MARKET INSIGHTS:
2020 Deal Making: Insights from Global and Canadian Experts
Q4 - 2019

New year, new decade. We're entering 2020 with an air of cautious optimism for Canadian deal making. The Phase 1 China-US deal and the USMCA's recent approval by the US Senate, have, somewhat, eased trade-related economic unpredictability. But with sustained geopolitical instability and a business cycle that is well into late innings, we're entering the new decade with a dose of uncertainty.

So why do we, here at FirePower, feel cautiously optimistic about the dynamics of Canadian M&A? Our outlook, on the back of a slower, but still healthy, 2019 is premised on our ground-level experience, the record levels of capital in the hands of financial and strategic buyers[1], the low cost of debt, and a favourable perception of the country in buyers' eyes. While high valuations and concern about an inevitable downturn are prompting buyers to take different approaches to their deal making, we don't expect much change to the level of deal activity in 2020.

To test our thesis and gain a broader perspective, we interviewed Canadian, American and German experts that are active or interested in the Canadian market, including:

- **Kim Furlong**, CEO, Canadian Venture Capital & Private Equity Association, Canada (Industry Group)
- **Craig Korte**, Director of Business Development, Industrial Opportunity Partners, US (Private Equity)
- **Gregory Peter**, Regional Director, Origination The Riverside Company, US (Private Equity)
- **Jan Pörschmann**, Partner, Proventis Partners, Germany (Investment Banking)

Kim Furlong, CEO, CVCA

FP: Were there any results or trends that stood out in 2019 that you see carrying over to 2020?
KF*:* According to the CVCA's data, 2019 was a lower volume year, particularly Q3, but not far off the historical average. Value, however, was quite a bit lower, tracking well below historical average due to fewer mega deals. I don't expect to see significant change in 2020 in terms of volume and value; I think we've hit a plateau for now.

Canadian PE activity continues to be driven by the mid- and lower mid-market, and I expect that to be the case in 2020; for example, in the first nine months of 2019, deals in the $25 million and under range represented 66% of volume.

FP: How are PE firms responding to the current environment?
KF: With valuations at record (or close to record) highs, PE firms are holding onto their portfolio companies longer and building using add-on strategies, really playing a longer game. That's reflected in our data: 67% of 2019 deals were add-ons (as of Q3YTD), as compared to only 45% in 2013. I expect we will see more patience in the market through 2020. High valuations are also driving a real focus on due diligence. That focus will likely be sustained or heightened over the coming year.

Regardless of the economic environment, deals will get done that fit with a firm's investment strategy. Consistent with that, we expect to see a further increase in secondary buyouts, where one PE firm, reaching the end of its fund term, "passes the baton" to another PE who has the expertise to continue the company's growth trajectory.

FP: How do you see Canada positioned in a world of geopolitical and economic uncertainty?
KF: While uncertainty and volatility impact all businesses, including Canadian, Canada is perceived as a safe haven amidst the current global instability. For example, in the last year, we have seen an inflow of Mexican family office capital bypassing the US and flowing into Canada. We are attracting international investor attention because of our reputation as being stable and predictable.

Craig Korte, Director of Business Development, IOP

FP: What is your/IOP's outlook for 2020?
CK: We expect a strong M&A market over the coming year. There is so much capital in the markets from private equity and Canadian and US corporate buyers, and debt is cheap and accessible, so there is a lot of money looking for deals.

On the supply side of the equation, many private business owners in the US and Canada will need to transition over the coming few years, a trend that IOP has been seeing, and that will bolster deal flow.

FP: But a downturn beyond 2020 seems inevitable. Has that impacted your investment strategy or what you are seeing in the market?
CK: Generally speaking, we are being a little more cautious, and expect that at some point during our ownership there will be a downturn. But that's not so different from how we usually underwrite businesses. And we always use conservative capital structures and don't overleverage, so we won't make changes there either.

In the market, we've noticed that the banks are being a bit more conservative when it comes to leverage. We're also noticing a rift between sellers' expectations and what buyers are willing to pay, which we always see at the top of an M&A cycle. To address this, we look for businesses that can really benefit from our operating resources and expertise, and we will just say no to great businesses where the seller's price expectation is, in our view, too high.

FP: As a US investor, will you be looking to Canada for acquisitions in 2020?
CK: Definitely! There are great, mid-market businesses in Canada, and we've found Canadian management teams very good to work with. And while the market for a strong Canadian business is still robust, as it is in the US, it just feels a bit less competitive.

Gregory Peter, Regional Director, Origination, The Riverside Company

FP: What are your expectations for the North American market in 2020?
GP: It is hard to be specific about market conditions in a 12-month window, but in general within the coming three to five years, we are expecting continued growth followed by a modest recession, then a return to growth.

