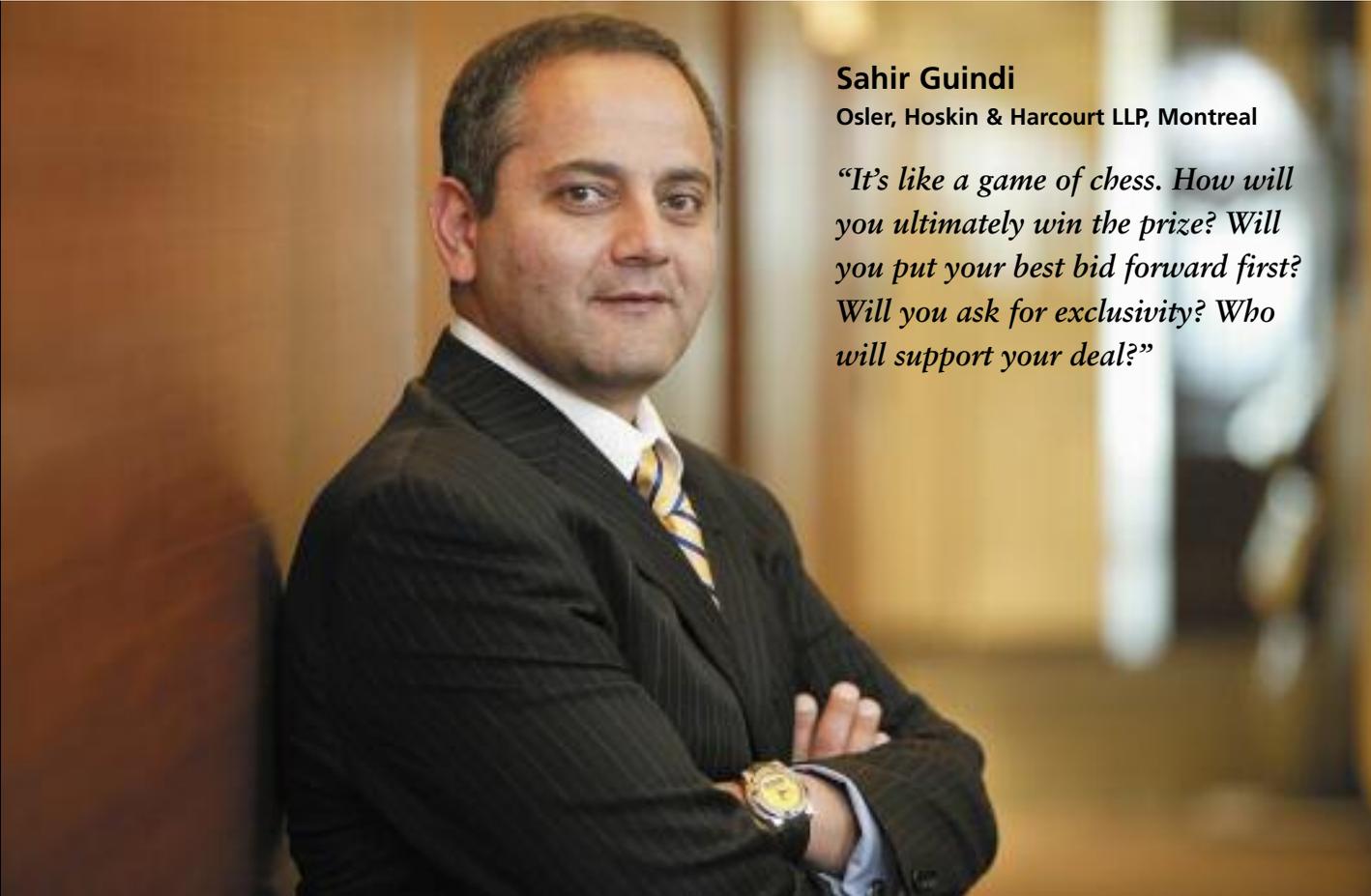


Going private

A portrait of Sahir Guindi, a man in a dark pinstriped suit, white shirt, and yellow and blue striped tie. He is standing with his arms crossed, looking slightly to the right of the camera. The background is a blurred indoor setting with warm lighting.

Sahir Guindi

Osler, Hoskin & Harcourt LLP, Montreal

“It’s like a game of chess. How will you ultimately win the prize? Will you put your best bid forward first? Will you ask for exclusivity? Who will support your deal?”

