Acquisition Finance: An Overview of the Current M&A Market in Canada

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Authors

Étienne Brassard

Partner, Lawyer

Felix Chen

Student

In 2025, the Canadian M&A market remained resilient despite broader economic uncertainty. Trade tensions with the USA contributed to a subdued start, but activity picked up in the second half of the year as market participants adjusted to the new environment, commodity prices strengthened, and interest rates eased. Canada also reflected the global shift towards larger transactions - while the transaction count declined from 3,411 in 2024 to 3,294 in 2025, total deal value increased from USD264.16 billion to USD398.36 billion in 2025. Mid-market transactions (valued below CAD250 million) continued to represent the largest share of M&A deals in Canada by deal count, accounting for 86% of deals (down from 88% in 2024).

Leverage levels for new acquisition financings were broadly consistent with prior years.

Tariff uncertainty affected cross-border deal flow in 2025. Inbound activity softened in Q1 as tariff risk weighed on pricing, diligence and execution, but improved in Q2 as buyers became more accustomed to assessing and allocating that risk. Trade tensions also prompted Canadian investors to diversify into US assets and build a presence in the USA to mitigate tariff-related exposure, contributing to increased outbound deal flow throughout the course of the year.

By sector, energy, utilities and mining were the most active sectors, with each recording an increase in deal value. This growth was supported in part by the infrastructure and energy demand associated with rapid AI-related investment. The wealth management sector also experienced a record year for M&A activity, driven in part by ownership succession at family-owned businesses and the resulting intergenerational transfer of wealth.

Legal and regulatory developments

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Amendment reducing the criminal rate of interest

Effective from 1 January 2025, the Criminal Code was amended to replace the former criminal-rate threshold (an effective annual rate exceeding 60%) with an annual percentage rate (APR) exceeding 35%. Given that an effective annual rate accounts for compounding whereas an APR does not, the amendments also changed the applicable method of calculation. The scope of the offence was further expanded to include offering or advertising credit at a criminal rate.

These changes are not expected to materially affect most acquisition financings because the regulations provide an exemption for commercial loans where:

- the borrower is not a natural person;
- the credit is advanced for a business or commercial purpose; and
- the amount of credit advanced exceeds CAD500,000.

Commercial loans between CAD10,000 and CAD500,000 that meet the first two conditions remain subject to a maximum rate of 48% APR. Accordingly, smaller commercial loans and certain small-ticket junior facilities may require closer scrutiny.

Amendments to the Investment Canada Act and the Competition Act

Recent amendments to the Investment Canada Act (ICA) and the Competition Act have increased regulatory scrutiny of transactions and, in turn, heightened closing risk and uncertainty. Amendments to the ICA and its regulations have broadened the scope of national security reviews applicable to investments by foreign investors. A national security review may be initiated if an investment by a non-Canadian could be injurious to Canada's national security. Following the review, the transaction may be permitted to proceed, permitted subject to conditions, or blocked.

The amendments also expand the authorities' powers during the review process. These powers include extending the review period and imposing interim conditions, such as restrictions on access to or the transfer of assets or IP. In addition, economic security has been expressly recognised as a factor in the national security analysis. The analysis may therefore consider whether a Canadian business's ties to a foreign state's economy make the business vulnerable to leverage by that state.

Given the highly discretionary nature of the ICA national security process and the fact that reviews may take months, these changes heighten uncertainty around closings, particularly with regard to timing and the ultimate ability to complete the transaction.

Under the Competition Act, the Competition Bureau may review mergers and may apply to the Competition Tribunal if it considers that a merger is likely to prevent or lessen competition substantially in Canada.

Amendments have introduced a rebuttable presumption that a merger substantially prevents or lessens competition where its Herfindahl-Hirschman Index (HHI), an index that measures market concentration, increases by more than 100 as a result of the merger and either:

- the post-merger HHI exceeds 1,800; or
- the parties' combined market share exceeds 30%.

Although the presumption may be rebutted with sufficient evidence that the merger is not likely to prevent or lessen competition substantially, this change creates a more demanding environment than the previous framework, under which market share and concentration evidence did not give rise to the same statutory presumption. The increased complexity of the merger review process has

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also contributed to longer Competition Bureau review timelines.

Taken together, these amendments increase the likelihood that transactions will face more intensive and lengthier regulatory review. Obtaining regulatory clearance or otherwise resolving the review may take months. This may delay closings and increase the risk that a transaction will not be completed. From an acquisition finance perspective, prolonged regulatory reviews may lengthen the period between signing and closing and require financing commitments to remain available for longer periods. Commitment expiry dates, extension mechanics, and the alignment of financing commitments with transaction long-stop dates therefore require particular attention.

Bank debt

Bank debt has traditionally represented - and continues to represent - the largest source of acquisition financing in Canada, reflecting the dominance of Canada's "Big Six" banks (the six largest banks in Canada). While these banks remain relatively conservative in their underwriting standards, their extensive relationships and early visibility into financing opportunities continue to position them at the forefront of the lending market.

Banks will typically provide senior secured facilities comprising the majority of the debt financing required for an acquisition. Subject to the transaction structure, applicable law, and agreed security principles, the security package will generally cover all or substantially all of the assets of the borrower and guarantors and may include security over the shares of the target. Target-level guarantees and security may be implemented at or following closing.

Direct lending

Direct lending, whereby a non-bank private lender provides a loan directly to a borrower, has gained traction in Canada and become increasingly established since the 2008 global financial crisis. Increased bank regulation following the crisis tightened bank underwriting for certain borrowers and transactions, thereby creating gaps in the market. At the same time, compliance costs rose for banks. Private credit lenders are generally not subject to the same bank capital and liquidity requirements, which has helped them expand to meet growing demand.

