



ENCOUNTERING THE EVOLVING SHAREHOLDER AND GOVERNANCE LANDSCAPE



2016 PROXY SEASON REVIEW

Kingsdale Shareholder Services' highlights of this year's proxy season, important developments in governance, and the trends that will matter in 2017.

SEPTEMBER 2016

We've established ourselves as Canada's number one shareholder advisory firm by striving to stay one step ahead of shareholders, activists and proxy advisors. Every year we advise on more annual meetings, transactions and proxy fights than all of our competitors combined. After each proxy season we put this experience to use, taking time to review the landscape to ask tough questions about what the latest developments mean for our clients and identify trends before they are trends.

Our commitment to challenging ourselves to learn, innovate, and solve unforeseen challenges, has made Kingsdale more than just a proxy solicitor: We are a trusted strategic advisor to management and boards on everything from governance to M&A to crisis communications.

We hope you see this report as the start of a dialogue. We are eager to share our unique perspective to benefit you in an increasingly complex and shifting shareholder and governance environment.

In our report last year we identified a number of key issues that proved invaluable to our clients:

- At the time our 2015 report was published there had only been 29 proxy contests declared in Canada. Based on what we were seeing behind the scenes we predicted that proxy contest activity was going to become even hotter. We were right. 2015 became the most active year on record with 55 proxy contests with activist winning 30 of those.
- After seeing a record number of issuers fail say-on-pay votes in 2015, we provided advice about how issuers can go about meeting the changing expectations of shareholders and proxy advisors. This year the three companies that failed dramatically improved their shareholder support with all passing their votes. That said, there were still two companies who failed to receive shareholder support in 2016.
- We predicted the cooling effect the new takeover bid rules would have with only one hostile bid being announced after Suncor's blockbuster hostile bid for Canadian Oil Sands at the end of 2015.
- We placed a big emphasis, as we do every year, on the need for directors to engage shareholders. As we have had more and more questions about how to do this, both on a proactive and reactive basis, we recently published Kingsdale's Definitive Guide to Director-Shareholder Engagement that is available on our website.

This year, just over halfway through, we have seen a big pivot from public proxy fights to behind the scenes antagonism (at least to start). We estimate only about one in three activist situations ever become public. As we see the types and tactics of activists evolving the race to better prepare directors to deal with them has begun.

We hope you find this report useful as you plan ahead and prepare for the most unexpected challenges.

We remain on standby ready to help when you need us the most.

Best regards,



WES HALL, ICD.D
Founder and Chief Executive Officer
Kingsdale Shareholder Services

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SECTION ONE

Proxy Season 2016



Contested Activity

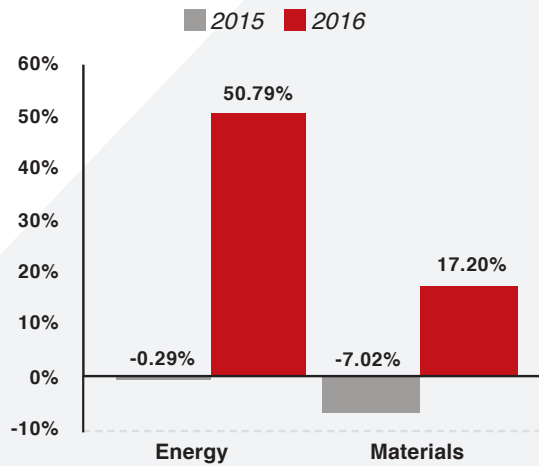
Back to Earth

After last year's record setting year, contested activity in the public realm is down in the first half of 2016 but is on pace to finish about where it has in the bulk of the last five years. It is important to note that as there no longer appears to be an 'activist season' as we have seen in previous years, an increase in the second half of the year is possible as activists pre-position for the next AGM.

To observers and those of us who are involved in behind the scenes activist activity this lower statistic may seem at odds with the constant media attention shareholder activism receives. This year we attribute the slowing in activity to a few factors:

- Stock recovery in the two most active sectors (Energy and Materials)

SECTOR TSR PERFORMANCE (2015 vs 2016, First Half)



- Global political and economic uncertainty leading to market prudence and scepticism of potential activists. Many have put their ambitions on hold recognizing that despite their best efforts at a target company the overall weight of market concerns may quash an ability to deliver returns.
- Difficulty in finding activist targets given strong share performance and vulnerable companies adopting defenses like advance notice have become prevalent

It is also important to note these numbers only include publicly disclosed proxy fights. In 2016, as in past years, Kingsdale advised multiple large-cap Canadian companies who were engaged with

activists behind closed doors. Activists know that boards don't want to waste time and money in a proxy fight if they can avoid it and directors certainly don't want to have their reputations damaged in the media. This makes activists more willing to attempt to negotiate behind closed doors and use the threat of a public fight, however credible it may be, as leverage.

We consider a proxy fight to have initiated when an activist shareholder (or group of shareholders), in opposition to management, makes an early warning filing of its activist intent, requisitions a shareholder meeting, solicits alternative proxies, conducts a 'vote no' campaign or announces the intention to launch a hostile takeover bid, regardless of whether a vote or the hostile bid actually takes place, as long as the opposition is publicly known. Our proxy contest data captures the campaigns that served as a tool to drive change for activists seeking board representation; changing board composition; catalyzing changes in strategy; changes in capital allocation; a sale or break-up of the company or other value-enhancing transactions; blocking a board approved transaction; or making a hostile bid directly to shareholders, among other dissenting actions.

A WORD ABOUT WINNING AND LOSING: DOES IT REALLY MATTER?

When we think of proxy contests most automatically think – who won? Unlike the world of sports where there is a clear winner and loser, the world of proxy contests is far greyer. Does it in fact actually matter who 'wins' and who 'loses'?

Sure there are the optics of being able to claim victory, but in the end either side is driven by two different objectives that do not necessarily correlate with the outcome of a proxy fight. For management, the focus should be on creating value and asking if shareholders, as a whole, ultimately gain from the venture over the long-term. For activists, it is about making money within the timeline they deem acceptable, usually by seeking to improve the company rather than strip it of its assets as was common in the 80's.

One of the fundamental tenets of being a public company is the creation of value for shareholders. Activists typically identify a situation where shares are underperforming and some form of action –be it a sale or operational changes– can create value. To us that premise as a whole is a winning proposition – if properly tested and true.

PROXY CONTESTS IN CANADA

(2003 - Present)



Information current to August 31, 2016

* (Activist win is defined as the activist achieving more than a majority of objectives. Activist partial win is defined as the activist achieving equal or less than a majority of objectives.)

The idea of activism as inherently ‘good’ or ‘bad’ is disappearing as the ideas activists put forward are increasingly being judged on their merit, not their source. Management and boards have become more open to discussing value creating opportunities with shareholders either because they may have good ideas born out of their depth of experience or, at the very least, the conversation may help thwart an expensive battle.

In a public proxy fight management typically wants to be able to claim they were available and open to dialogue. When the fixes appear easy they are often quickly implemented. But when jobs are threatened under the suggestion of a sale, or where management and the board may be replaced stronger defense mechanisms tend to kick in.

Management has the benefit of the corporate purse strings to fund its defense, unlike a shareholder who has to dig into his or her own pocket with the risk of never being reimbursed. If the activist pushes for change and the changes are implemented as a ‘defense’ mechanism to avoid having an activist on a board shouldn’t that be considered a win for the activist?

Conversely, in a case where an activist ‘loses’ but share price improves because their presence has forced the board to acknowledge certain issues that clearly seems like a win for all. Often simply highlighting that shares are undervalued brings renewed attention to the stock. There are many examples where the activist was destroyed

from a campaign perspective by losing the vote but made millions over a relatively short timeframe on its investment.

Beyond the immediate economics, you also have to factor in the benefit to shareholders of an activist acting as catalyst for companies to address issues like poor governance and upgrade management. Especially when the activist has been able to force changes that thousands of smaller shareholders could not feasibly force on their own.

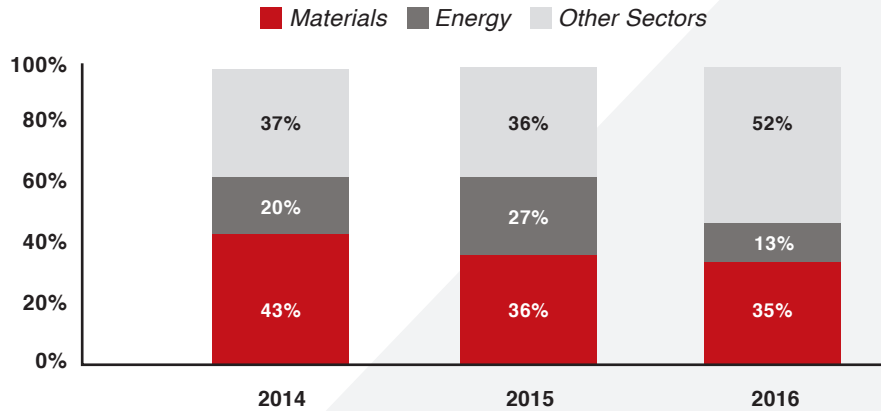
If one estimates a proxy battle could be a seven figure proposition, the breakeven on your shareholdings if you are able to derive value is a pretty simple calculation. While many of us track proxy statistics of who won/who lost/who settled, bravado should be parked aside — at the end of the day if shareholders are using the system to hold management more accountable and boards and management are therefore held to a higher standard, in our mind this makes everyone a winner.



