MID MARKET INVESTMENT BANKING

Spring 2020

Market update

We are pleased to share our thoughts on the rapidly evolving M&A environment to help you navigate through these unprecedented times.

Since the original COVID-19 outbreak in Wuhan, China, the virus spread throughout the world at a record pace. Canada identified its first few cases in late January 2020 in Toronto and Vancouver. Following accelerating spread from coast-to-coast, federal, provincial and municipal governments put in place drastic social distancing measures, which are expected to plunge the nation in the first self-inflicted recession in history.

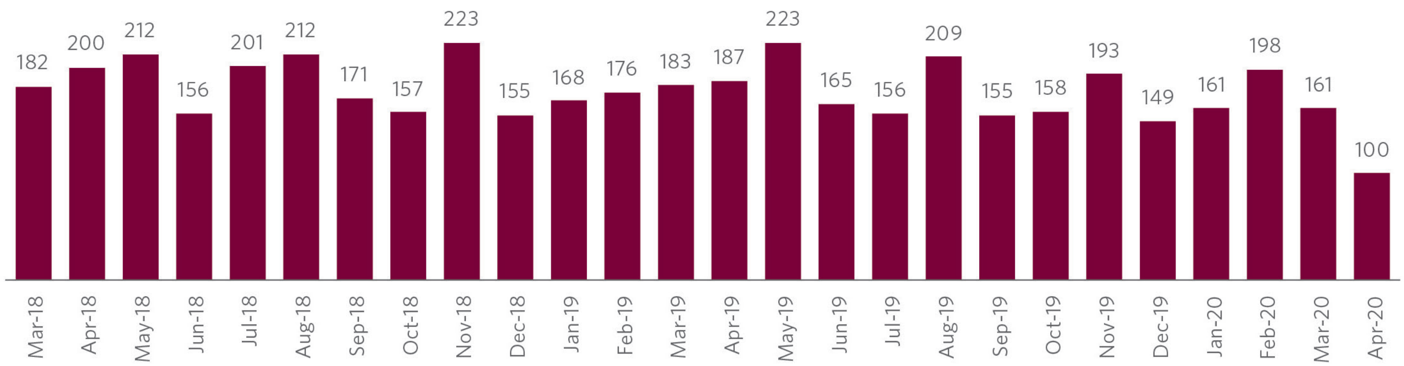
Every M&A cycle is unique. What we are seeing today compared to 2008 is the difference between a systemic collapse of the financial industry and an event-driven pullback as a result of the COVID-19 pandemic. Economies tend to recover faster from event-driven downturns. We expect some sectors, such as healthcare and technology, to recover before others like retail, energy and basic industrials, which may take a while longer.

Beyond the headlines, a new reality is taking shape. Office workers are getting used to working from home. Travel plans are cancelled and replaced by video conferences. Online shopping is more popular than ever before. While some of these changes may be temporary, these shifts in behaviour will have lasting impacts on certain industries, especially for retail.

As in any rapidly evolving environment, we believe there are substantial opportunities to capitalize on in the M&A market for investors and acquirers able to identify the right trends.

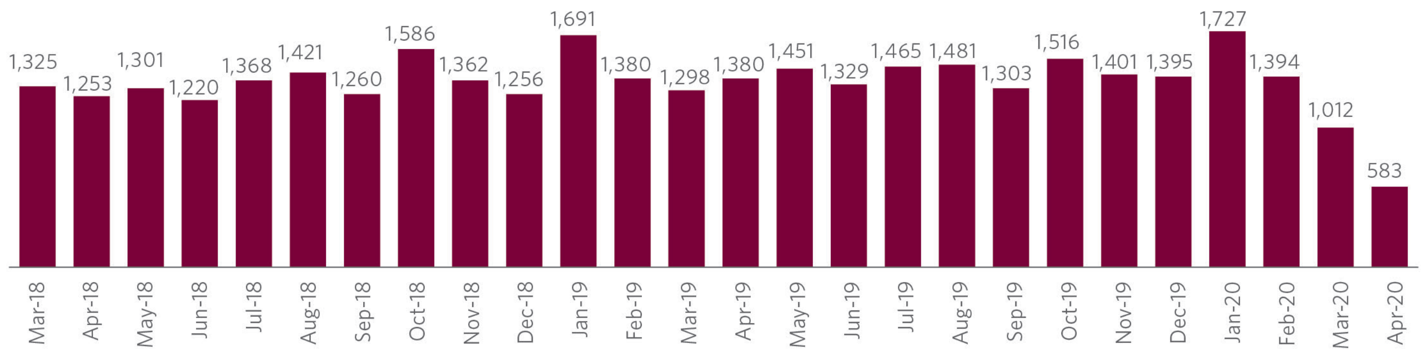
Canadian and U.S. M&A activity update

Monthly M&A transactions in Canada



Source: Capital IQ.