It’s mid-morning, but Shahir Guindi is ready for dinner. He’s still jetlagged from a due diligence mission to Dubai. “I was there looking for pools of capital available for investment,” says the mergers and acquisitions practitioner. “In fact, there are oceans of capital.”

Most of that capital coming out of the United Arab Emirates will likely flow through in the Middle East, North Africa, and South Asia, with some going to India, China, and Russia, says Guindi, a partner at Osler, Hoskin & Harcourt LLP’s Montreal office. But a healthy trickle will find its way to Canada, where it can merge with the flood of U.S. capital rushing into the country.

PIERRE CHARBONNEAU

Private equity mega-deals are grabbing the headlines in Canada and fuelling a vibrant M&A marketplace. For lawyers who facilitate deal-making, these are boom times.

By Susan Goldberg

Matt Cockburn

Torys, Toronto

“Private equity can offer a chance for a family to liquidate some of their holdings and diversify some of the assets, while still maintaining a significant ownership interest or say in how the company is run.”



Add that to Canada's own solid pool of investment capital, and it's no wonder that our M&A marketplace is thriving. Bolstered by a strong economy, low interest rates and inflation, and willing lenders, M&A activity in this country hit record levels in 2006. A recent KPMG report shows a 26% increase in the number of deals, with their total value nearly doubling to US\$173.6 billion over the previous year. So far, there's little reason to doubt the trend will continue in 2007.

Most M&A deals have involved so-called "strategic" acquisitions: public companies buying other public companies. But "financial" acquisitions — those conducted by private equity firms — are making bigger inroads into the Canadian marketplace, as increasing numbers of (mostly American) private buyout companies look to Canadian targets. According to KPMG, one dollar out of every five in the global M&A market in 2006 came from private equity.

Le règne du privé

Les fonds de capitaux privés ne cessent de défrayer les manchettes. Dans cet environnement en pleine effervescence, les juristes canadiens spécialisés en fusions & acquisitions et en capital d'investissement tirent très bien leur épingle du jeu.

Shahir Guindi, un praticien spécialisé en fusions et acquisitions chez Osler, Hoskin & Harcourt LLP à Montréal, est de retour d'une mission à Dubai. Il était à la recherche de sources d'investissements et il en a trouvé des myriades. La majeure partie de ce capital demeurera probablement au Moyen-Orient. Une petite partie sera cependant investie au Canada.

Le marché canadien des fusions et acquisitions est florissant. Il est soutenu par une économie en bonne santé, des taux d'intérêt peu élevés, un taux d'inflation relativement bas et des prêteurs intéressés. Des niveaux d'activités record ont été enregistrés en 2006.

La plupart des accords de fusions et acquisitions qui ont vu le jour au cours de la dernière année portaient sur des acquisitions dites « stratégiques » impliquant l'achat par le secteur public d'autres entités publiques. Mais les acquisitions par des fonds de capitaux privés sont de plus en plus courantes puisqu'un nombre croissant de ces fonds ciblent le Canada.

La majorité de ces derniers sont américains, mais certains proviennent aussi de fonds de retraite canadiens qui,

souhaitant augmenter leurs bénéficiaires et diversifier leurs méthodes d'investissement, ont opté pour ce type de véhicule de placement.

« Les conditions du marché au Canada sont très favorables aux activités des fonds de capitaux privés, croit Susan Garvie, associée chez Goodmans LLP à Toronto. Bien que ce marché soit de plus en plus compétitif, il se trouve encore 10 ans derrière celui de nos voisins du Sud ».

Le nombre croissant des transactions découlant des fonds de capitaux privés requiert davantage de travail de la part des avocats spécialisés en fusions et acquisitions et en capital d'investissement.

« Un très grand nombre d'investisseurs sont à la recherche d'un nombre restreint d'occasions d'affaires, constate Me Garvie. Notre cabinet a pris part à des transactions pour lesquelles 80 à 100 investisseurs potentiels ont manifesté leur intérêt. Il s'agissait principalement de fonds de capitaux privés américains. De ces investisseurs, 50 à 60 étaient très sérieux et en mesure de conclure des ententes de confidentialité. »

Cela explique en partie pourquoi le

marché actuel est jonché de conflits d'intérêts potentiels. Les services d'un même cabinet peuvent être sollicités par plus d'un investisseur. « Nous avons déjà été sollicités par quatre ou cinq clients différents pour une même transaction », confirme Me Garvie. Ce qui ne veut pas dire que la situation est à chaque fois problématique. « Au bout du compte, il n'y aura qu'un seul gagnant. La plupart des clients sont suffisamment sophistiqués pour comprendre cela », renchérit-elle.

