CIBC

MID-MARKET INVESTMENT BANKING

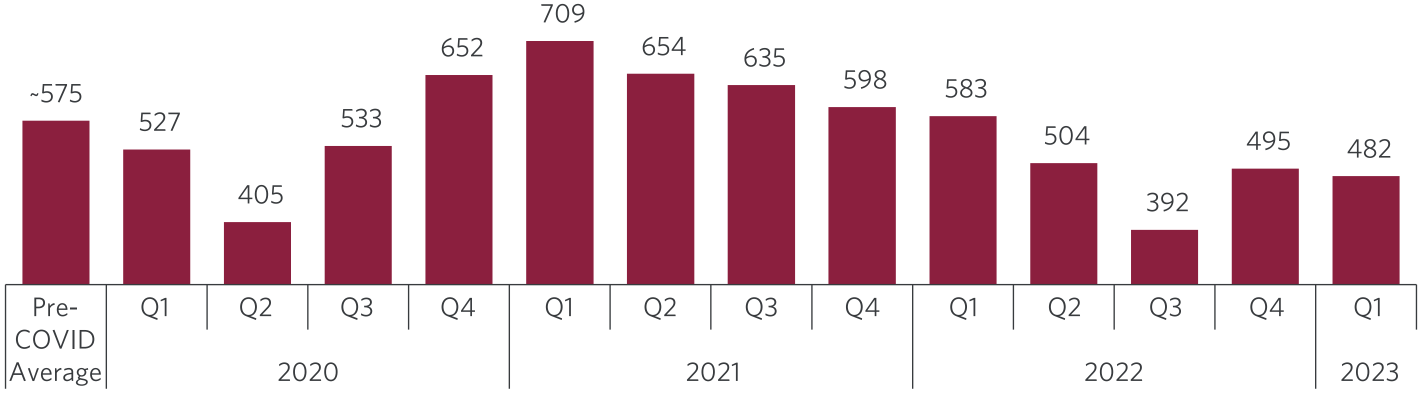
Spring 2023

Market update

We are pleased to share our views on the M&A environment so far in 2023.

M&A activity

Canadian quarterly M&A transaction count



Source: S&P Capital IQ.

Transaction volumes in Canada remain stable having come off the highs seen in 2021. Our team has largely seen M&A activity return to pre-COVID volumes. Many owners are continuing to explore the sale of all, or a majority, of their business. While we are seeing fewer buyers at the table, quality companies in recession-resistant sectors, continue to attract considerable interest, particularly given fewer deals in the market. Valuation multiples seem to be holding up, with negotiations placing greater emphasis on determining the target's level of sustainable EBITDA. Additionally, earn-outs are being used more frequently as a tool to bridge valuation expectations.

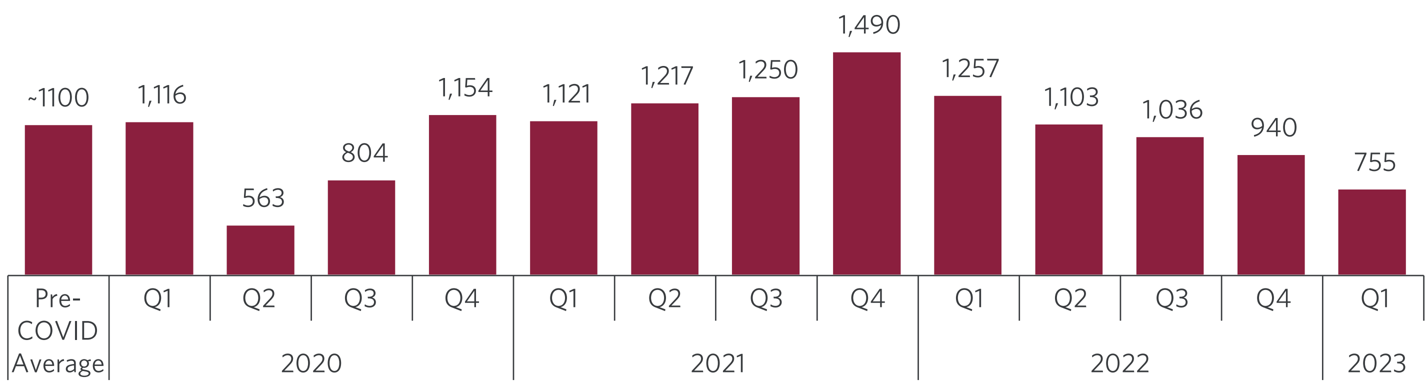
Trends in Private Equity

Private equity continues to play a key role in the M&A market. The chart below shows quarterly volumes are currently below pre-COVID levels.

While PE activity is down, much of their current focus is on seeking add-on acquisitions to their existing portfolio companies. We reviewed deal announcements from many US and Canadian PE groups we interact with, and found that in 2022, PE firms made 6 add-on acquisitions to every 1 new platform investment - significantly up from an average of 3.5 to 1 three years ago.

Another observation is that many PE groups have raised their latest fund in the past 12-24 months and do not feel pressure to deploy capital just yet. This may begin to change as we head into 2024 and beyond, and funds begin to age. If this coincides with better visibility on the economic outlook, we could see increased PE activity next year.

North American PE-backed transaction count



Source: S&P Capital IQ.

Debt market update

Private equity transactions typically use debt as a key source of capital to facilitate acquisitions and continued growth. The amount of debt a lender is willing to provide impacts the valuations PE buyers can offer. As can be seen in the table below, the amount of leverage as a multiple of EBITDA has tightened over the past several quarters. It is interesting to note that the lower mid-market (deals below $50 million) is showing less of a decline than the larger deals as they tend to be less levered.