Sector Outlook

Once again the Materials and Energy sectors remain most active as a proportion of total proxy contests. While this is in part a reflection of the makeup of the Canadian economy as a whole, it is also a reflection of the sectors where shareholders have been hit hard and lost patience with management's attempts to weather the storm.

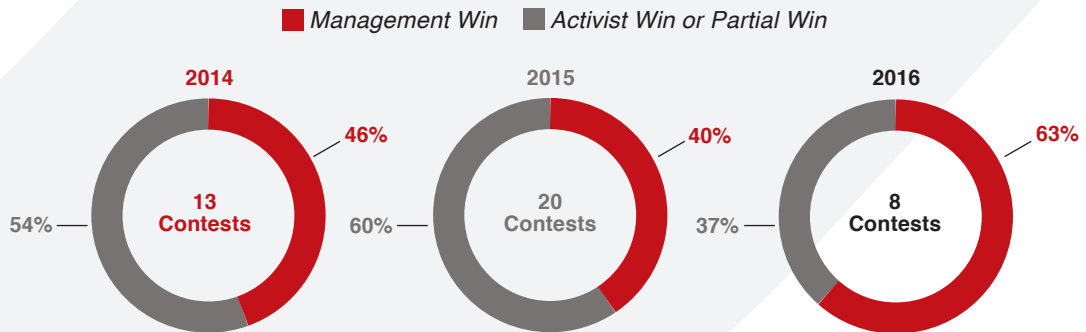
MATERIALS AND ENERGY SECTOR MOST ACTIVE



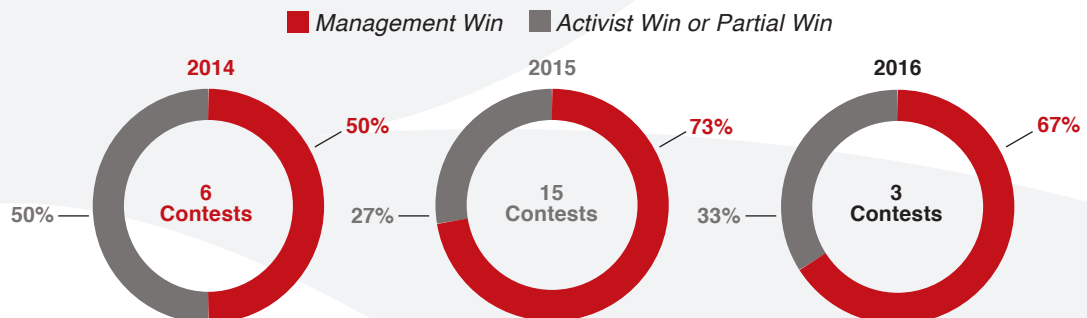
Information current to August 31, 2016

Interestingly however, management has performed well against activists in these spaces indicating that shareholders are sympathetic to a message that in the midst of challenging times there are only so many levers available to jumpstart value creation.

PROXY CONTESTS IN THE MATERIALS SECTOR



PROXY CONTESTS IN THE ENERGY SECTOR



Information current to August 31, 2016

SUCCESS RATES ANALYSIS

Management has proven to be more successful in 2016. In fact, activist success has trended down for the past three years as companies have taken heed and become more prepared. This said, companies should remain on guard as this information only captures what is known publicly.

While this year's sample size so far is smaller, activists have been less successful compared to the overall success rates in the Consumer Discretionary, Industrials, and Energy sectors.

SECTOR	2013 Management Win	2013 Activist Win/Partial Win	2014 Management Win	2014 Activist Win/Partial Win	2015 Management Win	2015 Activist Win/Partial Win	2016 Management Win	2016 Activist Win/Partial Win
Consumer Discretionary	100%	0%	50%	50%	50%	50%	100%	0%
Industrials	50%	50%	nil	nil	100%	0%	100%	0%
Consumer Staples	nil	nil	0%	100%	nil	nil	nil	nil
Health Care	0%	100%	nil	nil	33%	67%	100%	0%
Financials	0%	100%	50%	50%	33%	67%	0%	100%
Information Technology	0%	100%	nil	nil	25%	75%	50%	50%
Telecommunication Services	nil	nil	nil	nil	0%	100%	nil	nil
Utilities	nil	nil	0%	100%	0%	100%	nil	nil
Energy	37%	63%	50%	50%	73%	27%	67%	33%
Materials	37%	63%	46%	54%	40%	60%	63%	37%
Other	0%	100%	33%	67%	25%	75%	nil	nil
Overall Success Rates	34%	66%	43%	57%	45%	55%	63%	37%

Information current to August 31, 2016



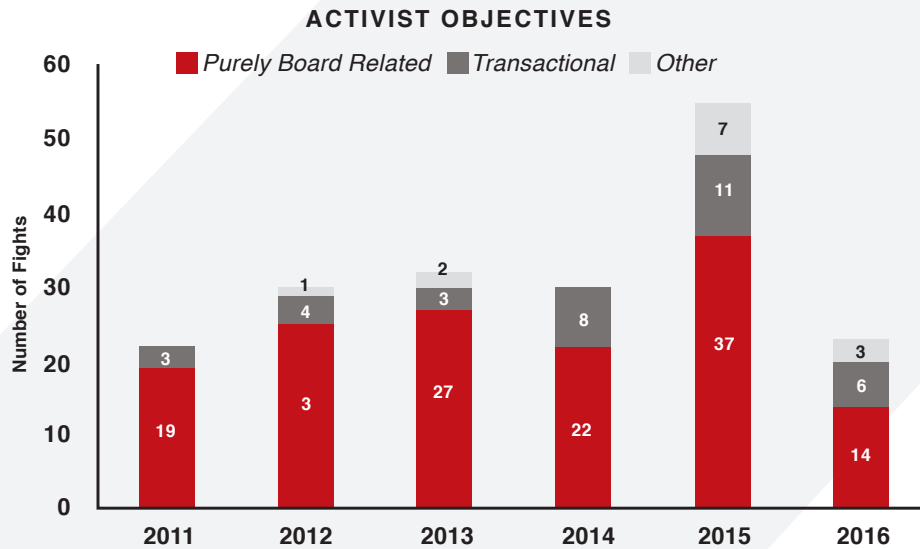
Activist Objectives and Slate Type

Stated activist objectives and the tactics they use to achieve them vary. Two of the trends we have been keeping any eye on over the last few years are activist intervention in transactions and the use of short slates as a tactic.

Campaigns where activist objectives are “transactional” have declined in 2016 vis-à-vis 2015 from 11 to just six but actually increased in terms of proportion of all fights (20% increased to 26%).

To date we have seen six proxy fights focused on a transaction (Wesdome Gold Mines vs. Resolute Funds pushing for sale of the company; Corus Entertainment vs. Catalyst Capital Group blocking a transaction; SunOpta vs. Tourbillon Capital Partners

pushing for sale of the company; Sirius XM Canada Holdings Inc. vs. Van Berkom and Associates Inc. and other shareholders opposing taking the business private; Nordex Explosives Ltd. vs. Omnia Holdings Ltd. stopping the proposed private placement that would result in a change in control; Twin Butte Energy Ltd. vs. Bondholders opposing a plan of arrangement they believe favours shareholders). Sometimes activists could have multiple objectives including board representation and transactional matters. For example, Nord Gold N.V. seeks board seats and purchase of Northquest Ltd.; Timothy J. Stabosz and others demand the resignation of the CEO of Aura Minerals Inc. and the initiation of a corporate sale process.



Information current to August 31, 2016

The use of minority slates remains elevated versus last year as the general trend shows that the use of minority slates is sloping upwards and majority slates sloping downwards. The fights where activists sought a majority board replacement include: Titan Logix Corp. vs. The Article 6 Marital Trust; Eastmain Resources Inc. vs. Columbus Gold Corp.; InterOil Corp. vs. Petroleum Independent & Exploration, LLC and Mr. Mulacek; Shore Gold Inc. vs. David Wright; Taseko Mines Ltd. vs. Raging River and RC LLC; Ellipsiz Communications Ltd. vs. Mr. Mat Lee (Michael) Koh; a concerned shareholder group versus Hemotsemix Inc.; Ka An Development Co. Ltd. and K2 Principal Fund L.P. vs. Eastern Platinum Ltd.; and a concerned shareholder group vs. Parkit Enterprise Inc.