Certains s'inquiètent du fait que les fonds de capitaux privés étrangers s'intéressent aux compagnies canadiennes. Depuis quelques temps, la compagnie de la Baie d'Hudson, Inco et Falconbridge, la chaîne hôtelière Four Seasons Fairmont, Molson, Labatt et Sleeman ne sont plus détenues pas des fonds canadiens.

D'autres considèrent que ces acquisitions sont très profitables pour le Canada puisque le nombre de sièges sociaux d'entreprises et d'emplois est en hausse constante.

Pour Shahir Guindi, il ne faut pas trop s'en faire puisque de telles transactions sont dans l'ordre des choses. Le marché actuel lui rappelle une scène qu'il a vue à Dubai. « Les navires arrivent et tous les commerçants se rencontrent sur le quai. Ils peuvent acheter quelque chose le matin et le vendre à la fin de la journée. Personne n'achète quelque chose pour le garder éternellement. La dynamique est fluide : les biens sont ainsi recyclés et ont une autre vie. » ■

— Yasmina El Jamaï

Pension funds

Some of the money is coming from Canada's rich pension funds, which, in recent years, have turned more aggressively to private equity as part of an effort to seek out new investment strategies and better returns. The Ontario Teachers' Pension Plan, the Canada Pension Plan, OMERS, CBC Pension, and the Caisse de depot et placements du Quebec have all been active in private equity investing, on

their own or in "club" deals, in which they band together to bid on larger companies.

In 2002, Teachers partnered with leading buyout firm Kohlberg Kravis Roberts & Co. (KKR) to buy most of Canada's Yellow Pages Group Co. from BCE, for \$3.1 billion. They then spun the company into an income trust in 2004. Last March, Teachers' private equity investment arm teamed with Hong Kong-based CCMP Capital Asia to buy New

Susan Garvie
Goodmans LLP, Toronto

“The Canadian marketplace is under-served. So market conditions are very favourable for private equity investors to come here.”

Zealand’s print and online Yellow Pages for approximately \$1.85 billion.

In recent years, KKR has also bought Canadian General Insurance (\$160 million; 1995), Shoppers Drug Mart (\$2 billion; 2000), and Masonite International Corp. (\$3.3 billion; 2005). As the magazine went to press, the firm had partnered with two Canadian pension funds to explore the remarkable possibility of taking BCE private.

“When KKR did the Yellow Pages deal, that really opened up private equity’s eyes to the fact that there are a lot of good businesses in Canada — and less competition for them,” says Matt Cockburn, co-head of Torys’ private equity group in Toronto.

“The Canadian marketplace is under-served,” explains Susan Garvie, a partner in the M&A group at Goodmans LLP. “So market conditions are very favourable for private equity investors to come here.” While the private equity market in Canada is increasingly competitive, she says, it is still five or ten years behind that of our neighbours to the south.

As a familiar, stable and legally compatible market in close proximity, Canada is a promising destination for U.S. private equity looking for targets. Our regulatory and corporate law environments make it relatively easy to complete M&A deals, even cross-border ones. Our resource-based economy and high commodity prices are also drawing bidders interested in Canadian companies.

And to stay ahead of the competition, cash-flush private equity firms — both American and Canadian — are expanding their horizons. Deals are underway at all ends of the spectrum, from early-stage venture capital for start-ups to high-end buyouts and going-private deals.

“Rarely have I seen a market that is as driven by both financial and strategic buyers,” says John Leopold, a senior



M&A partner in the Montreal office of Stikeman Elliott LLP.

In Canada, another compelling driver for M&A and going-private transactions is the federal government’s recent decision to introduce an income trust distributions tax. Predictions that the fiscal changes would lead to more buyouts are playing out. In the five months following the October 31, 2006 announcement, 17 publicly traded trusts were bought or were in the process of being bought — for a total value of \$15.2 billion — mostly by foreign private equity or corporations. The value of the S&P/TSX capped income trust index fell 15% in the 52 weeks ending March 31, 2007.