Market conditions from 2022 onwards further supported private credit activity. Interest rate increases implemented in response to elevated inflation following the COVID-19 pandemic and Russia's invasion of Ukraine increased returns on many private credit loans, given their floating-rate structure. Higher rates also tightened bank lending and, in turn, allowed private credit to expand to fill the larger gap. In those market conditions, private lenders with longer-term committed capital were often able to continue deploying funds - although funding structures vary among lenders.

In 2025, economic uncertainty in Canada supported further growth in private credit. In volatile market conditions, borrowers placed particular value on private credit's potential to provide speed, structural flexibility, and execution certainty and were often willing to pay a premium for those attributes. In parallel, private equity firms entered 2025 with significant levels of dry powder (committed but undeployed capital), which supported sponsor-backed acquisition activity.

Regulatory developments may further reinforce direct lending's role in transactions involving extended closing periods. As amendments to the foreign investment and competition law regimes come into effect, more transactions may be subject to governmental review, and review timelines may lengthen for affected deals. Where governmental review extends the period between signing and closing, parties may require committed financing that remains available throughout that period. Direct lenders' ability to offer flexible commitment periods and execution terms may therefore be attractive in affected transactions.

Although direct lending may be the sole source of acquisition financing, it is commonly used to

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bridge the gap between the borrower's funding needs and the amounts banks are willing to provide. In such a hybrid debt financing structure, banks may provide senior debt, while private credit may provide junior debt or mezzanine financing.

Unitranche financing, where senior and subordinated debt are combined into a single facility with one interest rate and one set of covenants, also gained popularity in the Canadian market in 2025. Such a structure can reduce the need for the borrower to negotiate with multiple lender groups, thereby facilitating faster execution - a particularly valuable advantage in volatile market conditions.

Despite making significant headway in recent years, private credit remains smaller and less mature in Canada than in the USA or Europe, and its growth has been more modest. Canada's "Big Six" banks continue to dominate the lending market. Furthermore, some of the factors that have driven the development of private credit in the USA and Europe - particularly bank retrenchment in response to prudential regulatory constraints - have not materialised to the same extent in Canada. In the near term, private credit will therefore likely remain primarily complementary to bank debt - although it may compete directly with banks in certain transactions.

The global growth of private credit has attracted increased attention from Canadian policymakers, who have identified potential vulnerabilities, including limited transparency and interconnectedness with the banking sector. At the same time, policymakers in Canada have acknowledged private credit's role in filling funding gaps and supporting new investments.

As private credit continues to evolve in Canada, its implications for acquisition financing will need to be monitored.

Deal structuring

In a year marked by volatility, misalignment of valuation expectations between buyers and sellers led parties to adopt more flexible purchase-price structures. Many acquisitions incorporated purchase-price mechanisms that reduced the amount of cash payable at closing and, consequently, the amount of immediate external funding required - although some of these mechanisms may create future payment obligations. The following mechanisms were used in 2025 to bridge the valuation gap and complete transactions.

Seller financing

Seller financing continued to gain momentum in 2025, following several years of increased use. Seller financing is an arrangement whereby the seller agrees to defer a portion of the purchase price to a future date, typically with interest – effectively becoming a lender to the buyer.

The growth of seller financing reflects - among other factors - a more conservative approach to underwriting by banks, as well as the growing prevalence of independent sponsors and search funds, which may seek more flexible financing instruments. Beyond providing funding, seller financing may keep the seller economically exposed to the success of the business, aligning the seller's interests with the acquirer's.

Earn-outs

Earn-outs are contractual provisions included in M&A deals that defer a portion of the purchase price and make payment conditional on the achievement of certain post-closing performance targets. This mechanism is used to reduce the buyer's risk of overpaying if the target company does not perform as expected. However, the use of earn-outs remains selective, particularly in deals where performance can be measured using clearly defined metrics that are less susceptible to post-closing

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manipulation; EBITDA-based targets remain among the most common.

In 2025, earn-outs were also used to address increased risks related to businesses potentially exposed to tariffs. By linking a portion of the purchase price to a company's future performance, the buyer shares part of that risk with the seller. If trade policy adversely affected the acquired company, the agreed-upon performance targets could become harder to reach and the purchase price could be reduced. In 2025, earn-outs were frequently considered in Canada–USA cross-border transactions involving businesses with material tariff exposure.

Earn-outs, however, can create significant post-closing complexity. The increased use of earn-outs in recent years has also led to more frequent disputes and litigation. Payouts may be lower than sellers expect, while disputes concerning post-closing performance and the calculation of contingent consideration can create substantial costs and uncertainty for both parties.

Rollovers

Rollovers involve a seller receiving a portion of the purchase price in the equity of the post-closing entity or the buyer instead of receiving full payment in cash. The seller thus typically receives a combination of cash and shares.

Rollovers continued to be used in 2025, particularly in cross-border transactions where they can help bridge valuation gaps. Although many rollovers involve management teams, they may also involve other shareholders to support continuity and alignment following closing. By reducing the cash consideration payable at closing, rollovers can also reduce the amount of external financing required.

Outlook

Tariff uncertainty that weighed on the Canadian M&A market in 2025 has continued into 2026, but market participants have become increasingly accustomed to pricing and allocating that risk.

In the near term, public policy will likely be a driver of deal activity. Deal activity could therefore increase in sectors aligned with the Canadian government's priorities - most notably, in defence and energy.

As uncertainty persists and private equity dry powder remains substantial, direct lending will likely continue to grow and fill funding gaps. At the same time, private credit is attracting increased regulatory and policy scrutiny, which may affect the pace and form of its continued growth. Its interaction with the Canadian banking industry will remain an important development to monitor.

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