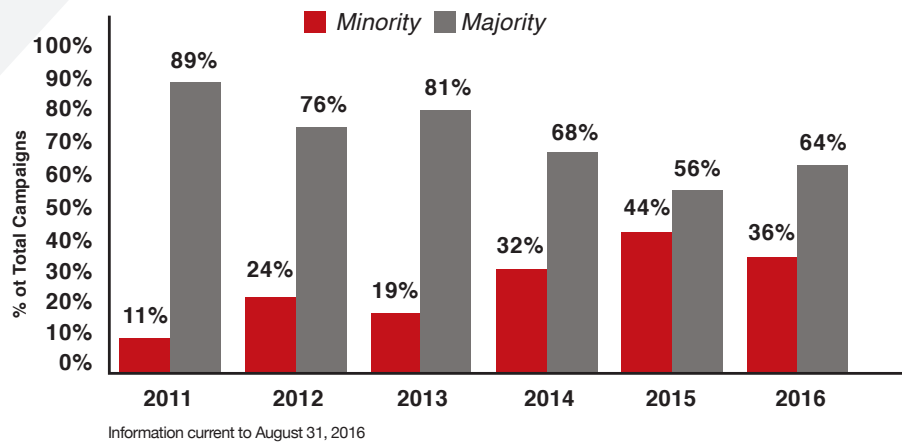
As we noted in our review last year, minority slate usage was a tactic to keep your eye on and one that continues to remain popular this year. Where minority slates were used, activists won in more cases in 2011, 2015 and 2016 but between 2012 and 2014, it appears that majority slates were more effective at winning proxy contests seeking board seats.

The chart to the right serves to highlight the percentage of times activists either win outright or win partially (some of their demands met) in fights where board seats are sought – analyzing the difference in winning percentage when minority slate types are used versus majority.

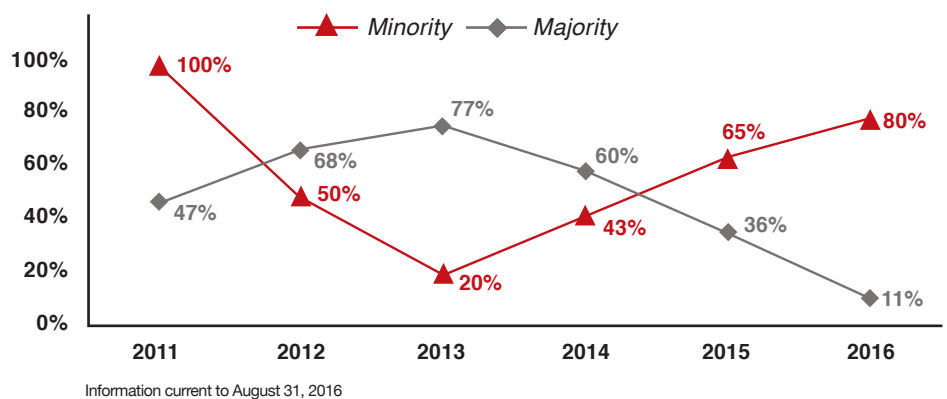
We attribute the appeal and success of minority slates to a few factors: First, it is easier to win with a minority slate as you only need to establish that two or three of your nominees are better than the existing directors (and easier to assemble such a short-slate), not an entire slate of incumbents. From a messaging perspective, with minority representation activists argue they want to contribute ideas to the strategy not fundamentally overhaul it as would be implied by a board take over. There is far less need to come up with a detailed plan to take to shareholders that will be publicly challenged. Retail shareholders buy the ‘skin in the game’ message readily and support representation – but are way more wary of those seeking control. They support a shake-up over a coup d’état.

Second, when only seeking a small representation on the board versus a full takeover, activists have found management is willing to consider a small expansion of

ACTIVIST SLATE TYPES



ACTIVIST WIN/PARTIAL WIN FOR DIFFERENT SLATE TYPES



the board or identify a few sacrificial lambs amongst the incumbent directors who can be given up to cut a deal.

Third, by seeking to replace a minority of the board, the burden of proof required by proxy advisory firms to obtain their support is lower (e.g. no detailed strategic business plan is needed).

Fourth, assuming they occupy a large enough position, the theory of proportional representation is supported with ISS and Glass Lewis more likely to support a small number of directors proportional to share ownership.

Lastly, activists who are most confident in their case for change generally push to replace a majority of the board. As such, the increased use of minority short-slates may indicate that activist investors have become less confident in the cases they are making, that they are taking on increasingly sophisticated targets, or the quality of activists and subsequent willingness to go to a fight has diminished.

It is also worth noting we often see cases where activists recommend directors that are seen as independent or having skills

lacking on the incumbent board.

Generally, they get better support for seats as opposed to, say, multiple fund representatives. This focus on the quality of nominees arguably has limited the choice of replacing a majority of the board given the time and resources required to assemble a high caliber slate. It may be just enough to find a small number of qualified and independent nominees to show the activist is trying to represent all shareholders and not only itself. It also shows a potentially better depth to strategic contribution.

Now with all this said, tactics should not drive strategy. A short slate on its own by no means guarantees a more successful outcome and such a decision should not drive a proxy fight. Activists and issuers should be mindful of:

- Quality of activist and activist track record
- Quality of arguments put in place
- The quality of the nominees put forth
- Shareholder base (e.g. influence of proxy advisors)
- Performance and industry of the target company



Say-On-Pay

IT IS IMPORTANT TO BE CLEAR THAT EVEN IF THERE IS NO SAY-ON-PAY VOTE, SHAREHOLDERS AND PROXY ADVISORS WILL EXPECT COMPANIES TO BE RESPONSIVE TO COMPENSATION CONCERNS. THE LACK OF A FORMAL MECHANISM DOES NOT EXCUSE A LACK OF RECEPTIVITY ON BEHALF OF THE BOARD.

The steady stream of say-on-pay adoption continues to trend upward. This year the number of new adopters has edged up slightly but has revolved around the 30 adopter per year mark since 2012 with 235 adopters in total. Say-on-pay support levels averaged around 92%, a slight decrease vis-à-vis last year.

Approximately 131 or approximately half of S&P/TSX Composite Index constituents hold a say-on-pay vote. Controlled or significantly influenced companies may not have adopted despite shareholder pressures.

Conversely, one case where a controlled/influenced company adopted say-on-pay was Quebecor after its Compensation Committee Chair received less than majority support in 2014 and 2015 respectively. In the absence of a say-on-pay vote shareholders turned to withhold votes to make their views known. Quebecor had adopted majority voting in 2015 but decided not to accept the Compensation Committee Chair's resignation. Subsequently, the Compensation Committee chair did not stand for election in 2016 but, purportedly as the result of shareholder discontentment and several years of shareholder proposals urging for a say-on-pay (which never received majority support), Quebecor adopted and held its inaugural say-on-pay, receiving 98% support.

TO SAY OR NOT TO SAY

Adopting a say-on-pay vote voluntarily still represents the best vehicle for shareholders not happy with compensation arrangements to express their displeasure. In cases where no say-on-pay vote is held, proxy advisors and shareholders will express their displeasure by holding the Compensation Committee responsible via withhold votes.

We are aware of two cases during the 2016 proxy season where companies did not hold say-on-pay votes and where Compensation Committee members received low support due to negative ISS recommendations and shareholder dissatisfaction:

- Concordia International's Compensation Committee Chair received 52% support
- H&R REIT's Compensation Committee Chair received 55% support

It is important to be clear that even if there is no say-on-pay vote, shareholders and proxy advisors will expect companies to be responsive to compensation concerns. The lack of a formal mechanism does not excuse a lack of receptivity on behalf of the board.

A CLOSER LOOK – SECTOR BY SECTOR

On a sector by sector basis, Healthcare companies received the lowest support given that there are

only six adopters and a low result from Valeant Pharmaceuticals (62.35%) skewed the results.

Materials has the most adopters in 2016 followed by Energy, in-line with analysis last year.

SECTOR	2016 AVG	2016 #OF VOTES
Energy	91.0%	39
Materials	91.6%	44
Industrials	90.5%	21
Con. Discretionary	92.0%	11
Con. Staples	92.6%	7
Healthcare	87.9%	6
Financials	92.9%	25
IT	92.9%	5
Telecoms	96.3%	5
Utilities	93.9%	8

This year only two companies (Canadian Pacific Railway and Crescent Point Energy) failed as opposed to three last year (Barrick Gold, Yamana Gold, and CIBC).

Both failed cases faced negative recommendations from both ISS and Glass Lewis, indicating that issuers face an uphill battle when both proxy advisors recommend against say-on-pay.

Of note, the companies that failed in 2015 all received support from both ISS and Glass Lewis in 2016 and saw significant improvements in support levels.

