BDO KNOWS INTERNATIONAL PRIVATE EQUITY: SPOTLIGHT ON CANADA

Lee Duran, BDO USA's Private Equity practice leader, sat down with **Chris Porter**, Director of BDO Canada, to discuss the latest PE trends in Canada. Here are some insights from their conversation.

Lee Duran

Chris Porter

What is the investment environment for private equity funds in Canada?

Overall, the investment environment is favorable, especially for U.S. investors. Our team has conducted extensive research into the Canadian investment climate, which revealed that, during the past five years, there have been almost 600 investments by U.S. PE funds into Canada, particularly in the middle and lower mid-markets. For the transactions where deal value was available, about 60 percent of the deals were valued at $100 million or less.

Post-Great Recession, there have been a variety of factors leading to an attractive investment environment. First, funds have significant capital to invest, and lower Canadian multiples have also spurred deal activity. Lower multiples can be partially attributed to Canada's fiscal conservatism – for example, big banks in Canada will usually provide senior debt up to three times earnings; American lenders may provide up to six or seven times earnings.

We have also seen growth and maturity in terms of the types of investors coming into Canada, especially from the United States. A few years ago, foreign investors did not offer services and expertise that distinguished them from Canadian investors. Now, U.S. funds understand the market better, and many are in the position to be industry specialists in a way that is unique. Many Canadian investors simply can't compete in market specialization due to the smaller size of the economy.

Which industries do you see being most attractive to foreign investors looking into Canadian opportunities?

In spite of the recent market downturn, oil and gas services continue to be an attractive sector for investors. Even with lower gas prices and reduced exploration initiatives, oil and gas production still needs to be pumped and serviced, and Canada is a major resource center for that activity. We anticipate that even with market uncertainty, there will continue to be opportunities in this sector. Depressed valuation multiples arising from the recent weakness in oil prices will also drive deal flow in this sector.

Manufacturing also provides a range of investment opportunities. With the Canadian

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dollar significantly declining in value, the price of business and resources has dropped. As such, it is now easier and cheaper to export to the United States – and manufacturers are capitalizing on this opportunity.

What type of capital flow are you seeing coming into Canada?

Outside of U.S. investment, we're seeing a lot of Asian investment, especially in Western Canada. Some of the most notable investments from Chinese and Japanese investors have been in the oil, gas and agriculture sectors. The appetite has been primarily for larger deals and headline opportunities.

Most of the capital coming into Canada is coming from investments by funds – we don't see as many individual investors coming in with checks. There is also a fair bit of capital available within Canada. It is important to note, however, that Canadian investors tend to be more conservative. You're less likely to see venture capital-backed deals. Because of this caution, many American funds have a competitive advantage, since they are willing to go higher in price.

What exit strategies are you observing?

Canada is on the cusp of a wave of exits, but it is too early to tell what those may yield, as we are at the end of the first investors' holding periods. We are starting to see a few exits, but it is premature to assess whether they are indicative of larger trends. That being said, many investors who got in early – 2009, 2010 – are doing well on their exits.

We are beginning to see more PE-to-PE deals in Canada. Financial buyers are starting to mine each other's portfolios to drive a smoother exit process.

Others who invested post-recession are beginning to circle around various exit strategies; listing on the Toronto Stock Exchange (particularly the Venture exchange) could be a lucrative option for some smaller companies. The TSX has been negatively affected by the recent oil price decline, but it has recovered to previous levels over the past few months.

What do you think will be the next hot opportunity for PE investment in Canada?

Looking into the future, many of the hot opportunities for investment will likely be contingent on geography, particularly with a focus on outside of the main centers. There is impressive growth in regions like Saskatchewan and Manitoba, places that are often overlooked for more well-known hubs like Toronto. In these areas, there are opportunities in agriculture and food & beverage operations that are particularly attractive. Technology is also geography-agnostic, so there are opportunities there, as well.

Green technology will likely be a promising sector in the coming year. Mining and the oil sands are hot topics of conversation, and the remediation and containment of oil production will become increasingly important (and likely profitable) for the right type of investor.

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