FP: Given that a downturn seems inevitable, how has that impacted your investment strategy?
GP: First, we are literally always preparing for the next downturn, by searching for investments that are not cyclical. We avoid companies relying on activities such as construction or highly discretionary consumer spending, for example.

Second, our firm recently launched a new product, The Riverside Value Fund, that allows us to be a proactive investor, leveraging our skills and resources in companies that are experiencing operational problems. There tend to be more companies like this when the economy is challenged, so we're anticipating an increase in these types of investments.

We will also continue to pursue add-on investments, which have always been a focus for us, enabling us to heighten the pace of growth of our portfolio companies, and often to average down the purchase price of our initial investment. Add-ons might be a smaller, single product or single market company that would not be as attractive to acquire standing alone, so the price for these types of companies can often be below the market average.

FP: Riverside has a number of Canadian mid-market investments. Why is Canada attractive?
GP: We have made 25 investments in Canadian businesses in our history, including both platforms and add-ons, and will pursue more in 2020. We find that Canadian business often have strong technical expertise and work-ethic, differentiation, and high attention to product development and R&D.

Additionally, and beneficial to Canadian business owners as well, we can help developers and manufacturers of Canadian products grow sales throughout the US market, and support a company's expansion throughout North America, and even globally.

Jan Pörschmann, Partner, Proventis Partners

FP: According to a recent MergerMarkets report, while total European M&A was down significantly in 2019, outbound activity was up more than 28%, with much of that directed at North America. Are you seeing this trend playing out in Germany?
JP: Absolutely! Cross-border deals have always been a key driver for German companies, as Germany is globally a highly networked and export-driven economy. According to our data, German acquisitions abroad have nearly tripled over the past 6 years.

FP: Is this outbound activity restricted to larger buyers? Or are you seeing it in the middle market as well?
JP: This is definitely not a large-corporates-only-domain. In most executive meetings we have with the many, family-owned Germany "Mittelstand" companies, access to international markets, resources and new technology are highlighted as core elements of their M&A strategies.

FP: How much outbound deal activity are you seeing from Germany to Canada?
JP: Deal activity from Germany to Canada has been relatively low in the past. In total, German investors have acquired less than 70 Canadian companies over the last five years with a total cumulative transaction volume of around USD 2.6bn. However, many German companies are concerned about what is going on in the US and therefore hesitant towards doing more deals there. This represents a good window of opportunity for Canada in 2020.

FP: What are your expectations for the year ahead?
JP: 2019 was a very good year for Proventis and the pipeline is full. For the broader economy, our forecast for 2020 is a sideways movement at a high level.

Despite fears of an economic slowdown, the trade conflict between the USA and China, geopolitical tensions and Brexit, low interest rates led to strong investment activity in Germany over the course of 2019. As long as the low interest rate scenario persists, the investment environment will remain favourable.

Moreover, the fundraising levels of private equity firms reached all-time highs, with PE-backed transactions accounting for nearly one third of all German M&A deals. Those companies typically are highly acquisitive and are very open to cross-border deals.

A (Cautiously) Positive Conclusion

The deal makers we interviewed shared our cautious optimism about the year ahead. But for us, the highlights were their observations about Canada and Canadian businesses: the former as a safe haven for investors in a world of geopolitical and economic uncertainty, and the latter, for their strengths in management and innovation. Those bode well for the year ahead!

RECENT TRANSACTIONS

DECEMBER 2019	NOVEMBER 2019	NOVEMBER 2019	OCTOBER 2019
EQUICAPITA	Gap Debt	Majority Investment	Gap Debt
Acquired	For	in	For
Caryl Baker VISAGE	sprout	PROFESSIONAL INSTALLATIONS THE INSTALLATION GROUP	KONTROL ENERGY CORP.
The undersigned acted as advisor to the seller	The undersigned is a lender to the company	The undersigned is an investor in the company	The undersigned is a lender to the company
FIREPOWER CAPITAL	FIREPOWER CAPITAL	FIREPOWER CAPITAL	FIREPOWER CAPITAL

ABOUT FIREPOWER CAPITAL

FirePower Capital is the M&A advisory and private capital firm built for Canada's entrepreneurs.
Our team of 35+ deal-makers help their mid-market businesses complete mission-critical transactions.

For more information and resources please visit www.firepowercapital.com.

1) According to PWC's Deals 2020, Private Equity Firms and US Corporations are **each** holding more than US$2 billion in capital. And in November 2019, Pitchbook reported that US Private Equity fundraising had reached an all-time high..