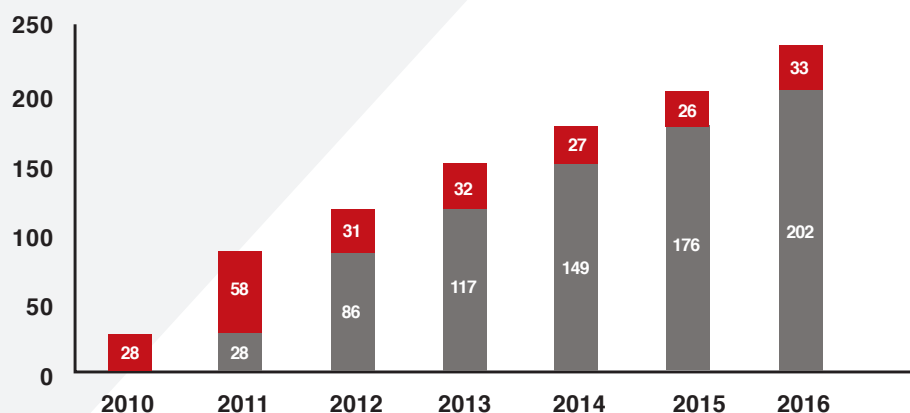
2015 VS 2016:		
BARRICK GOLD	26.58%	90.95%
YAMANA GOLD	37.27%	87.11%
CIBC	43.16%	95.50%

One of the reasons these companies were able to turn things around was that they all not only conducted but disclosed extensive off-season shareholder engagement campaigns, including responses to shareholder concerns raised in that process. A best practice we think deserves a special examination:

- Barrick Gold disclosed they engaged in extensive dialogue with 20 shareholders, representing nearly 22.5% of the shares outstanding
- Yamana Gold disclosed they engaged with Canadian, U.S. and European institutional shareholders representing approximately 40% of their shareholder base

SAY ON PAY ADOPTION

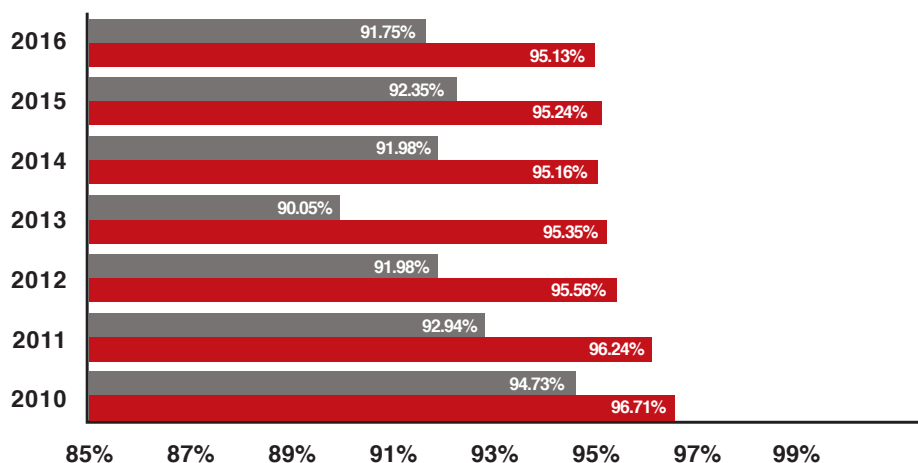
■ Adopted ■ Adoption Year



Information current to August 31, 2016

SAY ON PAY SUPPORT LEVEL

■ Average ■ Median



Information current to August 31, 2016

- CIBC disclosed that they continued to broaden their commitment to proactive shareholder outreach and that they met with many stakeholders during the year – shareholders, shareholder groups, proxy advisory firms and regulators, notwithstanding CIBC’s main issue was a one-time payment rather than systemic problems

As we will discuss later in this review, when things go or have gone awry, having a shareholder engagement policy in place and conducting regular governance outreach and roadshows is critical.

TIPPING POINT FOR ISS

This year ISS recommended against say-on-pay at more than ten companies, which handily exceeds the total number of negative recommendations since Canadian issuers were pressed to adopt say-on-pay

‘voluntarily’ in 2010. This represents about 5-10% of companies that hold say-on-pay votes. The jump in negative recommendations from ISS could be due to a variety of reasons but nonetheless indicate a move towards more stringent views from ISS as more issuers are adopting the advisory vote. There is chatter that some issuers want to take away their say-on-pay resolution or go from the current annual vote to a less frequent vote. Neither option will probably resonate with ISS or shareholders without a strong rationale.

Issuers cannot underestimate the power ISS wields or overestimate the sway they as a board may have over an ISS subscriber. ISS’ influence is large and absent significantly influenced or controlled shareholders, an ISS against recommendation could spell a failing say-on-pay vote.

Tips on Securing Positive Proxy Advisor Recommendations

- Disclose credible shareholder engagement activities (coupled with a transparent shareholder engagement policy) in the circular
- Outline any concerns raised by stakeholder groups and the response taken by the board
- Highlight any structural changes to compensation and/or pay quantum reduction in the proxy upfront
- Add a descriptive narrative explaining how pay is aligned with performance (and increasingly with business strategy) but not necessarily shareholder returns if applicable
- Describe how the pay programs (e.g. metrics within the short- and long-term incentive programs) are designed drive the business strategy and lifecycle
- Assess the rigour of performance goals and ensure that goals are actually stretch in short- and long-term incentive programs – explain any discrepancies if goals are set lower than before
- Evaluate compensation peer group to ensure appropriateness in terms of size, similarity and strategy
- Conduct a Realizable/Realized pay analysis and see how this stacks up with performance
- Reduce cash bonus to best reflect shareholder experience in face of declining shareholder returns
- Avoid one-time awards, and if granted, explain them thoughtfully





What Else We Saw This Year:

Notable Updates

FORUM SELECTION

Last year, Kingsdale showcased the arrival of a forum selection by-law subject to a shareholder vote in Canada for the first time at Yamana Gold Corp. Since then, at least two additional companies have put the forum selection by-law to a shareholder vote. Shareholders of Dundee Corp. voted on its by-law amendment proposal which included a forum selection provision but did not disclose the support level. Enerplus Corp. also voted on a by-law proposal containing forum selection, receiving 54.72% support. Consistent with the Yamana case, support was low but shareholders were willing approve the by-law amendments. In addition, more than a dozen recent IPO companies have adopted a forum selection provision in conjunction with their constating documents with the effect of avoiding a vote.

MAJORITY VOTING

In 2016, we tracked two public cases where directors triggered the Majority Voting Policy. At the 2015 AGM of Alarmforce Industries Inc., Mr. George

Christopoulos nominated himself as a director pursuant to the advance notice policy and was elected to the board after receiving slightly higher votes than another management nominee (56.05% vs 53.79%). At the 2016 AGM held on April 26, Mr. Christopoulos received 35.5% support and as a result was required to submit his resignation to the board for consideration. On August 4, Alarmforce announced that “Mr. Christopoulos has submitted his resignation as a director of the Company effective August 4, 2016 and such resignation has been accepted.” At the 2016 AGM of Maxim Power Corp. held on June 2, CEO Mr. John R. Bobenic did not receive majority support. On the same day he tendered his resignation as CEO. The board accepted the resignation after careful consideration and in a news release, it was announced that Mr. Bobenic was no longer serving as Maxim Power Corp.’s CEO. One day later, it was announced that the board accepted the resignation of Mr. Bobenic as a director after careful consideration.



Creative Activist Tactics from 2016

For every one public activist campaign, there are multiple others that are fought behind the scenes and settled out of the public view. This year we witnessed a few leading edge tactics we thought were worth noting.

PUBLIC INTEREST ACTIVISM

In 2016, we saw the emergence of public interest activism by Canada's Catalyst Capital Group in its attempt to halt a transaction between related parties Corus Entertainment and Shaw Media, both controlled by the Shaw family. While Catalyst wasn't itself heavily tied economically to Corus or Shaw, it did have concerns about the impact the transaction could have on the integrity of the equity market and protection of minority shareholders, thereby raising the opposition flag and launching a public interest campaign against the merger.

Catalyst asserted, and many shareholders agreed, that the non-arm's length transaction benefitted the Shaw family at the expense of Class B shareholders. Catalyst, who up until then, had been an active player in the debt market, chose the Corus-Shaw deal as its foray into the equity markets and wanted to introduce the same set of discipline it had previously instilled in the debt market in the equity market. Although, due to the late nature of the Catalyst campaign, the transaction was successful, Catalyst was able to raise awareness and establish itself as a formidable activist both within the debt and now the equity markets.

MINI-TENDER OFFER

Another noteworthy tactic was the reemergence of a mini-tender offer in the context of a proxy fight. In its fight against Kobex Capital, Kingsway Financial offered to purchase shares of Kobex, which up until then were rather illiquid, for a slight premium so long as those shares were voted in support of Kingsway by the selling shareholders who held them on the record date.

Although the premium was 18%, Kingsway was only able to take-up a few additional percentage of the shares as Kobex had put in place a poison pill triggered when a shareholder had accumulated more than 15% of the stock when Kingsway started to raise its position.

This was the second time that this tactic has been used in Canada, the first being in Orange Capital's fight against Partners REIT. Ultimately, the tactic did not achieve its intended result of bringing in significantly more votes as those shareholders who were interested in selling were for the most part the same shareholders

who were not happy with Kobex's management and who were already supportive of Kingsway.

In addition, because of the poison pill, Kingsway could only take up a portion of the tendered shares on a prorated basis. However, notwithstanding that Kingsway could only take up a prorated portion, it nevertheless had the ability (under the documents) to have voted all of the shares tendered even if not taken up. Kobex for its part highlighted this feature which resulted in fewer shareholders tendering their shares.

