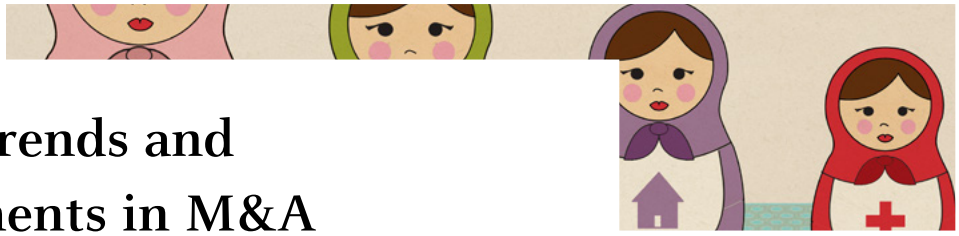


Notable Trends and Developments in M&A

by Emmanuel Pressman, Clay Horner & Don Gilchrist

Return of the Strategic Deal: Although overall M&A volumes trended down in 2013, the M&A markets witnessed increased confidence in strategic dealmaking as well as investor receptivity to mergers with sound business logic and demonstrable synergistic value. Significant strategic transactions of this nature undertaken in 2013 include deals in the retail, real estate and healthcare sectors, such as Loblaw Companies Limited's acquisition of Shoppers Drug Mart Corporation, and Valeant Pharmaceuticals International, Inc.'s acquisition of Bausch + Lomb Holdings Inc., on which Osler acted for Shoppers and Valeant respectively.

Other strategic deals in these sectors undertaken in 2013 include Sobeys Inc.'s acquisition of Canada Safeway Ltd. and Hudson's Bay Co.'s acquisition of Saks Inc. Interestingly, the buy-side stock price after announcement of several of these transactions increased substantially, evidencing investor appetite for sensible, strategic transactions. Ordinarily, sell-side stock prices rise, while buy-side stock prices tend to dip due to factors such as dilution, hedging, deal risk and concerns about overpayment for a coveted asset.

We anticipate that in 2014 we will see more M&A transactions in furtherance of strategic growth – albeit in a slow and steady manner consistent with the cautious approach to strategic decision-making we have witnessed for several years. For some time, the essential ingredients of a robust M&A market have included a high-performing stock market, the availability of capital and strong corporate balance sheets (outside the mining sector). While these elements existed in large measure in 2013 and should support broader M&A activity, worldwide confidence levels have yet to return to pre-financial crisis levels.

Moreover, the energy and natural resources sectors, which historically represent nearly half of Canada's corporate economy and which in past years have generated a significant volume of transactions, saw greatly reduced dealmaking in 2013.

The last major mining take-over, First Quantum Minerals Ltd.'s acquisition of Inmet Mining Corp., on which Osler represented Inmet's special committee of independent directors, closed at the end of the first quarter of 2013. While the metals and mining sector saw significant write downs and management shuffles in 2013 that might have been a catalyst for M&A, very few companies were unaffected by the carnage inflicted by significantly reduced metal prices and massive cost overruns on flagship projects that appeared to deter broader M&A activity in the sector. In the absence of improvement in commodity prices, we expect to see more risk sharing through joint ventures, fewer blockbuster mining M&A transactions, and potential insolvencies and restructurings for junior mining companies that are not able to attract new investment.

The energy sector saw a dearth of M&A activity in 2013. Investment by state-owned enterprises (SOEs) in the energy sector, which in 2012 accounted for almost $28 billion worth of activity, was almost completely absent in 2013 during which there were only two material SOE transactions worth approximately $1.5 billion in aggregate. The oil sands sector reported its lowest level of transactional activity in a decade, while M&A activity in the broader energy sector was off by more than 80% compared to 2012. However, the fundamentals for the oil and gas sector appeared to be improving at year end as concerns about the pace of infrastructure development lessened somewhat. There was also a sense that SOE investment in the oil & gas sector could rebound significantly in 2014 on an improving outlook for the development of a Canadian seaborne export market for domestic energy products and greater comfort with the Canadian regulatory environment for foreign direct investment in the resource sector.

Regulators Have a Seat at the Table

The list of transactions rejected by the federal government on regulatory, policy and national security grounds continued to grow last year. BCE Inc.'s acquisition of Astral Media Inc. finally closed in 2013 after having been initially rejected by the Canadian Radio-television and Telecommunications Commission (CRTC) in 2012. That deal was made possible, in part, by a series of specialty television channel and radio station divestitures that Bell Media Inc. agreed to make to Corus Entertainment Inc. (Osler represented Corus). The CRTC also rejected TELUS Corporation's proposed acquisition of Mobilicity Inc. on regulatory grounds, and the Minister of Industry rejected Accelero Capital's proposed acquisition of the Allstream division from

Manitoba Telecom Services Inc. on national security grounds. Subsequently, TELUS announced that it had agreed to acquire Public Mobile and obtained regulatory approvals in the fourth quarter of 2013. Osler represented TELUS in both of those transactions.

Successful completion of acquisitions in circumstances where material regulatory approvals are required, or which are politically sensitive, require experienced advisors and careful transaction planning and execution. In our experience, completion risk can be mitigated by undertaking a comprehensive risk assessment at an early stage, and promptly engaging with political and regulatory authorities if material risk is identified. Further, friendly board-supported deals can typically be more effectively structured to mitigate the increased deal risk and uncertainty associated with transactions in regulated and politically sensitive industries.

