newspapers, stationery items, and book publishing.

### MID-MARKET ACQUISITIONS IN WESTERN CANADA (\$25 million - \$500 million)



### Top 10 Canadian Deals in Q2 2016

Date	Industry	Target	Buyer	Value (\$mm)
May 02	Tech, Media & Telecom	Manitoba Telecom Services	BCE	\$ 3,893
May 10	Real Estate	InnVest REIT	Bluesky Hotels and Resorts	\$ 2,122
Apr 25	Energy, Mining & Utilities	Husky Energy	Power Assets Holdings	\$ 1,154
Jun 10	Energy, Mining & Utilities	Penn West Petroleum	Teine Energy	\$ 975
Apr 27	Energy, Mining & Utilities	Syncrude Canada	Suncor Energy	\$ 937
June 13	Consumer Products & Services	Kerr Investment Holding Corporation	Xiwang Foodstuffs; Primavera Capital Group	\$ 932
June 21	Energy, Mining & Utilities	Encana Corporation	Birchcliff Energy	\$ 625
May 10	Energy, Mining & Utilities	Husky Energy	Whitecap Resources	\$ 595
May 20	Forestry & Paper Products	Catalyst Paper Corporation	Kejriwal Group International	\$ 567
Apr 11	Energy, Mining & Utilities	Reservoir Minerals	Nevsun Resources	\$ 511

Capital West remains active, and continues to see strong acquisition interest on its current transactions due to higher mid-market deal values this quarter in Canada and in North America overall.

## What will the Bank of Canada do next?



At its latest monetary policy meeting on July 13th, the Bank of Canada decided to leave the overnight lending rate on hold at 0.50% as economic uncertainty continues to loom. The outcome was in line with the majority of economists who forecasted that the Bank of Canada would hold firm on interest rates.

While most economists say rates will stay flat in the near term, some economists such as David Watt, chief economist at HSBC, speculate that a rate cut remains likely later in 2016. This speculation is based primarily on concerns surrounding increased household debt and expectations that fiscal spending by the federal government will begin in the latter half of 2016.

Most economists surveyed stated they expect the Bank of Canada to leave rates unchanged in the near term. However, many expect a rate hike in late 2017 or early 2018. This is in line with interest rate forecasts by three of the five big Canadian banks, which predict a 25 basis point increase in Q4 2017.

Interest rates are at record lows, and with the potential to go even lower M&A activity in Canada is being pushed by a strong tailwind. With purchasers able to source large amounts of debt financing at record low rates, valuation multiples continue to increase. How long this trend continues is in part dependent on what the Bank of Canada does next.

### Canadian Interest Rate Forecast by Big Five Banks

	2016				2017			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<b>RBC</b>	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>TD</b>	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
<b>BMO</b>	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75
<b>Scotiabank</b>	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75
<b>CIBC</b>	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75

## Royalty Financings



There is not only a substantial amount of capital in the market seeking investment opportunities, but the range of deal structures available for companies in search of capital is wider than ever. Deal structures for new investments include the old standbys – common shares, preferred shares, senior debt, subordinated debt – as well as other options that have been more recently developed by capital providers.

One of the new structures that has become increasingly popular for capital seeking companies is royalty financing. This involves a company selling an annual variable payment to a capital provider over a certain period of time, up to a specific amount. The annual payment is often calculated as a percentage of a key financial metric such as revenue or gross margin (i.e. 5% of annual revenue).

There are many advantages of this financing structure, one of which is that the annual royalty payment is subordinated to any debt the company has and does not affect its banking covenants. Another advantage is that the annual payment fluctuates depending on the performance of the business. For example, in good times, the payment is higher and in bad times, it is lower. Lastly, the royalty owner does not have the rights that a shareholder does; as a result, the business owners remain in control.

Today, there are many groups that provide royalty financings, some focusing on larger deals of up to \$200 million and others on deals as low as a few million. Some of these groups in Canada include Alaris Royalty, Crown Capital Partners, Diversified Royalty, Founders Advantage Capital, and Grenville Strategic Royalty.

### Royalty Financing Providers (CAD millions)

Company Name	Market Cap	TEV	Rev LTM	TEV/Rev		TEV/EBITDA	
				LTM	NTM	LTM	NTM
Alaris Royalty	1,061	1,121	87	10.5x	9.7x	12.3x	11.1x
Crown Capital Partners	89	66	3	5.0x	3.6x	8.2x	5.2x
Diversified Royalty	248	297	24	12.6x	9.7x	14.4x	11.2x
Founders Advantage Capital	170	152	NM	NM	NM	12.2x	N/A
Grenville Strategic Royalty	35	40	7	5.7x	7.3x	12.3x	6.2x
<b>Median</b>				<b>8.1x</b>	<b>8.5x</b>	<b>12.3x</b>	<b>8.6x</b>
<b>Average</b>				<b>8.4x</b>	<b>7.6x</b>	<b>11.9x</b>	<b>8.4x</b>

## Royalty Financings

*(Continued)*



In many cases, the valuation multiple for these royalty financings is as high as a deal multiple for the sale of control of the company, or even higher. But in a royalty deal, the owner retains control of the business.

A wide range of companies are candidates. Examples of firms who have recently completed royalty financings include Mr. Lube Canada, Original Joe's Restaurants (Franworks Franchise), and Dominion Lending Centres.

### Royalty Financing Transactions (CAD millions)

Date	Target	Buyer	Transaction Value	Transaction details
July 2015	Mr. Lube Canada	Diversified Royalty	\$139	Acquisition of the trademarks and certain other intellectual property rights utilized by Mr. Lube in exchange for an initial royalty payment of \$12.4 million per annum
Sept. 2014	Franworks Franchise	Diversified Royalty	\$103	Acquisition of an approximate \$12 million of annual top-line royalty from Franworks
June 2016	Dominion Lending Centres	Founders Advantage Capital	\$79	Provides Founders Advantage with 60% of the first \$14.6 million of annual distributions paid by Dominion to its security holders
May 2013	SCR Mines Technology Inc.	Alaris Royalty	\$41	Investment of \$40 million in exchange for pre-tax annual preferred distribution of \$6.4 million for the first full year after the investment
Nov. 2011	Quetico, LLC	Alaris Royalty	\$28	Contribution of \$26.9 million in exchange for pre-tax annual preferred distribution of \$4.25 million for the first full year after the contribution
Nov. 2015	Agnity Global	Grenville Strategic Royalty	\$3	Gross sales royalty from Agnity Global based on gross revenue within an average royalty rate of between 1% and 4% in exchange for an advance of US\$2 million with a US\$750,000 convertible promissory note

Whether a company is looking for growth financing or partial liquidity for its owners, a royalty financing should be considered along with the other options.

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