GOING-PRIVATE TRANSACTIONS: A NEW EQUILIBRIUM?

KEY CONSIDERATIONS FOR TARGET BOARDS IN 2023

THE COMBINATION of low interest rates and government stimulus at the early stages of the COVID-19 pandemic contributed to one of the strongest equity markets in Canada's history. This market included a wave of initial public offerings (IPOs), particularly in the technology sector, that began in the latter half of 2020 and continued to the end of 2021. Bloomberg reported that in 2021 alone, 173 Canadian companies completed IPOs, collectively raising approximately $12 billion. In addition, M&A activity in 2021 reached all-time highs in North America (and globally), driven by the same factors noted above and pent-up demand due to a pause at the outset of the pandemic.

The market reset

In mid-2021 and into 2022, numerous factors began to weigh down the capital markets, including rising inflation rates (followed by forceful increases in interest rates by central banks), the withdrawal of governmental support and stimulus relating to COVID-19, geopolitical uncertainty (including Russia's invasion of Ukraine in February 2022), and the risk of recession.

As a result of these factors, global equity markets were punished in 2022, with investors turning from "risk on" to "risk off" in the face of increased volatility. In October 2022, *The Globe and Mail* reported that of the 20 Canadian technology companies that went public in 2020 and 2021, only four were trading at prices above their IPO price, with several of these companies trading at a price that was more than 70 percent below their IPO price.

Additionally, M&A activity retreated to pre-COVID levels in mid-2022, following the all-time highs of 2021. A disconnect regarding valuations, lack of access to financing, and enhanced regulatory scrutiny of large transactions all contributed to more conservative buyer psychology.

> "GLOBAL EQUITY MARKETS WERE PUNISHED IN 2022 WITH INVESTORS TURNING FROM 'RISK ON' TO 'RISK OFF' IN THE FACE OF INCREASED VOLATILITY"

A new equilibrium

Notwithstanding the market volatility, in our experience, financial sponsors and strategic players remain committed to completing M&A transactions, and public companies with depressed valuations have become prime potential targets. The critical question is, will expectations shift between buyers and sellers with respect to valuations, considering the current market realities?

The acquisition of Magnet Forensics by Thoma Bravo is notable in this regard. While the take-private price of $44.25 per share was a significant premium on Magnet Forensics' IPO price (April 2021), it represented only a 15 percent premium on the closing price of the subordinate voting shares on the TSX on the last trading day prior to announcement of the transaction. It was also significantly below the highs of $50–$65 per share seen on the TSX in August and September 2021 when the market, particularly the tech market, was "risk on" for investors. The transaction was contested, but shareholders (other than the roll-over shareholders) ultimately took the certainty of a fixed cash price at a premium and approved the transaction on March 23, 2023.

The decision of a public company board as to whether to entertain or engage with financial sponsors and strategics on going-private overtures will be more difficult as we move further into 2023. We also believe that these overtures may become more frequent and aggressive if share prices remain stagnant or companies (particularly companies that recently went public) appear to be strapped for cash or miss guidance.

In anticipation of these approaches, we believe the following are specific key considerations for target boards:

- Are share price valuations from 2021 far enough in the rear-view mirror that historical M&A premia on the current market price would now be attractive to shareholders? In this regard, is the certainty of an all-cash transaction at a premium more attractive than attempting to execute upon the company's strategic plan?
- If a board and management team believe in the company's strategic plan, are the board, management, and advisers prepared and able to defend it even in depressed capital markets? Performance has always been the best defence against unsolicited overtures, but external market and geopolitical factors have not been favourable in the past 12 to 18 months.
- Boards will have to reflect on whether being public is ultimately in the best interests of the company and its stakeholders. With increased scrutiny on guidance, an emphasis on short-term and quarter-by-quarter results, and increased costs, being public

has its drawbacks – especially for companies who viewed access to the frothy public markets for financing as a factor in favour of being a public company.

- Should a board determine to engage in discussions regarding a potential go-private transaction, what type of market check, if any, should the company engage in? This will likely be driven by the premium offered and the universe of relevant competing bidders when weighed against the risk of losing the "bird in the hand" if the initial approach is considered attractive.

- Lastly, deal certainty is crucial. M&A transactions are costly and disruptive. Boards, management teams, and their advisers must be diligent in understanding any financing risk in the current environment and the regulatory risk (or lack thereof) presented by any would-be buyer.

Boards of public companies have faced significant challenges since the outbreak of the pandemic. If the shift in equity valuations of public companies persists and the debt markets thaw, these same boards may continue to be faced with difficult decisions in the second half of 2023 and into 2024.

The authors would like to extend their acknowledgement and gratitude to Navin Kissoon for his contributions to this article.

Vanessa Coiteux
Partner, Montréal office
vcoiteux@stikeman.com

Mike Devereux
Partner, Toronto office
mdevereux@stikeman.com

Victor Gerchikov
Partner, Vancouver office
vgerchikov@stikeman.com

Janel Young
Partner, Calgary office
jyoung@stikeman.com