M&A in 2021: It's the Season of Bidding Wars Here in Canada!

Description

We are almost halfway through 2021 and have already seen plenty of big M&A deals this year. Like other crises, the pandemic made financially vulnerable companies weaker, making them worthy targets for their bigger counterparts. According to *Global Times*, the M&A deals in Canada hit an all-time high of US$115 billion in Q1 2021, per data from Refinitiv.

M&A and bidding wars in Canada

Apart from the high transaction value, the bidding wars have risen recently. The recent one has been for **Inter Pipeline**. Peer **Pembina Pipeline** offered to buy Inter for $19.25 a share, valuing the deal at $8.3 billion. The strategic expansion is expected to increase Pembina's presence in Western Canada significantly.

However, just a day later, **Brookfield Infrastructure Partners** made a hostile offer, increasing the bid to $19.75 apiece. Driven by back-to-back offers, Inter shares have risen by more than 15% in the last two trading days. Whether Pembina further raises its offer remains to be seen.

In March 2021, the country's second-biggest railroad company **Canadian Pacific Railway** announced a merger with **Kansas City Southern** valued at US$29 billion. The rail network of KCS has been important mainly due to trilateral trade activities after the USMCA deal.

However, peer **Canadian National Railway** swooped in, raising its offer to KCS to US$33.6 billion. Although KCS has agreed to CNR's offer, the deal has yet to clear regulatory hurdles. Canadian Pacific did not raise its offer.

Are you destroying shareholder value?

There are several motives behind mergers and acquisitions. Companies generally look at acquisition opportunities to expand, kill competition, and, when they are short of opportunities, grow organically.

Sure, bidding wars can result in higher premiums for target companies. Also, this can result in significantly higher profits in the merger arbitrage strategy for investors than originally expected.

However, there is a downside as well. The acquirer can end up paying meaningfully higher than the target is worth. Also, bidding higher can make a good deal a bad one. The time lost and higher premiums amid bidding wars can increase payback periods for acquirers. This, in turn, notably destroys shareholder value.

According to reports, very few M&A deals increase shareholder value. Failed operational synergies and overlaps post-integration fall short of creating value of the corporate action. So, bidding higher could result in a double blow for acquiring companies.

Canada's biggest passenger airline **Air Canada** (TSX:AC) made an offer to acquire **Transat A.T.** at $5 a share last year. Canadian media baron Pierre Karl Peladeau made a counteroffer of $6 apiece, believing the flag carrier's deal would hit regulatory snags. However, after several months, the Air Canada-Transat deal fell apart on anti-competitive issues, and Peladeau also retracted his offer. AC stock kept rising while Transat shares notably fell after the deal broke up.

Bottom line

We will likely see more M&A activities amid the economic re-opening, as markets continue to offer lucrative financial conditions. Some of them might get turned into bidding wars. However, companies should avoid paying too much for targets, driven by ego, which can harm shareholder value.

Warren Buffett is no fan of bidding wars. He let go of the **Tech Data** deal in 2019 when the counteroffer was US$5 per share higher than his bid. **Berkshire Hathaway** was sitting on a mammoth US$130 billion of cash then!

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