

SHAREHOLDER ACTIVISM IN CANADA - ON THE RISE

There was a time when shareholders would passively defer to the judgment of corporate management. If a significant shareholder disagreed with how management operated a company, they would simply divest of their holdings. No more. Today we are seeing unprecedented levels of shareholder activism. Examples are everywhere: an environmental group uses its investment to press for improved performance; a pension fund pressures a company to improve its corporate governance structure; or a hedge fund disagrees with management's strategic plan and agitates to change the board through a proxy battle.

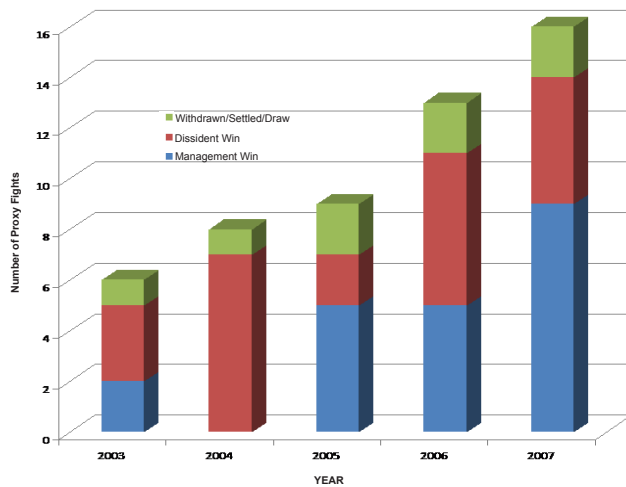
RISING NUMBER OF PROXY FIGHTS

In Canada, the rise of activist investors has led to an unprecedented number of proxy fights. Witness the events at ATS Automation Tooling Systems Inc. in the early autumn of 2007. On the day before its 2007 annual meeting of shareholders, ATS Automation issued a press release announcing that its board of directors would resign on the morning of the meeting. Having reviewed the proxies submitted by its shareholders, the company's board realized that they were soundly trounced by a dissident group comprised of hedge funds Goodwood Inc. and Mason Capital Management, LLC.

The board resigned to allow the shareholder meeting to proceed in an orderly basis, with the election of new directors nominated on the dissident slate.

Disappointed with ATS Automation's plummeting stock price, the failed IPO of a subsidiary, and the refusal of the incumbent board to axe its CEO, the dissidents moved to trigger the proxy fight. Their campaign to ATS Automation shareholders clearly struck a nerve and turned out to be a resounding success, at least from the point of view of Goodwood and Mason. After winning the proxy fight, the challenge for the new board is to now implement the appropriate strategies to reverse the deterioration in shareholder value.

This scenario, the wholesale replacement of a company's board by a dissident slate, once relatively rare in the Canadian marketplace, is becoming much more commonplace. Also increasing in number are proxy fights over individual board members and battles to scuttle proposed mergers or acquisition. Indeed, we have seen a steady increase in proxy battles over the last five years, rising from only six in 2003 to 16 in 2007. And, thus far in 2008, the trend shows no signs of abating – we have already seen nine contests and there are rumblings of more to follow.



The outcomes of these fights suggest that board directors cannot be complacent. Across all proxy fights over the last five years it appears that dissident shareholders have been successful approximately 50% of the time. This is an amazing result given all the strategic advantages held by an incumbent board and it shows that in the right circumstances shareholders are willing to take a chance that fresh thinking will enhance shareholder value.

THREE MOTIVATIONS OF SHAREHOLDER ACTIVISM

Of course, not all activist investors engage in proxy contests. Depending on the motivations and objectives, other tactics include public pressure, private dialogue with management and board directors, and shareholder proposals.

At Kingsdale, we view modern shareholder activism as having one of three main rationales: as a tool for advocating greater social responsibility by corporations; as a mechanism for forcing the enhancement of corporate governance; and as an investment strategy.

Activism to Advance Corporate Social Responsibility

For investors driven by ethical considerations, the annual shareholder meeting represents a convenient forum to have their voices heard by corporate management and, in some cases, generate publicity for their cause. Exxon Mobil Corp., for example, has no less than 17 shareholder proposals on its ballot for its AGM on May 28, 2008. The resolutions address such diverse issues as gender equity, political donations, and climate change.

The corporate response to activist investors is crucial. Responsive corporations are being proactive – they are not waiting to react to the latest NGO or social investor campaign. Instead, they are looking for ways to monitor and identify corporate social responsibility trends and they are actively engaging in dialogue with proponents of various issues. Some of the world’s leading corporations are finding that improved social and environmental performance is also helping the bottom line.

Activism to Improve Corporate Governance

Shareholder activism to force corporate governance improvements has been mainly within the purview of institutional shareholders. Major issues include calls to increase the independence of the boards, separate the chair and CEO positions, reign in excessive executive compensation, and adopt majority voting standards for board members. Based on the statistics gathered by Institutional Shareholder Services

“ISS” – now part of RiskMetrics Group) and data examined by such surveys as the Globe and Mail’s annual corporate governance report, real progress is being made. For example, as ISS noted in its 2007 Postseason Report, one indication that corporations appear to be responding to investor concerns is the steady decline in the number of directors receiving unfavourable recommendations by ISS. In 2003, ISS recommended withholding support from 25 percent of directors. That number has dropped steadily each year, down to 15 percent for 2007.

One of the significant drivers for change in the Canadian landscape is the Canadian Coalition for Good Governance which not only monitors corporate governance and reports on best practices, but also actively engages with boards and regulatory bodies in an attempt to initiate and influence changes in the Canadian environment.

Activism as Investment Strategy

The business press is now full of examples of activist shareholders who have become adept at using the assorted tools available to the activist as an aggressive investment strategy. Icons like Kirk Kerkorian or Carl Icahn, hedge funds like Greenlight Capital or Atticus Capital, or even Canadian income trust raider George Armoyan are all part of this trend. These activist investors seek out distressed (and sometimes not so distressed but cash rich) companies and take significant equity positions. They then demand changes designed to improve company performance, at least as measured by the stock price,

including demands for corporate restructurings, cost-cutting measures, and strategic changes. If there is also a sense that a change in management is in order, these activist investors will not hesitate to attempt to take control of the target company’s board.

Some view these activist investors as “bullies” after a quick buck, eager to load companies up with debt in order to extract a quick return. Others see them as a necessary and welcome check on underperforming management. Whatever the view, it is this group of activist investors who are most likely to engage the proxy battles described above.

CONCLUSION

Shareholders are finding their voice and flexing their muscles in ways they never have before. And it is clear that the ground is shifting beneath the feet of corporate Canada. With a growing number of proxy battles – roughly half ending in favour of the dissident – we have entered a new environment of accountability. Combined with the increasing frequency of shareholder proposals, and calls for improved corporate governance practices, companies must not only do well but be seen to be doing well. If not, there will surely soon be a knock on the boardroom door.

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