

Study - February 2024

Business Acquisition Opportunities in the Canadian M&A Market



Uncertainty is creating opportunities for buyers

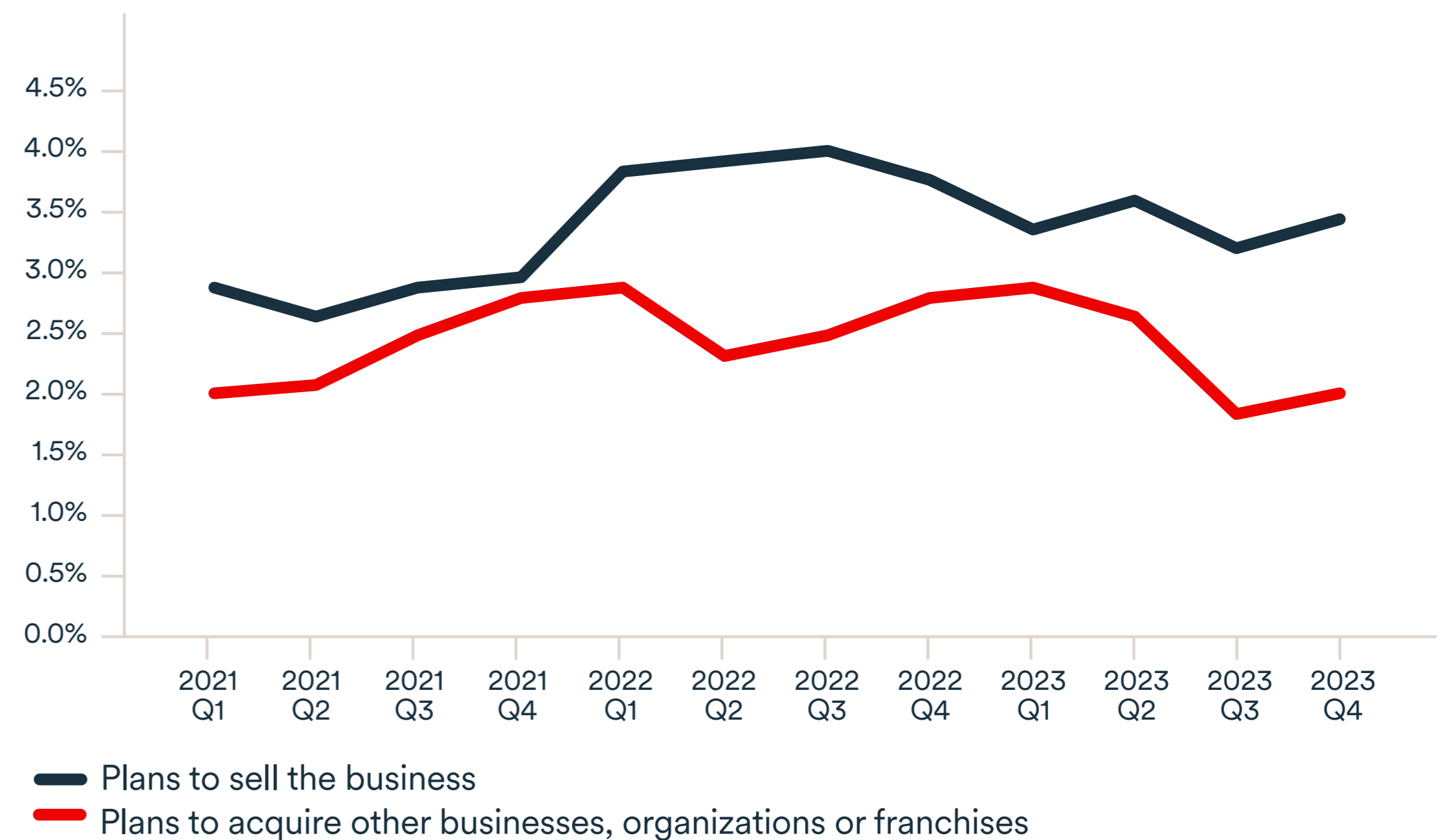
Soaring interest rates, slower economic activity and heightened uncertainty have made entrepreneurs more cautious about business acquisitions since 2022. As a result, mergers and acquisitions (M&A) in Canada in 2023 dropped by 25% compared to 2022.¹

Statistics Canada reports that business transfer intentions over the next year also declined (Figure 1). In this context, a growing gap between buyers and sellers has appeared. While 3.6% of firms intend to sell over the next 12 months, only 1.8% want to buy a business. This could make it harder for sellers to find a buyer.

