Cassels

Private Equity Outlook 2022: What Lies Ahead

Jake Bullen

February 8, 2022

After A Strong 2021, What Lies Ahead For 2022?

Deal Activity

Refinitiv

a record $349 billion across 4,558 deals in 2021

Refinitiv

1

According to the Q3 report from the *Canadian Venture Capital and Private Equity Association* (CVCA)

a *Crosbie & Company* report on Canadian M&A

Strong Fundraising Trends Will Continue in 2022

According to data from *Private Equity International's* (PEI) 2021 fundraising report

a recent *PE Hub* article on fundraising in 2022

Why are PE Trends Important for the Broader Canadian M&A Sector?

- PE deals constitute a significant portion of Canadian M&A activity (as noted above).
- Since PE funds focus on originating and closing transactions, funds and their advisors are often leaders with respect to deal trends. For example, the risk allocation discussions on representation

and warranty insurance are often driven by PE's perspective (see trend 4 below).

- Given the impact of PE funds on the larger economy (for example, a Hoover Institution study on the economic effects of PE found that PE-backed buyouts of private companies resulted in employment expanding by 13%), the manner in which the industry addresses important factors such as ESG principles impacts many sectors and regions of the country.

Outlook 2022: Top Trending Topics

ESG
Talent in Professional Services
Representation & Warranty Insurance
Indemnification Provisions
Material Adverse Effect Provisions
Anti-Hoarding Provisions
Merger Review
Regulatory Compliance
Tax Consequences
Ontario's Business Laws
Long-Dated Funds
Continuation Funds
Growth Equity
Escrow Amounts
Special Purpose Acquisition Companies
Tech Investments

Trends in Private Equity

(1) ESG: Increased Importance for LPs and a Focus on Consistent Standards and Measurement Criteria

According to a 2022 survey by *Bain* and the *Institutional Limited Partners Association*

the COVID-19 pandemic has prompted many Canadian businesses, including portfolio companies, to integrate ESG practices into their operations

the Canadian Securities Administrator (CSA) announced new climate-related disclosure requirements

An *EY* study on ESG reporting standards

In the 2022 *Bain* survey noted above

that measure ESG performance in their investments the International Financial Reporting Standards (IFRS) announced the formation of the International Sustainability Standards Board (ISSB)

an ISSB office would be established in Montreal

the CSA is supportive of advancing the ISSB, and believes Canada is uniquely positioned to be its home

ISSB will create good jobs here in Canada and accelerate growth in the green economy, at home and around the world

Towards Sustainable Mining

established an ESG Data Convergence Project

partnerships with Indigenous communities in Canada and the US

(2) Talent Constraints in Professional Services

C$150,000 to US$240,000 (plus bonuses) at US law firms

(3) Higher Costs & Reduced Underwriting Capacity for Representation and Warranty Insurance

75% of PE and private M&A deals are using RWI

(4) The Convergence of Representation and Warranty Insurance & Indemnification Provisions

(5) Negotiating and Drafting MAE Provisions in 2022

Mergermarket survey

Cineplex v. Cineworld

Cassels

While the decision is being appealed

(6) The Decline of Anti-Hoarding Provisions in Credit Facilities

(7) Competition Law: A More Aggressive Approach to Merger Review & Foreign Investment Scrutiny

Canada needs more competition

including the Commissioner’s challenge in December 2021 to GFL Environmental Inc.’s acquisition of Terrapure Environmental Inc

applied for an injunction

important to the lives of ordinary Canadians

Investment Canada Act

Canadian businesses that are related to public health or involved in the supply of critical goods and services to Canadians or to the Government

10 sectors identified by the government as constituting critical infrastructure

(8) Regulatory Compliance: Developments in Due Diligence Practices

(9) Tax Consequences of Non-Resident Control of a Canadian Company

1. In many instances, the issue with the FAD rules is one of compliance. There are various relieving measures available, such as mandatory and elective paid-up capital (PUC) reductions, which allow for dividends that are otherwise deemed to arise to be offset against the PUC of the shares of the Canadian corporation, and the pertinent loan and indebtedness election, which results in certain loans made to foreign affiliates being subject to interest imputation rules rather than resulting in a deemed dividend subject to withholding tax. However, notification and elections must be timely filed

with the CRA to benefit from such relieving measures.

2. The FAD rules contain a rule that deems partners to own their pro rata share of partnership property, based on the relative fair market value of their partnership interests. In the context of investments made through a limited partnership in shares of a Canadian corporation, an interpretive issue may arise with respect to the determination of control of the Canadian corporation for purposes of the FAD rules. Although the deeming rule may not attribute sufficient share ownership to a GP for it to have control of the Canadian corporation on this basis (i.e., more than 50%), the CRA's position is that, in the case of a limited partnership, it is generally the GP that has control.
3. The FAD rules may apply where a foreign parent contributes its shares to a Canadian corporation to be used by the Canadian corporation as consideration in the acquisition of a Canadian target where the fair market value of its foreign affiliates exceeds 75% of its total asset value.
4. For the FAD rules, an "investment" is defined broadly and includes not only direct acquisitions of shares, but capital contributions, the loaning of funds, acquisitions of options, and extending the maturity date of outstanding debt. Given the broad definition of "investment," a fund may be required to confirm, on an ongoing basis, that its investments are not creating an issue under the FAD rules.