Monthly M&A transactions in U.S.



Source: Capital IQ.

While the Canadian economy was showing signs of a slowdown in late 2019, there was a silver lining: the U.S. and China reached a trade agreement and the U.K. finally struck the terms of their exit from the E.U. Moderate optimism contributed to support M&A activity in Q1 2020, which remained in line with Q1 2019. On a month-to-month basis, March 2020 transaction volume remained consistent with the number of transactions observed in previous months. In the U.S. however, the number of transactions in March 2020 was 27% below the number of transactions in February 2020. The impact of the pandemic is clearly illustrated in April 2020 data, with year-over-year M&A volumes having decreased by 47% and 58% in Canada and in the U.S. respectively.

We had numerous conversations with investors, lenders and advisors over the last few weeks. The general consensus is the vast majority of ongoing transactions are on hold as buyers are trying to assess the impact of the situation. Most lenders and private equity funds remain focused on working with their portfolio companies and assisting them navigate through the crisis, rather than funding new deals. This trend will likely continue until there is more clarity.

There are however some deals that are moving forward with companies who have been deemed an essential workplace, shown resilience and demonstrated the ability to differentiating themselves from the pack. Industry, business resilience, financial strength of buyers and timing of the process are examples of factors that can positively influence the completion of a transaction in this environment.

As markets continue to normalize, we expect that many private equity groups sponsors and strategic buyers will continue to pursue opportunistic add-on acquisitions in the near term, particularly as M&A valuations reset to lower levels.

The M&A market is self-isolating

For perhaps the first time in history, some M&A transactions will be completed without anyone ever having to step outside. If the initial marketing and due diligence stages have already been digitized for the most part over the last decade, every step of the process must now be completed remotely. While some stages typically performed in person can be accommodated with the right tools, other workstreams are more challenging to digitize and will require creativity and flexibility from all parties involved until the situation returns to a more normal state. For example, factory visits have to be done in person and are an important element of due diligence for manufacturing businesses.

Timing of an economic recovery will dictate when M&A activity will go back to normal. In turn, any economic recovery will be kickstarted by a softening of mandatory business closures and stay-at-home orders. Timing for complete reopening the economy remains largely unknown at this time. The timing and extent of at least a partial reawakening is what markets will be monitoring, and for now the best leading indicators will come from news on the virus itself.

In the meantime, the effectiveness of government and central bank stimulus responses will impact the magnitude of the economic downturn. The Federal government responded with sizable measures to support the economy. As a share of GDP, crisis-related government spending is now approaching 8.5%[1], the fourth highest share seen in the OECD. And more is coming. That support is necessary, but it is also crucial to ensure that we maximize the effectiveness of each dollar spent.

Once businesses have had a period of operating history under a more stable post-crisis environment and visibility on future results improves, M&A activity should progressively ramp-up towards historical levels. Until then, M&A transactions are expected to be mainly comprised of distressed sales and opportunistic acquisitions.

In the midst of chaos, opportunity lies

The crisis is reshaping consumer behavior, with some impacts likely to last. Online shopping has surged due to isolation measures – online orders in the U.S. and Canada increased 56% year over year for the two weeks ending April 4[2]. Amazon is hiring 175,000 workers to handle the increase in online shopping, while simultaneously implementing restrictions prioritizing the shipment of essential goods.

Some sectors historically reluctant to change have experienced a leap forward in digitization. Notarize, an online platform that provides digital notarizations, announced it was adding 1,000 notaries[3]. Teladoc Health, a telemedicine provider, saw an increase of over 100% in virtual medical visits per day in April 2020 as compared to the first week of March[4].