Shareholder Activism Here to Stay

Proxy contests and other forms of shareholder activism continued to be a growth industry and a significant part of the M&A landscape in 2013. Activist initiatives represent a cost-effective way in which to effect a change in corporate control as compared to committing the funds required to launch a hostile take-over bid. Activist initiatives can often be undertaken confidentially and thus the reputational risk of being associated with a failed deal can be potentially avoided. Further, higher (10%) "early warning" reporting requirements in Canada allow activists to engage in stealth accumulations and shield their investment intentions for a longer period of time than would be the case in the United States, although greater conformity between the Canadian and U.S. reporting regimes has been proposed by Canadian securities regulators. Further, the absence of staggered boards allows activist shareholders the opportunity to achieve their objectives over a shorter period of time than is the case in jurisdictions where staggered boards are common. Not surprisingly, Canada has seen increasing levels of shareholder activism over the past couple of years by both domestic and U.S.-based funds. Going forward, we expect to see continued initiatives by activist shareholders – especially in the small cap and mid-markets. Activists are also targeting larger companies, as evidenced by Carl Icahn's recent investment in Talisman Energy Inc., resulting in two board seats in exchange for standstill commitments; Jana Partners' failed proxy battle for Agrium Inc.; and activist overtures made to Tim Hortons Inc.

Osler Represented

Shoppers Drug Mart Corporation *in its proposed $12.4-billion acquisition by Loblaw Companies Limited*

Valeant Pharmaceuticals International, Inc. *in its $8.7-billion all cash acquisition of Bausch + Lomb*

KingSett Capital *in its take-over bid for Primaris Retail REIT and, ultimately, $5.0-billion friendly plan of arrangement with H&R REIT and Primaris*

Although most proxy battles can be resolved without a fight, they have become more litigious, as both the target board of directors and the "concerned" or "dissident" shareholders increasingly resort to the courts to resolve allegations of misconduct and entrenchment. In our experience, the courts have tended to side with incumbent boards. However, the smaller size of Canadian corporations compared with U.S. and international counterparts has generally made them more vulnerable to attack. This may be attributable, in part, to these types of companies being characterized by concentrated ownership blocks, which facilitate proxy solicitation efforts and because small cap companies have more often than not been the subject of concerns expressed about entrenchment and governance practices.

Regulatory Reforms

Although there may have been a reduction in M&A activity in 2013, there was no shortage of ongoing regulatory reform proposed by Canadian securities regulators that, if implemented, will have a meaningful impact on the way in which hostile take-over bids are conducted and "early warning" disclosure is made in connection with stock accumulations. A new rule that would govern the adoption and termination of shareholder rights plans (poison pills) in Canada was announced with the expectation that it would be readily adopted. However, a competing proposal from the securities regulatory authority in Québec that would shift the balance of power to boards of directors gained traction, as did an alternative proposal by a group of senior securities practitioners that proposed more holistic reform to the take-over bid regime to address substantive deficiencies as opposed to a narrow focus on poison pills. It is expected that the shareholder rights plan rule will be re-issued for further comment in 2014 and will be the subject of ongoing debate.

A proposal to reform the early warning and alternative monthly reporting regimes was also subject to extensive comment. The proposal contemplates (i) decreasing the trigger for early warning reporting from 10% of the outstanding securities of a class to 5%; (ii) including certain equity derivatives positions and securities lending positions in the calculation of what must be reported; (iii) disqualifying eligible institutional investors from using the more permissive alternative monthly reporting system if they intend to solicit proxies relating to the election of directors or certain corporate restructurings; and (iv) prescribing enhanced disclosure of investment intent. The proposal is expected to be re-issued for further comment later in 2014.

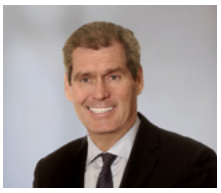
The rights plan proposal is a welcome initiative since hearings before regulators to cease trade a rights plan under the current bid regime often result in uncertainty as to the timing of bids, detract the attention of both targets and bidders from the transaction, and typically have marginal impact on the actual outcome of the bid. Deal certainty and allocation of regulatory resources favour regulators "getting out of the business" of cease-trading pills. That said, the regulation of rights plans is a very narrow matter of law that generally speaking arises in the hostile take-over bid context. As there are only a handful of rights plans cease-traded in any year, the significance of the rule may be disproportionate to the attention paid by market participants. In contrast, the proposed changes to the early warning disclosure rules have widespread and daily implications for both activist investors and passive investors.

Looking Ahead

We are optimistic that M&A activity will increase somewhat in 2014 in light of increasing confidence in the strength of the economic recovery and access to capital for many companies. However, concerns about the strength of commodity prices and the pace of infrastructure development in the energy sector may continue to be a drag on deal-making. We also expect that activist shareholder initiatives will continue to be a significant part of the M&A landscape in 2014. However, widespread adoption of advance notice by-laws, potential changes to the rules regarding reporting of share ownership positions and other regulatory initiatives may dampen the rapid increase in the number of activist initiatives that we have seen in the last couple of years. Further, governmental and regulatory considerations will continue to be part of many proposed transactions. Finally, the decisions of the Canadian securities regulators concerning poison pills and defensive tactics and the other regulatory initiatives discussed above could result in important changes in the manner in which contests for control are undertaken.

CONTRIBUTORS

Emmanuel Pressman
Partner, Corporate
epressman@osler.com
416.862.4903



Clay Horner
Firm Co-Chair
chorner@osler.com
416.862.6590

Don Gilchrist
Partner, Corporate
dgilchrist@osler.com
416.862.6534