BALLOT DESIGN

Another tactic worthy of note occurred in Raging River Capital's activist action against Taseko Mines. In this case, Raging River, owning more than 6% of the issued and outstanding shares of the company, requisitioned a meeting of shareholders to replace the majority of the board. As Taseko is a British Columbia registered company, Raging River required two-thirds of the votes to remove incumbent directors in a non-AGM meeting. As such Raging River, anticipating that it may not receive the two-thirds threshold, designed the ballot so that if the first resolution (removal of board members) did not pass, then the second resolution (which would increase the size of the board and add the Raging River nominees) would be put to the shareholders, which only requires a majority approval. Raging River withdrew its requisition prior to the shareholder meeting.



Proxy Fight Grudge Match: *The Insider Activist*

HAVING SEEN HOW
DECISIONS WERE
MADE AND WHO TOOK
WHAT SIDE MEANS
THE INSIDER ACTIVIST
WILL BE ABLE TO
IDENTIFY POTENTIAL
WEDGES TO DIVIDE A
BOARD AND EXPLOIT
THESE PUBLICLY.

More and more companies are finding out that the most dangerous activist encounters don't always come from the outside. Former CEO's, directors and founders are targeting the companies they once led and presenting a unique set of challenges for the boards defending against them. Since both sides know each other well, these fights become more personal and risk clouding the judgment of otherwise rational minds. As Steven Davidoff Solomon, a law professor at University of California, Berkley has pointed out, "When a founder goes ballistic on his own company, the turmoil consumes all."

Notable examples this year include Performance Sports Group Ltd. that was targeted by former Chairman Graeme Rouston; Lululemon Athletica Inc. that was criticized by founder Chip Wilson; InterOil Corp. that faced a proxy fight by founder and former CEO Mr. Phil Mulacek; and Parkit Enterprise Inc. where three then current officers launched a proxy contest to nominate their own slate. Behind the scenes, Kingsdale has advised on similar fights involving both public and private companies.

WHY DO THEY COME BACK?

The boards who confront their former friends and allies often puzzle aloud, "Why can't they just go away — don't they have anything better to do?"

The specific reasons why former insiders return vary but there are two common elements: First, they remain large shareholders —often larger than the directors they are engaging— with an economic interest in the continued success of the company. On this point they can differ from traditional outside activists who are often criticized for their short-term interest in the company in that insider activists have demonstrated they are willing to stick with the company over the long term.

Second, they are prompted and encouraged to take action by other shareholders or employees, who likely benefitted under their leadership, in the belief the company has lost touch with its roots or diverged from the path that made it successful.

WHAT MAKES INSIDER ACTIVISTS DIFFERENT?

Boards who are going up against a former insider need to recognize the advantages these types of insider activists have over outside activists.

Paramount of these is the depth of knowledge they have about the company and awareness they have of non-public information — and a willingness to use it. While bound by confidentiality agreements and fiduciary duty, the experience of exploring the company at multiple levels and considering alternatives will give a former insider a base of knowledge far superior to traditional activists. It will also mean that anything a board says in defense of their attack will be torn apart faster and to a greater level of detail than it might otherwise be. Not surprisingly then, the focus of insider activists and their thesis for change tends to be more focused on operational issues and leadership changes as opposed to balance sheet engineering in the form of dividends or share buybacks.

This insider knowledge also extends itself to personal relationships and the decision making process. Not only will having friends on a board and inside a company help the insider activist identify allies but it also helps them identify potential weak spots.

Boards should be extra wary of information leaking to an insider activist, even if it is not malicious in intent. Some inside the company may think they are just being helpful to a former colleague — in many situations a former colleague who is responsible for their current success.

Having seen how decisions were made and who took what side means the insider activist will be able to identify potential wedges to divide a board and exploit these publicly. It is not uncommon in these situations for other shareholders or the media to be made aware of the internal thinking and workings of a board.

Former insiders also bring with them some inherent weaknesses, especially if they behave like an aggrieved family member vs. a rational business associate. The objectivity an outside activist possesses may at worst be absent and at best clouded given the insider activist's history at the company and relationships with those who now sit on the other side of the table.

There is often a pre-disposition to assume shareholders will see things the same way the insider activist does without having the same level of detailed information they have access to (or the personal bias they may possess). What may appear self-evident

to the insider activist may seem far-fetched or like a conspiracy theory to other shareholders from the outside looking in. Similarly, while we are all subject to it, the insider activist appears to be more at risk for confirmation bias. That is the tendency can exist to interpret new material from and developments at the company in a way that confirms and validates the insider activist's existing beliefs or theories.

Just as an insider activist will know their former company, shareholders and other stakeholders like creditors, suppliers and government officials very well, a company will know their former employee equally as well. This means that any baggage

that may exist can be used to discredit the former insider and provide details that might not otherwise have been available such as personal legal issues, spending and use of the company plane.

For boards who will be confronting their former founders, CEOs or directors, they would be well advised to prepare for a very personal attack and not assume the bounds of fiduciary duty and confidentiality will hold. This means ensuring they prepare a case against the insider activist with the same level of detail and aggression that will be brought against them.



A Big Year for M&A

The first half of 2016 saw a record number of M&A transactions unseen since before the 2008 financial crisis. According to Bloomberg, the total value of Canadian deals in the first half of the year amounted to close to \$90 billion with close to \$72 billion occurring in the first quarter of the year.

Most of these deals were led by Canadian companies who up until now had been sitting on the sidelines assessing market conditions. Many are now ready to leverage their balance sheets in order to diversify their income streams. As of the time of publication, some notable examples include Enbridge Inc.'s \$37 billion acquisition of Spectra Energy Corp. (\$165 billion enterprise value), the US\$36 billion merger between Agrium Inc. and Potash Corporation of Saskatchewan, TransCanada Corp's \$12 billion acquisition of Columbia Pipeline Group Inc., Fortis Inc.'s acquisition of ITC Holdings Corp. for US\$11.3 billion, BCE Inc.'s acquisition of Manitoba Telecom Services Inc. for \$3.9 billion, Lowe's Companies Inc.'s \$3.2 billion acquisition of RONA Inc., Progressive Waste Solutions Ltd.'s combination with Waste Connections, Inc. valued at \$2.7 billion, Centerra Gold Inc.'s Gold's US\$1.1 billion acquisition of Thompson Creek Metals Company Inc. and Teranga Gold Corp.'s \$63 million acquisition of Australian company Gryphon Gold Corp.

There have been fewer inbound M&A transactions which may be partly explained by US election concerns and to a lesser extent concerns regarding 'Brexit'. However, we expect the number of domestic transactions to pick up in the tail end of the year particularly in the oil and gas sector. This is due to the number of distressed companies in that sector, creating buying opportunities for those with healthier balance sheets. Suncor Energy Inc. is one example of the latter who, after its successful acquisition of Canadian Oil

Sands Ltd. in the first quarter, has been on the hunt for additional assets, most recently purchasing an additional five percent interest in Syncrude.

As we had predicted before, with the new takeover bid rules effective as of May 2016, almost all of the transactions so far completed or announced in 2016 have been by way of friendly mergers. We don't expect that trend to change for the remainder of the year and well into 2017. The first announced hostile bid was Hecla Mining Company's offer for Dolly Varden Silver Corporation. However, that bid was precipitated by a repayment of a "restrictive loan" back to Hecla and was thwarted by Dolly Varden via a private placement that diluted Hecla's holdings. There was also Omnia Holdings' offer for Nordex Explosives Ltd (withdrawn after shareholders of Nordex approved another friendly transaction). In both cases, the target company was a venture issuer and used a private placement successfully as a key defense tactic to place shares in friendly hands.

It is worth noting an interesting couple of instances we saw in the use of plans of arrangement (POA) in 2016. Whereas usually multiple classes of securities holders are treated equally (albeit often separate) for the purposes of an approval vote, this year we saw two cases in which they were not. First in Lowe's Companies Inc.'s plan of arrangement with RONA Inc., including both preferred and common shareholders, it was made clear that if preferred shareholders did not support the arrangement they would simply be removed from the POA, becoming orphan securities under the new Lowe's subsidiary. Second, Postmedia Network Canada Corp. knew its noteholders would support its proposed recapitalization transaction but structured the POA such that if the required shareholder support was not obtained, the plan would be altered to exclude shareholder support.

{ SECTION TWO }

Anticipated Developments



Rise of the Reluctavists

The face of activism is continuously changing. The landscape, the players and their techniques evolve constantly as new upstarts and more money enter the space. What is new this year is the emergence of ‘reluctavists’. That is shareholders for whom activism is a last stop. Different than the ‘constructivists’ we showcased previously, these are those who begrudgingly adopt activist tactics when all other avenues are exhausted or when a board fails to heed the message sent via withhold votes, majority voting or poor say-on-pay results.

As a case in point, this year BlackRock launched an activist campaign publicly soliciting votes against an asset sale by mining company G-Resources. BlackRock was confronted by some unique circumstances that led to this decision: G-Resources was selling its main asset to a consortium led by a private equity firm its executive vice chairman was chairman of, then deciding to continue the company without its main asset in the financial services business rather than distributing the proceeds of the sale to shareholders.