With their strong cash flow, low debt, low volatility and — now much more attractive — valuations, “income trusts are clearly fertile ground for private equity and going-private deals,” says Leopold. “We have a couple of deals currently in place in 2007, but they are the tip of the iceberg; we anticipate significantly greater activity over the course of the year.”

Fewer demands

The “private” in private equity is also a significant factor in today’s M&A market, as increasing numbers of public companies become the willing targets of private buyouts — or never go public in the first place.

“For smaller-cap businesses, the benefits of public ownership aren’t always there,” says Guindi. “Instead of manage-

ment teams and boards of directors running to the TSX or the NASDAQ, they are choosing private deals. They want to go public eventually, but for now, they are more content to build value” without the demands of public ownership.

Here come the lawyers

With the changing landscape and the growing number of private equity transactions comes more work for — and increased demands on — Canadian private equity and M&A

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Those demands have become more onerous of late. The regulatory headaches facing publicly listed companies have expanded to include Sarbanes-Oxley in the U.S. and similar Canadian investor confidence laws, such as Ontario’s new liability-for-disclosure rules. The costs of public listing and regulatory compliance aren’t negligible, and neither are the legal responsibilities.

Plus, in a privately held company, notes Cockburn, value is not a function of public whim and quarterly results. Board and investor relations are a lot easier when you can count shareholders on one hand and the investment horizon is the four to seven years typical of a private equity firm: “You can reinvest in the business in a way that may be harmful to short-term earnings, but could add medium- or longer-term value to the company.”

Also driving the private equity trend is an ageing generation of Canadian business founders looking to retire and get some value for the businesses they’ve built. Take Four Seasons Hotels, which became a privately held company owned by founder and controlling shareholder Isadore Sharp, in tandem with Bill Gates and Saudi Prince Alwaleed Bin Talal, a nephew of the late King Fahd and one of the richest businessmen in the Middle East.

“Private equity can offer a chance for a family to liquidate some of their holdings and diversify some of the assets, while still maintaining a significant ownership interest or say in how the company is run,” says Cockburn.

But that may be changing, too. Strategic deals tend to “keep the owner/entrepreneur in as an owner, post-acquisition, with some significant skin in the game — generally 20 to 30 percent, so the person is still financially motivated,” says Garvie. “But with going-private deals, there isn’t necessarily the same incentive to keep management on. My impression is

lawyers. Not that they’re complaining.

“The vast quantity of people pursuing these deals is really interesting,” says Garvie, who acts primarily for ONCAP, Onex Corporation’s mid-market private equity business. “There are too many dollars chasing too few deals. Our office has been involved in a number of transactions where the first summary is sent out to as many as 80 to 100 potential bidders, mostly or all U.S. private equity firms. Of those, 50 or 60 could sign back confidentiality agreements and expressions of interest in the deal.”

With so many bidders, though, law firms with private equity expertise are heavily solicited. It explains in part why today’s vibrant M&A marketplace is so fraught with pitfalls, not least of which are potential conflicts of interest, like firms acting for more than one bidder. “We have been called by four to five different clients to act in the same auction,” says Garvie. Conflict searches, openness with clients, and the appropriate fire walls are all *de rigueur* when acting for competing bidders.

“At the end of the day, there’s going to be only one winner, and many clients are sophisticated enough to understand and appreciate that.” Still, she notes, it can be awkward when you’re acting for two clients, and only one wins.

Conflict is also inherent in a going-private transaction in which management teams are retained and have a significant stake in the business. “On the one hand, the board and management should be trying to sell the business at the highest price possible for the shareholders,” says Cockburn. “On the other hand, they are trying to buy the business at the lowest price possible.”

Securities commissions rules requiring independent valuations and protection of minority shareholder rights, while necessary, complicate matters and increase execution risk, says Cockburn. He cites the example of the Four Seasons deal, which first required the approval of minority shareholders “who have no interest in the business beyond the price being right.”

Club deals also risk violating competition law, although most lawyers agree that, if handled correctly, mega-deals will become more frequent. “We are working on one deal right now where four or five clubs are bidding on one business,” says Leopold. “While there’s a lot of talk about antitrust laws in the United States, in my mind club deals increase competition by allowing in players who otherwise wouldn’t be able to participate because [the deals] are just too big.”

As complex as these transactions are, says Garvie, at least M&A practitioners have an ally in their private equity clients, who are themselves increasingly sophisticated.