Businesses with 5 to 99 employees are particularly likely to want to sell (4.0%), as are those in industries more affected by the pandemic and rate hikes, such as:

- accommodation and food services (11.9%)
- manufacturing (5.1%)
- retail trade (4.9%)
- wholesale trade (4.6%).

Figure 1: Business transfer intentions over the next 12 months in Canada



Source: Statistics Canada, Canadian Survey on Business Conditions

Note: this survey is not longitudinal, meaning the businesses included in the survey can differ from one wave to another.

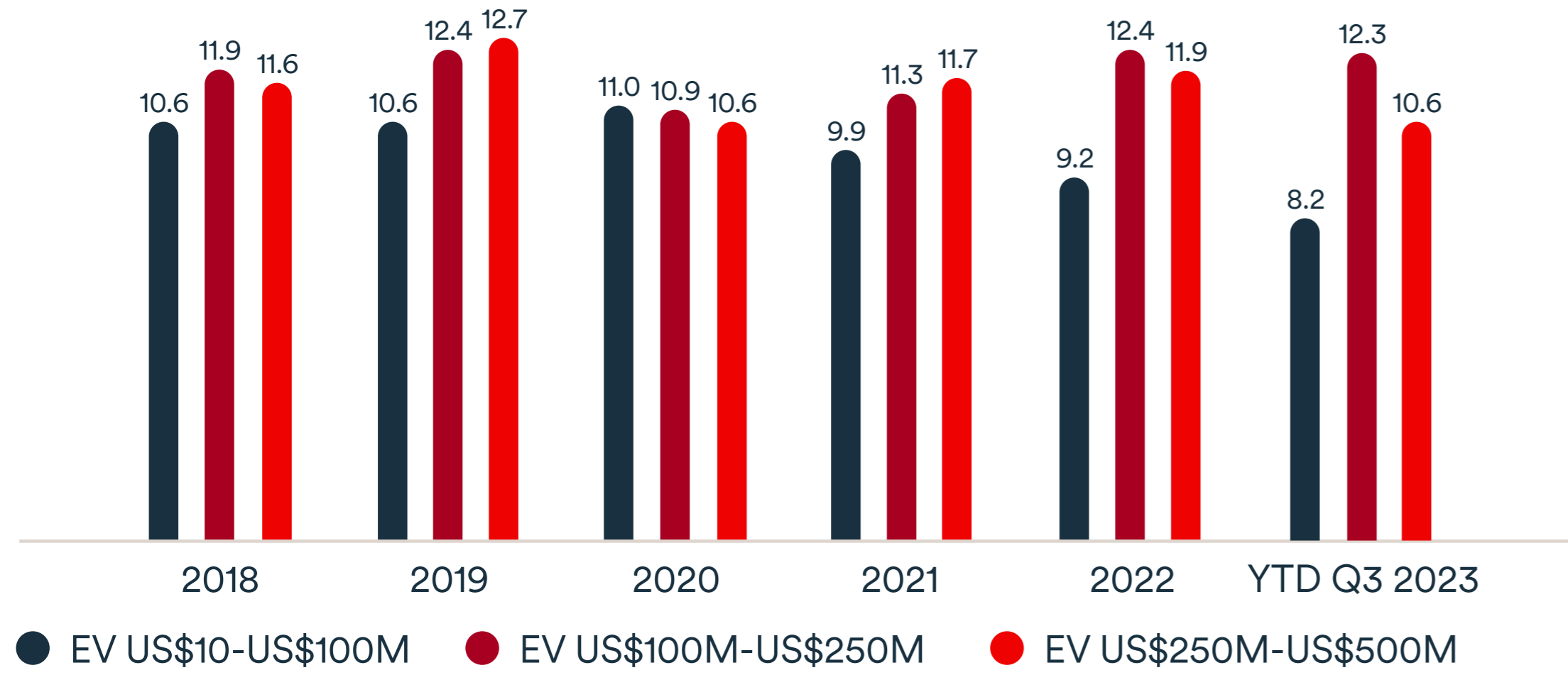
1. Institute for Mergers, Acquisitions & Alliances. [Canada M&A Statistics](#). (2023).