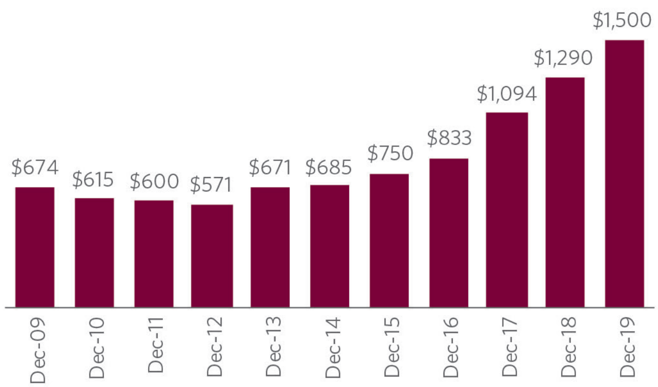
The Canadian healthcare sector is also experiencing a paradigm shift. Federal and some provincial governments stated their intent to increase domestic production capacity for strategic medical supplies. Medical companies are encouraged to adjust their supply chains to be less dependant on foreign suppliers. Non-medical companies are asked to adapt manufacturing capabilities to be able to switch production more rapidly to essential needs in times of crisis.

New behaviors acquired through the pandemic could well become more entrenched in consumers' daily lives after the crisis. As a result, companies with significant exposure to sectors such as ecommerce, digitization and telehealth, among others, may see an increased interest from potential acquirers and investors despite the overall negative environment.

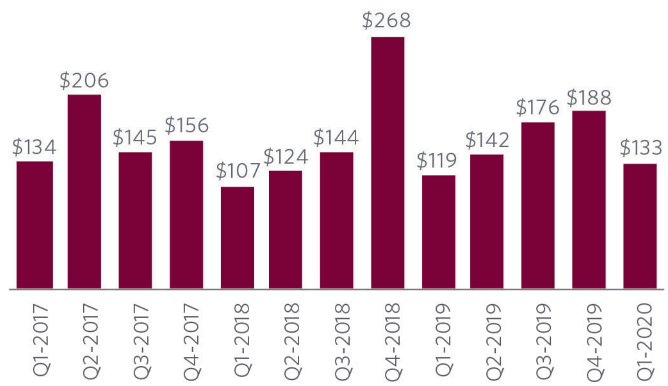
In addition, well capitalized companies will come out of the crisis faster and better than their competitors. Companies with strong balance sheets and a solid track record in M&A coming into the crisis will be able to take advantage of opportunities. Experienced dealmakers that engage regularly in M&A earn returns from downturn deals that are five times higher than those earned by occasional dealmakers[5]. Also, well capitalized companies can focus on integrating acquisitions while less prepared competitors are struggling to survive. Once the recovery phase arrives, those companies will earn the full benefit of synergies during times of growth.

Lending conditions may put a damper on private equity's enthusiasm

Private equity dry powder



Aggregate capital raise in billions



Source: Preqin, both graphs are in U.S. billions.

Based on our conversations with many Canadian and U.S. private equity firms, safeguarding portfolio companies are a priority, but most are still on the lookout for the right acquisitions. Global private equity firms sit on a record amount of capital to acquire new businesses - $1.5 trillion at the end of 2019[6]. On the other hand, lenders have a much more conservative view in this environment. Lenders are prioritizing the support of current portfolio companies and will become more selective on new deals. Leverage ratios for new loans will come down, to ensure borrowers can withstand additional market volatility in the event of a prolonged pandemic.

Valuations may be affected — the cure is preparation

With more challenging lending conditions and nervous investors, overall M&A valuations are expected to be volatile. Thorough preparation ahead of a potential sale will be more important than ever to mitigate buyers' and investors' concerns. Key areas of focus may include isolating the impact resulting from the pandemic on financial performance, properly assessing the lasting effects of the crisis on the company's industry and future prospects, and gathering evidence on the visibility of future revenue and earnings. Earnings Before Interest, Taxes, Depreciation, Amortization and COVID-19 ("EBITDAC") will undoubtably become a common term used for showing financial performance. Only with solid and factual data supporting an investment thesis will vendors be successful in achieving maximum value for their business.

Our transaction professionals have navigated through multiple crises, and are ideally positioned to assist you prepare and execute your next transaction to ensure a successful outcome. We look forward to meeting you (virtually) and discussing further.

About us

CIBC Mid-Market Investment Banking is a leading M&A advisor, providing services to private companies:

- Divestitures
- Acquisitions and management buyouts
- Raising equity capital and securing debt financing

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[1] CIBC In Focus, A Rent Solution for SMEs is Needed Now, Benjamin Tal, April 14, 2020.
[2] Grocery Retailers Adapt as Coronavirus Upends Shopping Patterns.
[3] We're Opening the Notarize Platform, Adding 1,000 Notaries.
[4] Teladoc Health First Quarter Business Preview.
[5] BCG: COVID-19's Impact on Global M&A, March 26, 2020.
[6] Private Equity Is Starting 2020 With More Cash Than Ever Before.