Multiple of total debt/EBITDA

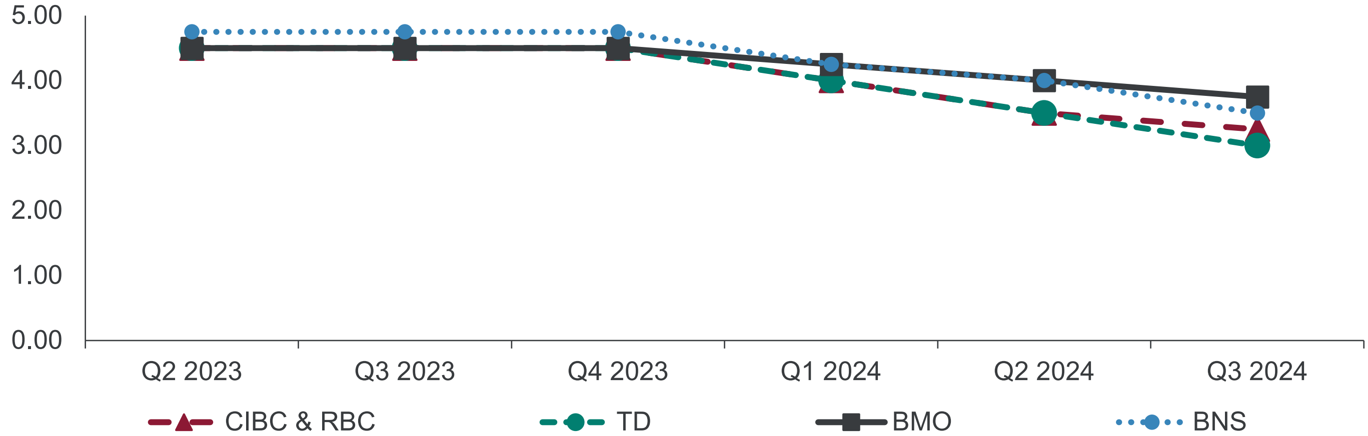
Total Enterprise Value	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023
$10-25	2.9x	3.2x	3.3x	2.9x	3.9x	2.8x	3.5x	3.3x
$25-50	3.1x	3.7x	3.3x	3.1x	2.9x	3.4x	3.4x	3.1x
$50-100	3.8x	4.1x	3.6x	3.7x	3.5x	3.6x	3.6x	2.9x
$100-250	4.5x	4.3x	4.0x	4.4x	4.1x	4.9x	3.5x	3.8x
Average	3.5x	3.8x	3.5x	3.5x	3.6x	3.5x	3.5x	3.3x

Source: GF Data, platform investments only.

In addition to the changes in debt availability, another key theme is the increased cost of borrowing. Pricing is generally based on a floating reference rate (Bankers Acceptance, or "BA") plus a spread. While spreads have not changed much, it is the increase in the cost of BA due to the Bank of Canada rate hikes, that has increased the cost of borrowing. For reference, the BA rate was ~2% in May 2022 and ~5% in May 2023.

Looking ahead, the chart below shows the forecasts for the Bank of Canada Overnight Rate. Notwithstanding the rate increase to 4.75% on June 7, there seems to be consensus among the 5 largest Canadian banks that interest rates are set to decline in 2024.

Bank of Canada overnight rate forecast



Source: CIBC Economics, June 1st, 2023.

How are Canadian privately-owned companies performing?

'Uncertain times are here' was a headline from our Spring 2022 newsletter. Indeed, it has been over a year since inflation took hold and interest rates began to rise. Against this backdrop, one of the most important factors in successfully closing an M&A transaction is that both buyer and seller continue to perform well financially during the process. With this in mind, we have been speaking with senior colleagues in our Commercial Bank. They service a broad cross-section of Canadian private company clients in terms of size, sector and geography, and we thought it would be of interest to share some of the comments and themes on how well their clients are performing:

- Some investment decisions were being deferred in the latter half of 2022 but with long term rates coming down, many companies are reinvesting in growth again (e.g. capex, real estate expansions, small strategic acquisitions)
- Labour: with the exception of the technology sector, lay-offs are not happening. Companies are deciding to retain talent to avoid having to rehire in the future
- Inflationary increases in working capital facilities are reversing with attention being paid to over-priced aging inventory. Many companies continue to hold excess inventory resulting from the supply chain issues, and are reducing purchases until quantities revert back to historical norms
- Searching for industrial real estate in larger cities is a challenge, with limited supply and increasing rental rates
- Consumer discretionary sectors such as retail and hospitality, along with cyclical commodity sectors are having mixed results with 'pockets of concern'
- Products and services into the industrial and construction markets, including those serving energy markets in western Canada, are performing well with good project visibility and pipeline of orders. Some challenges with general contractors on fixed price contracts

While no-one can forecast a hard or soft landing for the economy, and certainly recent reports of slowing freight and rail activity indicate a slowdown, many Canadian companies remain resilient and cautiously optimistic, which bodes well for continued M&A activity.

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

Contact us

Central

Trevor Gough
416 271-3660
trevor.gough@cibc.com

Christian Davis
416 371-7238
christian.davis@cibc.com

Iain Gallagher
647 531-6044
iain.gallagher@cibc.com

Dylan Moran
289 259-7687
dylan.moran@cibc.com

Jarred Seider
416 888-3757
jarred.seider@cibc.com

East

Philippe Froundjian
514 927-5173
philippe.froundjian@cibc.com

Gabriel Fugere
514 836-0773
gabriel.fugere@cibc.com

Abboud Kaplo
514 827-8327
abboud.kaplo@cibc.com

West

Amun Whig
403 200-9171
amun.whig@cibc.com

Raymond Zhang
778 858 6698
raymond.zhang1@cibc.com

Graham Drinkwater
587 983-3134
graham.drinkwater@cibc.com

Website

cibc.com/mmib