There is no time like the present

While the current economic environment can make it more challenging to complete an acquisition, it has also created opportunities for entrepreneurs.

The higher cost of capital and the economic slowdown have lowered [valuation multiples](#), effectively lowering the price of buying a business (Figure 2). The trend is sharpest in the US\$10 million to US\$100 million segment, where the average multiple fell 16% in Q3 2023 compared to a year before. Research shows that acquiring a business in times of lower multiples and demand improves the chances of success.²

Figure 2: Average U.S. middle market valuation multiples by enterprise value segment (EV/EBITDA)

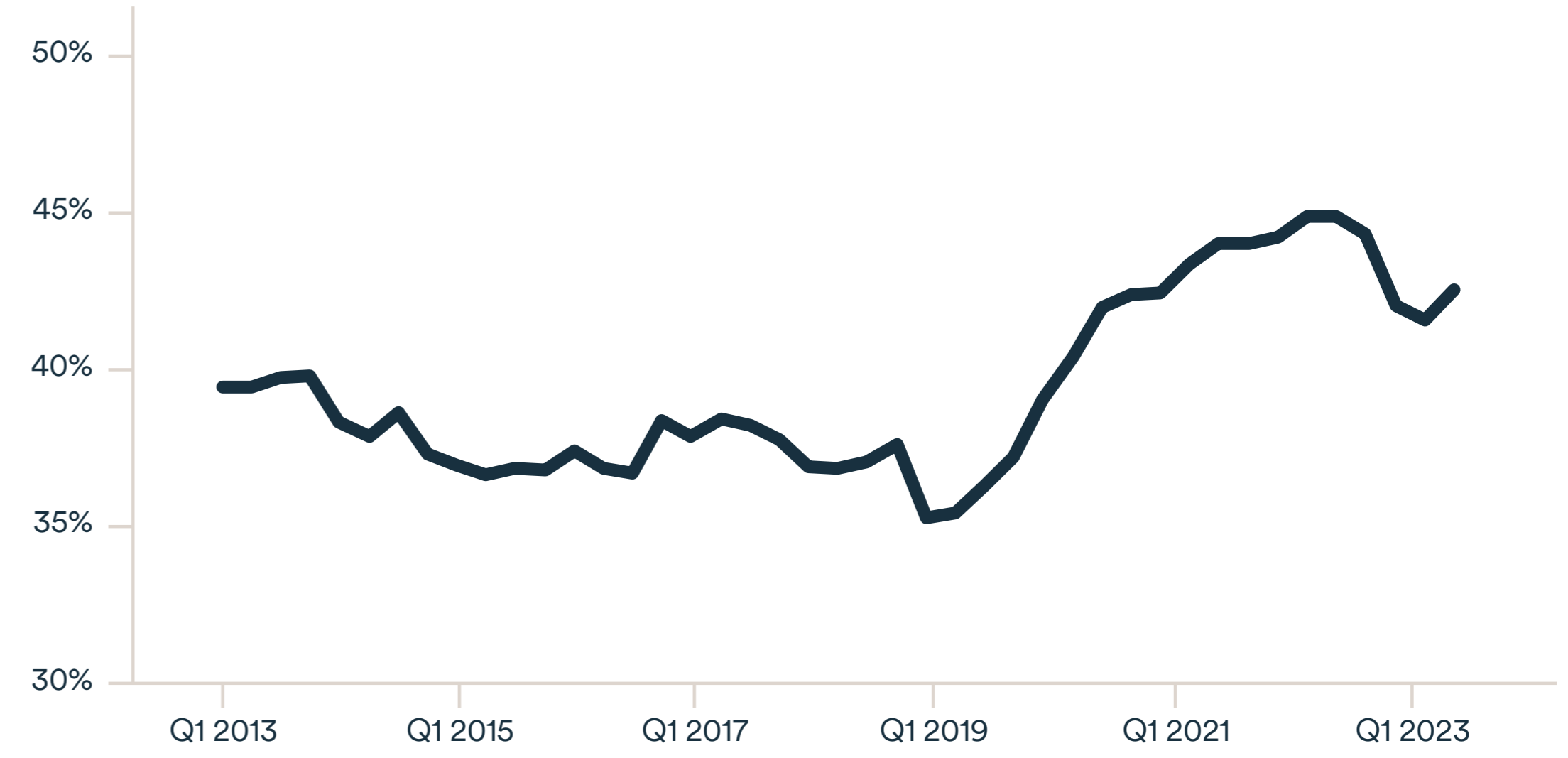


Source: Capstone Partners, Q3 2023 Capital Markets Update: Middle Market M&A Trends. (Jan. 2024).
 Note: We are using U.S. valuations to understand general trends for Canada as valuation data in Canada is scarce, and the market tends to follow the U.S. broadly. EV = enterprise value; EBITDA = earnings before interest, taxes, depreciation and amortization; YTD = Year to date
 2. Anthony Okafor Refocusing on the Success Enabling Factors in Mergers and Acquisitions. *European Scientific Journal*. Vol.15, No.16. (2019).

Thanks to record profits, businesses have more cash on hand than before the pandemic (Figure 3). Using this cash to finance part of a deal can be an excellent way to avoid borrowing at higher interest rates.

With 62% of entrepreneurs over 50 years old, many owners plan to retire, meaning a steady flow of businesses should hit the market in the coming years. About 10% of SMEs (135 000 companies) planned to sell to external parties between 2020 and 2025.³

Figure 3: Liquidity ratio of non-financial private corporations in Canada (percentage of cash over debt)



Source: Statistics Canada, National Balance Sheet Accounts (Table: 36-10-0580-01).
 3. Statistics Canada, Survey of Financing and Growth of SMEs. (2020)

A compelling business strategy

A [2021 BDC study](#) showed that businesses that grew through acquisition were 2X more likely to experience sales growth above their sector average compared to firms that grew organically.