Left with no alternative to them, BlackRock reluctantly adopted an activist stance and took its campaign to shareholders writing and creating a website to oppose the transaction. It was also able to gain the support of ISS and Glass Lewis. Despite this BlackRock was unsuccessful, losing with 58.82% of shareholders voting in support of the deal.

While this example in no way suggests that activist tactics will become a regular tool in BlackRock’s tool belt, it does demonstrate the continued socialization of the activist approach with traditionally passive investors. While previously we have seen institutional investors being more willing to support activist actions –even going so far as to issue ‘RFA’s’ or “requests for activism” – what the BlackRock example shows is that there may be cases where institutional investors bypass the assist from a traditional activist and run a campaign themselves.

We think this something to keep an eye on as traditionally passive investors reject the binary choice of activism or nothing and explore other avenues to influence change. This is something we are starting to see more of behind the scenes. We know from our conversations with traditionally passive investors that

withhold votes in majority voting situations and non-binding say-on-pay votes are increasingly seen as ineffective ways for them to express their views and effect change, especially for companies who are not demonstrating they are listening. In these situations, failing true majority voting where shareholders would be able to actually vote against a director, shareholders are left with few options. In the past unhappy passive shareholders may have voted with their feet and sold their position despite their long-term investment objectives. In recent years, however, with positions underwater, crystalizing a sizable loss is not an option perhaps forcing them to more actively engage.

Perhaps the precursor to seeing more active institutional investors is the growing desire to meet with independent directors and have substantive discussions that include challenging the strategy. As far away as an activist BlackRock may seem, five years ago this sort of engagement between governance groups and directors also seemed remote. The CEO of Vanguard, considered to be the most passive of the large index funds, explained its push for more meetings with directors by saying, “We have no interest in telling companies how to run their businesses, but we have valuable governance insights to share with the board of directors.”

A reason why we think we may see more institutional investors taking activist-like actions vs. outsourcing campaigns for change is because of the difference between the long- and short-term views of each. For example, an institutional investor who agrees that certain operational changes are required may not back an activist’s candidates if their investment horizon has historically been very short or if their changes included a fire sale of assets or special dividend that may have negative impacts on the future of the company.

Boards cannot just assume because they haven’t heard from an investor or that they have been traditionally passive they can be ignored. The fact is there has been very little communication between companies and investors. Boards won’t know what they don’t ask. You don’t want to wake up to questions on the public agenda you could have easily addressed before.



The Lure of Virtual AGMs:

Potent Tool or Big Mistake?

In 2001 changes to the Canada Business Corporations Act gave companies the ability to move away from the traditional in person annual meeting with paper ballots and snacks to virtual meetings with electronic voting and a teleconference or webcast. At the time there was thought to be a demand for virtual meetings and a pent up demand by shareholders to participate – if only they weren't limited by the confines of geography.

In North America, Inforte was the first to hold its annual meeting exclusively online in 2001 while online voting was pioneered in 2009 by Intel, but very few have followed suit. More commonly companies are conducting hybrid meetings that give shareholders the opportunity to tune in remotely to listen and, in some instances, ask questions over the phone or via email.

Proponents and service providers for virtual annual meetings are quick to sell issuers on the tactical benefits of electronic meetings including ease of control, less effort, lower costs and increased security. In our view the decision to utilize a virtual meeting is a strategic one that cannot be made in isolation on an annual basis as changing the approach itself year to year may indicate there is an issue.

The irony of the virtual meeting experience in the US is that on the face of it they are supposed to support shareholder democracy by removing the distance barrier. In reality, some have been criticized for having the opposite impact. Ignoring the law surrounding the formal meeting, there is a principle that shareholders' meetings are the one right shareholders have. They have the right to attend, be seen, heard and ask questions. Those that oppose virtual meetings contend that technology at best discourages participation and at worst can be used by the company to filter out the 'inconvenient' questions.

IMPLEMENTATION AND TECHNOLOGICAL CHALLENGES

Corporate by-laws needed to be changed in line with the Act to allow virtual meetings and technology needed to bring it all together. In Canada the vast

majority of shareholder voting is channeled through Broadridge and officially tabulated by the company's scrutineers. Whilst Broadridge US rolled out virtual meeting functionality some years back, it has yet to do so in Canada as Canadian meeting protocol has some key differences from the US. The challenge has not been lack of technology but rather design choices that best fit the Canadian nuances.

From a practical perspective many of the meeting protocol issues that could, and did, hijack physical meetings of the past have been dealt with by issuers via updated by-laws covering things like shareholder proposals and election of directors. However two issues required some careful consideration for Canadian virtual meetings; proxy cut-off and the appointee process.

Unlike the US, in Canada there is generally a proxy cut-off 48 hours before the meeting. Registered shareholders and appointed proxy holders have the right to vote at the meeting but beneficial shareholders need to have voted ahead of the proxy cut-off – unless extended or waived. In instances where the cut-off is waived, essentially all beneficial holders can also vote at the meeting and the processes around this needs to be carefully considered as waiving proxy cut-off generally signals a contested meeting.

The second, and more complex challenge is the appointee process for proxy holders. In the current environment shareholders can appoint a proxy holder in a number of ways including in paper and online form. The appointee does not always know that they have been appointed to vote on behalf of a shareholder but in the case of voting at a physical meeting, would need to prove who they are. In a virtual meeting the shareholder has been given a unique authentication token in order to log in and participate at the meeting so the challenge lies in handing that authentication token to a third party to enable them to vote. Given the ramifications of a change to the voting system, Broadridge has spent a great deal of focus on getting the appointee process right.

THE GENERAL EXPECTATION OF SHAREHOLDERS IS THAT VIRTUAL MEETINGS PROVIDE FOR THE SAME LEVEL OF ENGAGEMENT AND DIALOGUE AS WOULD BE POSSIBLE AT AN IN PERSON MEETING.

Most shareholder meetings are really a game of two halves. The first half is the “official” meeting required to be held in which business is transacted. The second half is an opportunity for shareholders and the issuer to receive updates and ask questions. Though not part of the ‘official’ meeting, the principle of the shareholder’s right to be heard at a meeting comes into play. The technology for online meetings exists already so the debate centers around how questions are fielded, whether all participants get to see who is asking what (to avoid the accusation that questions were limited), how to filter duplicate or largely similar questions, how/whether to censor clearly inappropriate online remarks/questions and when question time should wrap up.

As an aside, what online interaction has taught us is the perceived veil of anonymity that comes from being online vs. in the room, has the tendency to embolden and lower decorum for the disgruntled. Traditionally, the CEO has led the Q&A part of the meeting calling on directors or officers based on what has been raised. The physical nature of the interaction allows the CEO to ‘chair’ that part of the proceedings. In a virtual meeting, there needs to be a moderator interacting with the CEO to manage the interaction. The issues for shareholder interaction are choices for the issuer not really technology barriers.

Broadridge Canada does have a working group actively looking into the mechanics of virtual meetings for the Canadian marketplace and working with issuers to field their requirements and concerns with a view to supporting virtual meetings in the near future.

THE PROBLEM WITH AGMS

Let’s face it, annual meetings are boring (unless there is a controversial proposal or an activist in the room), and this is part of the reason shareholders don’t attend. It’s not just because they can’t get there, it’s because there is nothing for them when they get there. There are plenty of sparsely attended shareholder meetings in the financial districts of Toronto, Calgary and Vancouver all within minutes of the largest investors.

Rather than actively embracing and utilizing them to engage and educate shareholders when the seas are calm, shareholder meetings have become a ritualized annual event many issuers treat as a legislated inconvenience. Almost like the annual physical your spouse forces you to go to.

These largely scripted –yes, even the questions– non-substantive events give little reason for shareholders to attend or participate. We wonder why, if they are going to the expense of holding them, more companies don’t treat the annual meeting and the solicitation process around it as an opportunity to engage shareholders, especially retail.

While most companies are including a presentation and update from management as part of the festivities, management tends to view having to repeat what was in the quarterly results and annual report as a tiresome charade they are made to participate in. There are examples of companies that do a good job of engaging shareholders at their annual meeting, treating it as more than just a chance to vote, indoctrinating shareholders into the strategy and demonstrating what the company is doing.

By way of best-in-class examples, annual meetings for Berkshire Hathaway and Walmart are full-day affairs with everything from product sampling from the likes of Dairy Queen to director panels to comedians. Some even hold private meet and greets for their largest shareholders with independent directors before and after the formal meeting.

The point is a virtual or hybrid meeting –where there is a physical meeting with a telecast and possible submission of questions in parallel but no online voting– can remedy some of this malaise and engage more shareholders by virtue of convenience, but if you still aren’t giving them reason to tune in as owners of your company they won’t.

WHAT TO CONSIDER IN SELECTING A VIRTUAL AGM

The decision about whether or not to conduct a virtual AGM –either exclusively or as a hybrid– is a strategic one that should consider the current challenges facing the company, its historical relationship with shareholders and its objectives regarding shareholder engagement over the next few years. The reality is a virtual meeting can be used to both boost shareholder democracy and shut them out.