“The private equity funds are often much more suited than the strategics to do these deals: they have the capital resources, the financial expertise, the contacts, and the debt. The going-private process is complex and uncertain, fraught with risks, and the private equity firms have the sophistication to handle those risks.”

For lawyers operating in a seller’s market, those most thoughtful about identifying risk allocation will stand out. Particularly as it is no longer unusual for potential buyers to offer bids with no survival of representation warranties, or watered-down indemnification provisions.

As a result, Garvie notes — if price isn’t the issue — lawyers can inadvertently “over-lawyer” their clients out of an auction process: “On the selling side, if you get seven or eight bids, and two of those are heavily marked-up agreements, all other things being equal, you’re going to get rid of those two. As one of a possible 5, 10, 15 bidders, you need to know what your client really cares about and how they are best served. It’s very difficult to exercise discipline and make the fewest changes possible to an agreement that is hugely seller biased.”

“It’s a bit like a game of chess,” says Guindi. “How will you ultimately win the prize? Will you put your best bid forward first? Will you ask for exclusivity? Who will support your deal? Which shareholders do you approach? Which shareholders do you buy from? Which do you leave in the dark because they’re not going to support your deal? If I, as a lawyer, better understand all the drivers, I can give better advice to my clients on what steps to take and what holes not to fall into.”

The frenetic pace of the market is also forcing potential buyers into spending more time and money up front on due diligence, without guarantees or exclusivity.

“Without knowing where you are in the process or how many bidders there are, you may have to do full financial and legal due diligence before you submit your final bid — with the idea that if you are picked as a bidder, you could close or sign a purchase agreement within a couple of days,” says Garvie. “That’s a significant amount of work, and puts a tremendous amount of risk on the buyer. Many private equity firms, especially in Canada, don’t have unlimited human capital resources. So they really have to pick and choose where they think they have the best opportunity and where they’re going to spend the money.”

Because of this, Garvie favours “go shop” agreements, which — in contrast to exclusive, “no shop” provisions —

allow a seller to negotiate with and sell to any buyer, even while working with one buyer towards a purchase and sale agreement.

“At least you get a termination fee to compensate for time and effort, as opposed to walking away with nothing after not winning an auction,” she says.

Selling the crown jewels

Critics of the heightened M&A marketplace worry that a growing number of Canadian companies have found their way into foreign hands. Canadian stalwarts in the mining (Inco and Falconbridge), hotel (Four Seasons, Fairmont) and brewing (Molson, Labatt, even Sleeman) industries have been sold off to American, European, and Latin American interests. Our oldest company, the Hudson’s Bay Co., is now owned by an American. With the rumours circulating concerning BCE, it seems that no Canadian company is too large — or too sacred — a target for buyout firms. With foreign ownership on the rise, are we witnessing the “hollowing out” of corporate Canada?

“Every time these concerns come up, another Canadian company steps up to fill the void,” says Cockburn. “Look at the Yellow Pages deal. A U.S. private equity firm acquired a quiet Canadian business and what came out the other end was a premier media company, a stronger and better Canadian business well-positioned to very quickly consolidate the Canadian market.”

For lawyers whose bread and butter is the purchase and sale of companies — Canadian and otherwise — a debate over foreign ownership debate tends to be one-sided. But a recent report released by the Conference Board of Canada suggests that Canada’s corporate sector is thriving, despite — or perhaps partly because of — interest from abroad. The number of head offices and head office employment in Canada has grown in recent years. And in December 2006, the University of Toronto Rotman School of Business reported that Canada’s world-class companies are significantly larger and more numerous than they were 20 years ago: 72 Canadian companies today rank among the top five in the world in their particular business categories, up from 33 in 1985. Average annual revenue for Canada’s leading companies has also grown, from \$2 billion in 1985 to \$3.7 billion today, after adjusting for inflation.

Guindi likens the situation to a scene he witnessed in Dubai, standing in an office tower overlooking the Creek, the storied trading harbour, central to the city’s trade development.

“The ships come in, and all the traders meet on the dock,” he recalls. “They might buy something in the morning and sell it by the end of the day. No one buys something to hold it perpetually. The dynamic is fluid: these assets are getting recycled, and rejuvenated. We’re just happy to participate in helping our clients sell what they want to sell and buy what they want to buy, whether that be the biggest companies in Canada or the companies that are growing the fastest in Canada.” ■

Susan Goldberg is a Toronto lawyer and writer.