A study by the University of British Columbia found similar results. It revealed that acquirers experienced roughly a 20% increase in revenue compared to similar firms. Acquiring firms kept outperforming five years after a transaction.⁴

A structured approach can lead to higher growth years after the transaction

According to [research we conducted in 2019](#), businesses that followed a structured approach were 94% more likely to experience revenue growth over 10% three years after an acquisition than firms that didn't.

Figure 4: Steps in a structured acquisition process

Pre-acquisition phase	Acquisition phase	Integration phase
Preparing a strategic growth plan and defining objectives of the acquisition	Securing financing prior to approaching the seller	Establishing the integration objectives and synergies
Conducting a market review to gather information on potential companies to buy	Preparing a letter of intent and confidentiality agreement	Preparing and implementing an integration plan
Seeking external help (from accountants, lawyers or other experts)	Conducting in-depth due diligence on the acquisition candidate	Integrating key systems and processes such as IT, payroll or accounting
Appoint an internal and external team to help with the acquisition	Negotiating the price and terms of the agreement	Trying to retain key employees and merging business cultures
		Trying to retain key clients and suppliers

Source: Michael Cocolakis, BDC, *Buying a Business: A Winning Strategy for Purchasing Another Company in Canada*. (Montreal: April 2019)

4. Arnold, D., Milligan, K., Moon, T. S., & Tavakoli, A. Job Transitions and Employee Earnings After Acquisitions: Linking Corporate and Worker Outcomes. NBER. Working paper 31866 (2023, July 21).

What can increase the chance of a successful acquisition project?

To find out what drives a successful acquisition, BDC conducted an internal survey with 178 directors involved in acquisition deals from 2013 to 2021. The survey examined 115 transactions with defined outcomes and identified three key factors that increased the chances of meeting or exceeding the business objectives (Figure 5).⁵

1. Strong management team

A smooth transition and execution of the acquisition strategy require the right management team. A skilled and experienced team can provide clear guidance and ensure the acquisition targets are met.