In most cases a hybrid model is appropriate and provides the opportunity for shareholders, especially retail, to engage the company. Most companies do not meet in the midst of controversy or are of a large enough size to afford or warrant the spectacle of a Berkshire or Walmart meeting. For small- to medium-sized companies where a few or no shareholders beyond management historically attend, a hybrid meeting presents the best option to engage more shareholders.

While there is a wide spectrum of technology to use and how to structure a meeting –such as voice only webcast, video, questions or no questions, questions submitted in advance and screened, etc.– there are two key ingredients to a normal course annual meeting utilizing virtual capabilities we recommend.

First, it is important to provide the opportunity for shareholders to ask questions and get answers in real time. Having them submit questions and screening them in advance screams of a lack of authenticity and may actually serve to shake not shore up confidence in your board.

If there is concern about the ability of your leadership to answer tough questions well, then we would suggest this is more than just an issue limited to a Q&A session. We regularly work with directors in advance of potentially difficult annual meetings to anticipate questions and prep them on how to respond. (An even better approach is to seek out tough questions via shareholder engagement and answer them before they get to the floor of your meeting.) Answering difficult questions directly and well can often do more for a company than not having them asked at all. Furthermore, there has to be an end to question time at any meeting but if shareholders have questions that did not get addressed during the meeting, why not answer them after the meeting and post them online following the formalities.

Second, give consideration to how your chair and presenters will be seen by those not in the room. There is a big difference between presenting to a room of 50 people in person and playing to the camera to reach 500 online. Especially where BNN, Bloomberg, and others will take clips from your broadcast if there is something of note – or a gaffe. An analogous situation we point to is the first televised presidential debate between JFK and Richard Nixon. When surveyed, those who listened on the radio gave the win to Nixon while those who watched the photogenic and charismatic JFK on TV gave him the win. The point being if you are going to be going virtual, appearance and performance matter.

In situations where there is potential adversity on the agenda, we do suggest companies stay away from sharing the internal workings of their meetings broadly. In situations where a company has an activist in its stock that has not yet become public –in our experience one in three activist encounters fall into this category– we recommend not providing them with a platform to broadcast their intentions and send your stock on a ride. Even if a company has broadcast annual meetings in the past, the trouble of explaining why you aren't doing it this year is significantly less costly than broadcasting an activist uprising.

Related to this is the issue of whether or not to allow media to attend shareholder meetings. Our view is that shareholder meetings are family affairs for your shareholders. We can see very little upside to allowing media to attend or view your meetings in these situations. They are unlikely to cover any positive information you present to shareholders (trust us we have seen lots of really great meetings go unreported) and are only there to witness –and by virtue of their presence even encourage– any circus that might ensue.

If you have worked hard to keep an activist from taking their concerns public only downside risk exists by providing them with a soapbox now. (Having advised activist clients and attended meetings with them we can tell you we get very excited when the media is there and thankful to the issuer for inviting them for us.) Media can be accommodated in other ways such as setting up individual interviews prior to the meeting with company leadership or providing them with the presentation materials on an exclusive basis.

The flip side to this is the question of whether or not virtual annual meetings should be used as another defensive tactic. If you are moving, as Lululemon Athletica did this year, to an exclusively online meeting in an attempt to avoid criticism or scrutiny that is already public, you will probably only serve to reinforce that criticism.

You'll get blamed not only for using the technology as a shield but also for whatever shareholders intended to criticize you for in the first place – just as you would at an in person AGM. In fact, in the case of Lululemon, founder Chip Wilson used their decision to move to a virtual twenty minute meeting with four questions submitted by email in advance as a device to amplify his substantive criticism of the company by publishing an editorial in The Globe and Mail and attracting significant media attention.

So should you move to a virtual annual meeting or toward or away from the hybrid model? The answer is it depends. The use of this technology will reinforce what people already think of you. If they view you cynically this will be seen as a cynical attempt to limit dialogue. The general expectation of shareholders is that virtual meetings provide for the same level of engagement and dialogue as would be possible at an in person meeting. For companies looking to pioneer a new relationship with shareholders utilizing this technology, accompany the move to a virtual meeting with a PR blitz to ensure you motives are known and cannot be misconstrued.



Short-Seller Activists Coming to Canada

UNLIKE THE AVERAGE
ACTIVIST THAT IS
LIKELY TO ENGAGE THE
COMPANY PRIVATELY
BEFORE MAKING
ANY CONCERNS
PUBLIC, THE ART OF
THE ACTIVIST SHORT
RELIES ON THE SHOCK
AND AWE OF THE
PUBLIC RELEASE OF
THEIR ACCUSATIONS.
AS SUCH, SURVIVING
AN ACTIVIST SHORT
SELLER ATTACK WILL
DEPEND ON HOW
EFFECTIVELY YOU
RESPOND.

A new trend is emerging that combines the time-honoured tradition of short-selling with an activist approach. One that should be giving the C-suite and boardroom heartburn if they haven't started to think about how to deal with it. We are seeing more and more cases where short sellers are thinking and acting like activists.

While traditional activists aim to increase share price and activist short sellers seek to knock down the share price, make no mistake the objective is the same: Make money.

The challenge to companies, especially in Canada, is considerable. First, the fact is markets are asymmetric. They react quicker and more dramatically to bad news than to good, so short sellers have a leverage advantage. Moreover, this asymmetry can be exacerbated by program trading and automatic stop-losses which react before the stock owner has a chance to evaluate what is going on.

Second, securities regulators are more experienced dealing with the inverse which is pump and dump manipulation. Pumpers have to put out materially misleading information which is easier to make a legal case out of. Short sellers, on the other hand, can hide behind the copious caveats, assumptions and warnings in their reports making them harder to go after. As a result, litigation is a more difficult avenue to pursue given the burden of proof required.

Third, specifically for Canadian companies, they face a lack of visibility. While they may have information regarding total short positions in their company, they have no visibility into who the short sellers are or the size of their specific positions. It is often not until a short seller releases a report that their identity becomes known and even then, unless it is voluntarily disclosed, their position is not known.

The case of Valeant Pharmaceuticals International is well documented and put a spotlight on the powerful effects of short selling. Following a report by Citron Research, who held a short position in Valeant, alleging improper revenue recognition, Valeant's share price fell and then was sent into a tailspin with a lackluster response strategy.

And Valeant is not alone. Other Canadian companies like The Intertain Group, MDC Partners, and First Majestic Silver Corp. were hit by short

reports from Spruce Point Capital Management, Gotham City Research and Kerrisdale Capital respectively. Like the Pershing Square/CP Railway proxy fight that spawned a new crop of activists, we expect Valeant will spawn imitators.

ACTIVISTS AND ACTIVIST SHORT-SELLERS: "WE'RE HERE TO HELP"

It is no mistake that Gotham City Research named itself after the fictional city Batman watches over. Like Batman they claim to root out wrongdoing and put a spotlight on those responsible. While somewhat grandiose, this stated mindset and motivation does permeate through other short-seller activists and is not lost on those who read their reports. Many investors find them educational in helping them learn how to do their due diligence and sift through investment opportunities.

Like traditional activists, activist short sellers have a level of sophistication beyond that of average shareholders that allows them conduct in-depth research and analysis on a company. Activist short sellers help expose investors to analysis and research they alone are unable to do and serve to –credibly or not– put a spotlight on bad management, fraudulent practices, abuse of shareholder money and businesses in need of change.

Like traditional activists, their very presence can serve to ensure that maximizing shareholder value is top of mind for management. For example, just as traditional activists identify reasons why a company is undervalued and what levers can be pulled to correct that, activist short sellers identify reasons why a company may be overvalued, encouraging management to course correct as appropriate thus benefiting shareholders in the long-term.

HOW TO HANDLE ACTIVIST SHORT-SELLERS

Unlike the average activist that is likely to engage the company privately before making any concerns public, the art of the activist short relies on the shock and awe of the public release of their accusations. As such, surviving an activist short seller attack will depend on how effectively you respond.

While some best practices –like ensuring the board is being proactive in self-analysis and shoring up weak spots, proactively communicating strategy, and

engaging shareholders regularly— apply to mitigating both traditional activism and short selling activism, others do not.

In a traditional activist situation we encourage engagement so both sides can move closer to a common understanding and possibly a mutually beneficial agreement. However, when faced with an activist short seller this option is not available as no middle ground exists. The short seller only seeks the destruction of value and the greater that destruction the more they gain.

The battle and effectiveness of the response strategy then comes down to the information provided to the market and the trustworthiness of that information. The unfortunate reality for all companies in a post-Enron world is that no one trusts them. This crisis of credibility means everything you say will have to pass an even higher bar than the short seller you are defending against, especially when the business journalists and shareholders recognize that short sellers are often right.

It is important to remember the objective of an activist or an activist short seller is not to be right but to make money, often overnight. Even if you are right on the main points of contention it doesn't help your position unless the public and shareholders are convinced. This is all about managing public opinion before your shareholders cast their vote, by selling your stock.

Success comes for activist short sellers even if they can create the appearance that there are factors that are not being disclosed and reflected in a company's valuation. Shareholders will flee their positions based on rumours and the perception of what is going on instead of facts. Short attacks normally come in waves, holding something in reserve to follow their initial report to create a sustained impression. They proceed on the basis that the harder a company fights the more they are hiding. This encourages them to dig deeper and for others to send them information they might not otherwise have had.