(10) Modernizing Ontario's Business Laws

Business Corporations Act

help businesses and condominiums adapt to new ways of doing business that are more virtual and allow for broader participation

(Cassels partner Jake Bullen, one of the authors of this Report, is a member of the Ontario Business Law Modernization and Burden Reduction Council, which consulted on these amendments.)

(11) Longer-Term Investing Strategy 1: Long-Dated Funds

PEI data notes that long-dated funds have raised around $50 billion

Goldman Sachs

long-term, less liquid alternative investments that are driven by factors less correlated to market beta, such as private secondary offerings and more complex opportunities in the private markets

committed to a long-dated fund strategy

Cassels

(12) Longer-Term Investing Strategy 2: Continuation Funds

According to the *Financial Times*

Kroll

2

(13) Growth Equity Continues To … Grow

according to Buyouts data for 2021

(14) Purchase Price Considerations in M&A Transactions: Escrow Amounts

J.P. Morgan

3

American Bar Association's

4

- Generally, if the pace of M&A slows down, and market terms revert more to the median, buyers will have increased leverage.
- Buyers increasingly seek enhanced protections on indemnities and purchase price adjustments as, for example, market volatility increases.
- Sellers may point to RWI coverage to argue against onerous escrow terms.

(15) Private Equity Selling to Special Purpose Acquisition Companies

there are only two SPACs listed on the TSX as of November 30, 2021

had approximately 11 SPACs listed on its exchange as of the end of 2021

Cassels

Mergermarket

there are roughly 570 SPACs with $134 billion looking for a target to bring public in 2022

as SPACs often have a two-to-three year time horizon to complete an acquisition

1. Some of the pros include more economic certainty and potentially higher valuations for sellers to a SPAC due to (a) the fact that it is a reverse merger or reverse takeover acquisition transaction and (b) the value and purchase price are negotiated between the SPAC and the seller, meaning that the price is less prone to market volatility impacting the economics because the business is not marketed to the public and priced in the context of the market by an investment bank or underwriter, as is the case in a traditional IPO process. There is also less scrutiny of the target's business operations, financial health, and liabilities in a de-SPAC transaction because it is a non-offering prospectus (i.e., there is slightly less regulatory oversight than a traditional IPO) and there is not the same involvement of an underwriter conducting detailed due diligence on the business as there is in an IPO. Finally, due to the fact that a maximum of 20% of the founders' stock in the SPAC is locked until the de-SPAC transaction closes, founders have a strong personal interest and incentive to get a deal done within the regulatory timeline to get their promote.
2. On the con side, although some argue that a de-SPAC transaction is also quicker and less expensive than an IPO, in our experience this has not necessarily been the case. While the IPO and direct listing of the SPAC is typically much quicker and less expensive, the process of the SPAC conducting diligence, negotiating, and ultimately completing a de-SPAC acquisition transaction with one or more targets can be a lengthy process that ultimately rivals the completion of a traditional IPO in the end in terms of timing and expense. Following the IPO of the SPAC, the process to complete the acquisition typically involves another underwritten financing raise that is done as private investment in public equity deal, as well as months of negotiation, paperwork, regulatory filings, and often (but not always) a public company shareholder meeting, to close the acquisition transaction.

(16) Private Equity's Focus on Tech Investments

Houlihan Lokey

5

According to the CVCA's Q3 2021 report

a recent *Goldman Sachs* report

Importantly, companies in every sector have been reshaping their use of technology as their internal business processes and their interactions with suppliers and customers have been moving online

According to a Gartner report on cybersecurity predictions for 2021-2022

The Private Equity Group at Cassels includes over 35 lawyers in Toronto, Calgary, and Vancouver with expertise in all elements of PE transactions. We are leaders in M&A (consistently ranking as a top Canadian firm in PitchBook's global league tables), tax, fund formation, restructuring, competition/foreign investment regulation, debt financing, franchise, and intellectual property. Our clients include PE funds based in Canada, the US, and the rest of the world as well as international and domestic businesses, ranging from large multi-national organizations to start-up companies.

Contributions from across Cassels in the preparation of this report are gratefully acknowledged, including from Ryan Kay, Articling Student, and the following partners and associates:

- Davit Akman
- Jocelyn Arnason
- Frank P. Arnone
- Jeremy Barretto
- Andrea FitzGerald
- Dr. Alison R. Manzer
- Tegan O'Brien
- Chuck Rich
- Doug Richardson
- Brenda C. Swick
- George A. Wowk

[1] See: Refinitiv, "Canada – Private Equity Buyout Review" (First Nine Months, 2021).

[2] See: Kroll, "GP-Led Secondary Recaps and Related Fund Transactions" (Market Update) (January 2022).

[3] See: J.P. Morgan, "J.P. Morgan 2021 M&A Holdback Escrow Study" (2021).

[4] See: ABA M&A Committee Market Trends Subcommittee Meeting, "Deal Points Study – Private Target Mergers & Acquisitions" (January 28, 2022).

[5] See: Houlihan Lokey, American Bar Associate: International M&A Subcommittee (January 28, 2022).