2. Good integration planning post-acquisition

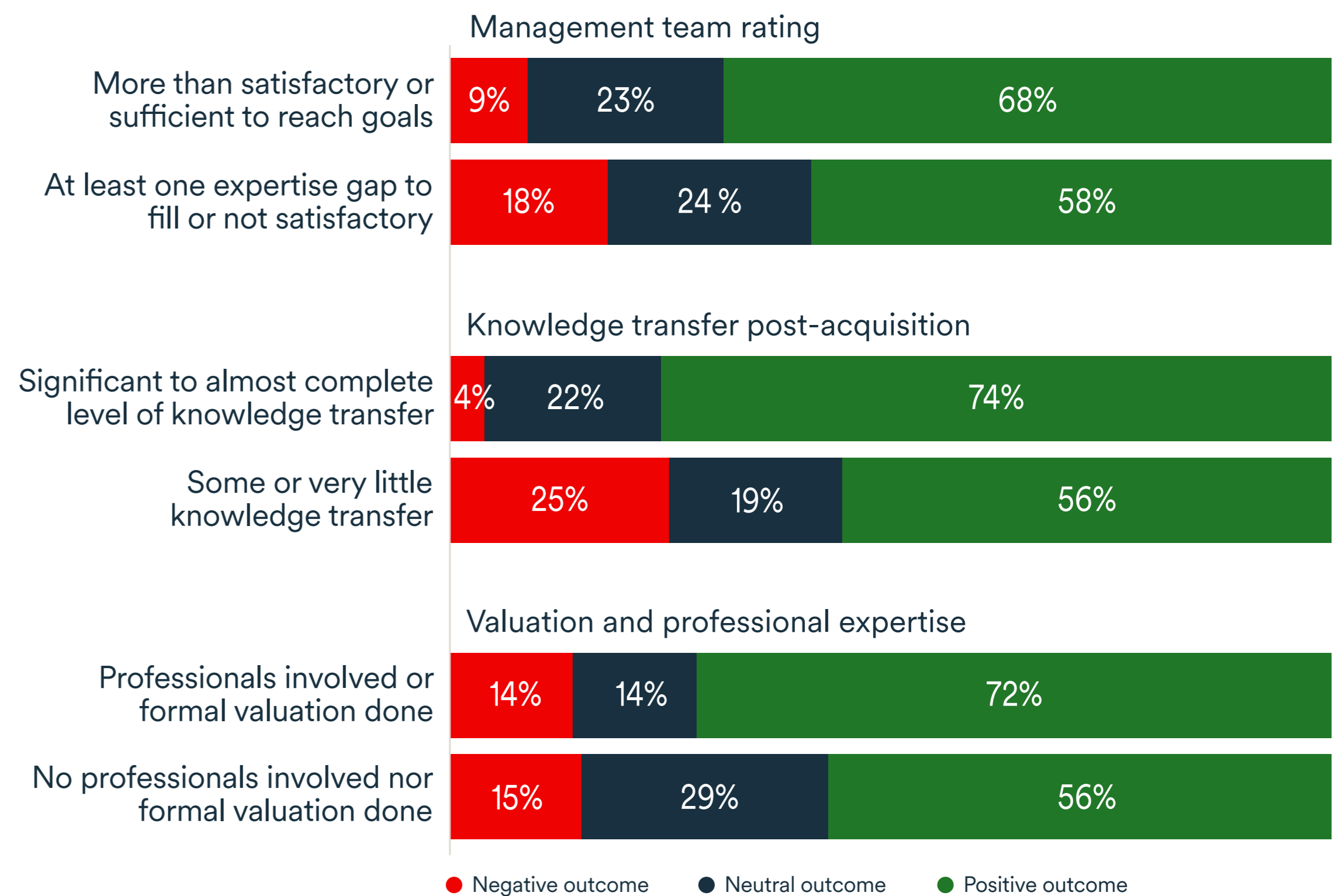
A solid [integration plan](#) can help retain key staff and knowledge in the acquired company. This helps minimize disruption and inefficiencies during the transition. An integration team also helps coordinate the process and ensures alignment of goals and culture.

3. Formal valuation and professional expertise

Acquiring a business involves a complex and multifaceted transaction that demands a diverse set of skills. [Professionals](#) can simplify the process by providing unbiased, specialized advice. These experts are especially valuable in the [due diligence](#) and valuation process to ensure realistic returns, lower risks and fair price for the business.

5. Additional information on the methodology can be provided upon request

Figure 5: Success rate of transaction by level of strength for each factor



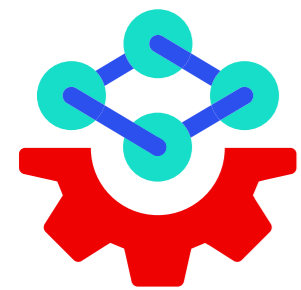
Source: BDC Business Transition Study (internal), Spring 2023, based on 115 responses

Other important factors when completing an acquisition



Effective communication

Clearly defining and communicating expectations, plans and changes to employees on both sides of the transaction helps reassure people about the impact of the acquisition. This can ensure employees remain engaged and work towards a successful integration.



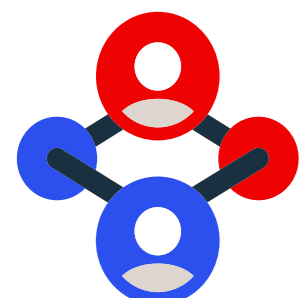
Consider technology compatibility

Systems and processes are some of the most challenging areas to integrate in an acquisition. The two organizations may have different levels of technological sophistication and maturity. Assessing the compatibility or complementarity of the technologies and including this aspect in the integration plan can improve outcomes.



Focusing on cultural commonalities, not differences

An us-versus-them mentality hinders integration, the realization of synergies and employee retention while preventing the two organizations from working as one. Finding common values to unite the businesses and foster growth as a combined entity can help bridge the cultures and realize the full value of the acquisition.



Implementing a change management program

Acquisitions affect every function of an organization. A [change management program](#) can provide the leadership and tools needed to cope with the changes. It can also set a direction to enable the other factors mentioned above.

Using a creative financing structure can help manage the cost of capital and mitigate uncertainty

Despite the opportunities created by the current economic context, higher cost of financing has made it less attractive for businesses to rely exclusively on term debt to carry out an acquisition. In response, businesses are getting creative. A survey by Grant Thornton found that 66% of U.S.-based M&A professionals are exploring alternative financing plans to fund transaction.⁶

Here are some examples of alternative financing options that can mitigate the impact of high interest rates and the risks caused by broader economic uncertainty. Multiple options can be combined to optimize the structure of a deal for all parties.

[Our Growth & Transition Capital](#) team can help you find the best option for your needs.

6. [Grant Thornton M&A professionals predict a continued jump in deal volume. \(August 2023\).](#)

Examples of alternative financing options

Earn-out

In an [earn-out](#), a buyer only pays part of the purchase price if certain performance milestones are met post-acquisition (typically over two or more years).



- Mitigates uncertainty on the company value or future earnings
- Lowers the purchase price and financing need in cases where the business doesn't perform as expected
- Lengthens the payback period for the acquisition
- Improves risk sharing with the seller



- Adds complexity to negotiations
- Can hold up debt financing, depending on terms and conditions
- Keeping the seller involved in the business can confuse strategic direction

Seller “rolled” equity

The buyer finances the transaction through company stocks.

- Reduces the need for financing
- Doesn't involve interest payments
- Doesn't impact the credit score
- Creates more operational flexibility for growth or to mitigate economic uncertainty
- Aligns buyer and seller with the investment thesis, with a potential “second bite” of the apple

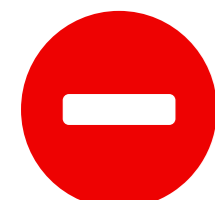
- Doesn't always align with the motivations for liquidity
- Can hurt the buyer's return on equity ratio
- Dilutes ownership of the business
- Structuring governance, shareholder agreement and future liquidity options can be complex

Vendor financing

With [vendor financing](#), the seller holds back part of the purchase price to be repaid later. The seller effectively becomes a lender to the buyer.



- Typically, offers more flexible terms than a bank
- Can lower the interest rate compared to a bank loan
- Can accelerate the transaction process
- Buyer shares some transition risk with the seller



- Keeping the seller involved in the business can confuse strategic direction
- Shortens debt repayment period
- Isn't always accepted by sellers
- Can be associated with more negative outcomes. BDC found that transactions with outsized vendor financing were more likely to report negative outcomes. Higher risk sharing in vendor financing could be leading to shorter and less thorough due diligence.

Unitranche financing

Different types of secured and unsecured debt typically available from different lenders are combined into one loan with a blended interest rate and a set repayment schedule.

- Simplifies the complex lending structure involved in a business acquisition, increasing the certainty of closing the transaction
- Reduces time and friction in negotiations
- Lowers transaction costs compared to traditional financing
- Improves access to financing for small and medium businesses
- Can be curated to offer more money with more patient repayment and covenant flexibility than traditional bank financing

- Moderately higher interest rates compared to secured debt
- Isn't always available at financial institutions

Acquisitions as a path to growth

BioConnect founder and CEO Rob Douglas has proof that, if done right, purchasing a company can offer you the quickest route to business growth.

In 2021, the Toronto digital security firm purchased Tennessee-based Medixsafe, which manufactures safes for paramedics and other medical professionals accessing narcotics. The acquisition made sense for BioConnect, which could apply its cloud- and network-based solutions to Medixsafe's standalone units. BioConnect provides biometric devices that secure access to doors, cabinets, safes and digital systems.

Modernizing Medixsafe's products with BioConnect's modern access control technology turned out to be a perfect fit, Douglas says.

"We've generated about a 400% return on our investment in two years. It's way beyond anything we expected."

He adds that BioConnect would have been hard-pressed to enter the medical narcotic segment had it not been for the acquisition. "That's a big financial investment and would have taken us years to penetrate it versus an acquisition that instantly gives us credibility in that space."



Rob Douglas,
Founder and CEO,
BioConnect

Douglas partnered with BDC Growth and Capital to finance the transaction. BDC provided additional flexibility to the financing package to ensure the company had enough cash on hand to continue investing in its growth. The experience has made Douglas a proponent of growing your company through acquisitions. “It’s a faster way to scale your business than by just continuously hiring people.”

He now plans to acquire a new company every year. In fact, Douglas completed his second acquisition in December 2023, purchasing Silent Partner Technologies—a company that provides tracking technology for vials inside safes. The technology rounds out BioConnect’s growing medical narcotics solutions.

“It’s going to allow us to take things to another level of growth,” he says.

A set of 11 criteria helped land the right company

Acquisitions require considerable preparation. For Douglas and his advisors, that meant defining a set of criteria to find a company that best suited BioConnect’s needs. Included in the 11-point list is that the company be 15-20 years old, which gives a tech innovator like BioConnect an added advantage.

“Essentially, we buy longstanding technology companies and then migrate them to our latest technology platform, to ‘SaaSify’ their business,” he says, referring to the software as a service sector. “We look for firms using mature technologies from yesterday to solve problems. They usually need millions of dollars to build the next generation for their platform.” He also looks for companies that are led by their founders.

“If the founder has been leading that business for over 20 years, they’re likely thinking about their succession. They also care about what happens to the future of their company and don’t want buyers who will just rip it apart. If they’re going to hand over their company, they want it to be somebody they can trust to take it to the next level.”

Rob Douglas’ must-haves for an acquisition

→ Third-party advisors

Douglas advises companies to hire someone with experience in mergers and acquisitions. “Third-party advisors will help you with skills you likely won’t find internally.”

→ A clear path for the acquired business

“You need to know what you intend to do with the acquired company,” Douglas says. You also need to reassure them of a place in the reconstituted business. Douglas went to great efforts to onboard and communicate with Medixsafe employees.

→ A post-merger integration playbook for the two companies

A playbook, spelling out how the company will be integrated, with 30-, 60- and 90-day milestones, is a necessary tool. “You need to have that playbook, with a methodology you follow religiously.”

“Growing your company through acquisitions is a faster way to scale your business than by just continuously hiring people.”

Rob Douglas,
founder and CEO,
BioConnect



Acquisition expertise that's with you every step of the way

- ➔ Our advisory experts can help you find the right acquisition strategy and manage the integration process.
- ➔ Discover flexible financing solutions that are tailored to your needs.

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Acknowledgements

This study was made possible thanks to the collaboration of Pierre Cléroux, Marcellina Daniel, Étienne Drouin, Devesh Dwivedi, Matthew Kellow, Marco Santos Pires and Béatrice St-Cyr.

BDC's economic analysis team prepared this study, in collaboration with the Growth and Transition Capital team. It is based on public and proprietary data analyzed and interpreted by BDC. Any errors or omissions are BDC's sole responsibility. Reliance on and use of the information herein is the reader's responsibility.

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Ce document est aussi disponible en version française.

ISBN: 978-1-990813-34-4
ST-ACQUISITION-E2402



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