There are a number of common mistakes we see companies make when confronted with an activist short seller that we advise against. Strategies to run from the attack in the hopes it goes away generally don't work. Putting the CEO in hiding or saying as little as possible can spark more questions, appear reluctant or confused, selective and not fully transparent. Similarly, brushing away too many small concerns may lead to a material concern.

We also caution against emotional or exaggerated responses where an issuer personally attacks the short seller, play the 'unfair' card, or allege things like 'conspiracy', 'illegal activity', or 'manipulation'. These tend to fail in refuting allegations as no one is going

to feel bad for a corporation and generally view all responses through a cynical self-interested lens.

What we do recommend in these situations is to walk a fine line between not being seen as running and not to provide so much information it looks defensive and fuels the debate. Explaining can sound a lot like making excuses. Effective companies on the other hand establish clarity, describe action steps taken and will take, or why none are required.

While it is unlikely you will be able to disprove all the allegations in a short report as it would probably require you to release confidential information, you can work a short seller to neutral, mitigate the immediate damage and set the optimal stage for your stock to recover.

So how do you know where the line between ignoring the attack and responding lies? Take your cue from your largest shareholders. This is yet another reason why companies should be engaging them regularly. You want to be in a position so that as soon as the news breaks you can take the pulse of your largest shareholders. If they are highly skeptical of the short seller's claims and only have a few minor questions then you can likely deal with them directly. If they are worried and are going to sell when the markets open then you need to take action on the issues the short report raises.

Even if companies can successfully refute short seller accusations the price of their shares will be slow to recover. After an activist short seller attack where the stock is down and issues are swirling, the risk of opportunism goes up significantly. As your stock begins its long climb back up you are at a very real risk for traditional activism or a takeover.

The key question then is how to optimally position for recovery in the moment of the crisis and how to accelerate recovery over the long term? Indeed improving the price of your stock will hurt a short seller more than any public debate. Price performance is your ultimate rebuttal.



Director Tenure:

The next frontier in good governance and wedge for shareholder activism.

FROM THE
SHAREHOLDERS WE
TALK TO, WHEN THE
ISSUE OF TENURE
COMES UP THE
CONVERSATION
IS REALLY ABOUT
PERFORMANCE
MANAGEMENT AND
A DESIRE TO SEE
THE APPROPRIATE
STEPS, LIKE BOARD
EVALUATIONS
AND SUCCESSION
PLANNING, TAKING
PLACE.

Shareholder expectations are changing when it comes to the length of time a director should serve on a company's board. While many shareholders are paying more attention to issues surrounding board composition, from gender and race diversity to skills matrix, tenure is receiving particular attention as it is a cross-cutting theme that can underlie many concerns shareholders have.

Issues related to a company's responsiveness to change and directors' accountability to shareholders often give way to a discussion about how long a board of directors has been in place. How long does someone have to be somewhere before they are no longer considered independent, is an elusive question to answer. One that boards must not only have a point of view on, just as their largest shareholders do, but an understanding and plan of action to ensure the tenure question doesn't even get asked.

We are often perplexed by a comment we hear all too often along the lines of, "Joe really should go but he's been here so long and he'll be off in a few years when he retires..." Sound familiar? The problem is this comment is usually made when a shareholder—either constructively or in an activist fashion—has raised the issue of tenure.

While we understand this comment we are puzzled why a board, in an age of heightened shareholder activism, would willingly (and complacently) maintain such a vulnerability. We acknowledge that removing one of the old guard can be a challenging and uncomfortable conversation but if you are unwilling to have it an activist will. Strong leaders will work to change directors who are not living up to expectations vs. waiting for their term to expire.

With the largest shareholders now housing specific teams dedicated to unpacking governance issues at their investments, we see more focus being applied to exploring and understanding how nominating committees make decisions. Whereas previously focus was placed on considering the total or average tenure of a board, more focus is being placed on individual tenure and what that means for the appropriate oversight of a company.

The rapid pace of change in today's business environment means shareholders want to know their board is keeping up, actively pursuing steps to ensure the expertise, experience, and the diversity of views needed to navigate and oversee an increasingly

complex world is available to the company. Some shareholders may even have an interest in influencing this composition.

On the activist side, tenure is quickly becoming the low-hanging fruit they will target. As companies are taking steps to proactively clean up other governance issues like excessive compensation, independent directors, and clarity of a strategic plan, tenure is emerging as a key reason directors are targeted.

IS TENURE REALLY WHAT THE WORRY IS ABOUT?

Tenure has become shorthand for all manner of sins. When we unpack concerns about tenure two main things expose themselves.

First, shareholders are worried about Stockholm syndrome sinking in. They want to be confident that directors are not only beholden to anyone but shareholders but there is no emotional attachment that may cloud their judgment and unnecessarily give management 'the benefit of the doubt'. As such, we wonder if length of tenure with the current CEO or length of tenure with the majority of the board are better metrics than a more arbitrary length of tenure in general.

Second, shareholders want to know that directors are nimble enough to understand and evaluate new developments and recommend an appropriate course of action. This is not to imply that age is necessarily an issue but that diversity of views and experiences in addition to leading edge thinkers who are abreast of the latest innovations are important. Shareholders don't want good ideas to be arbitrarily dismissed because 'we've tried that before' or that push a director from his or her comfort zone.

Now this said, a strong case can also be made for longer tenure including strong working relationships, industry relationships, demonstration of commitment, proof of long-term alignment, and knowledge retention, especially for companies based on proprietary intellectual properties. Similarly, shareholders are more likely to bite their tongues on this issue when the company is doing well.

WHAT IS THE FIX?

So how should boards address these concerns given the arbitrary nature of answering the question 'how long is too long'? Is there really a link between

length of tenure or age and performance? Studies have been mixed as have the solutions presented by investors, proxy advisors and companies, each with their own set of consequences.

PROXY ADVISOR VIEW

Currently, neither of the two prominent proxy advisors provide prescribed policies on limiting director tenure or considering a director non-independent solely based on their length of tenure on a subject board. Glass Lewis even states that they generally do not believe that term limits are in the best interests of shareholders. However, Glass Lewis will consider recommending that shareholders withhold votes from members of the Nominating or Corporate Governance Committee where term limits are enacted but waived.

While ISS remains silent in their benchmark guidelines, ISS' proprietary QuickScore system captures director tenure in one of its pillar categories and companies with a higher proportion of directors with lengthy tenures (deemed as greater than nine years) will yield lower results in ISS' QuickScore assessment. While ISS' current benchmark guidelines (for both the Canadian and US markets) remain silent on the issue of director tenure, ISS' Policy Consultation in 2014 indicated that they might be considering policies to director tenure. The survey after the 2016 proxy season raised the director tenure issue again. Specifically, ISS has asked about factors involving director tenure that may be viewed as raising concerns about a board's refreshment and nominating process, including the absence of new directors who were appointed in recent years, a board with average lengthy tenure (described as average tenure of ten to 15 years) or a high portion of directors with lengthy tenure (described as three-quarters of the board with service of ten years or more).

Glass Lewis, on the other hand, may hold the chair of the Nominating Committee responsible where the board's failure to ensure the board has directors with relevant experience, either through periodic director assessment or board refreshment, has contributed to a company's poor performance.

It is also worth noting the Canadian Coalition for Good Governance's view: "Rather than having director term limits or a retirement age, CCGG's preferred method of board renewal is through a strong annual evaluation process of the full board, board committees and individual directors. Because long-term directors can continue to meet individual assessment expectations, a robust board evaluation process should incorporate a consideration of the balance between experienced and fresh insights in board composition."

KINGSDALE'S VIEW

Tenure is not a problem in and of itself but an issue to be considered in relation to the views of your shareholders and within the unique parameters of the company. Factors that can impact what is an appropriate length of tenure include the type of industry, board size, and performance.

From the shareholders we talk to, when the issue of tenure comes up the conversation is really about performance management and a desire to see the appropriate steps, like board evaluations and succession planning, taking place. To ensure this is the case, boards need to think about succession planning well in advance of needing a replacement and in anticipation of the needs of the company over the long term. Ensuring the board has a certain skill set should not be taking place on a reactive basis and leave shareholders with the only option of expanding the board to get skills the company needs.

Solutions like term limits or mandatory retirement ages should not be the primary method by which boards seek to refresh themselves. Such solutions can eliminate productive and non-productive directors alike. In our view, experience and skills should dictate board membership.

So how long should a director sit on a board? Only so long as to ensure shareholder confidence that the board is properly situated to respond to new and emerging challenges and properly aligned and accountable to shareholders and not a moment longer. Once that threshold is passed it's time to go. Knowing where that line is is more of an art than a science and requires you to understand the investment philosophy, expectations and evolving concerns of your shareholders. A good tip is when you recruit directors set the tone for what you think an appropriate term of service should be – then expectations are there. In the end it takes a strong independent chairperson to turn around tenure issues.

Key Institutional View

INSTITUTIONAL INVESTORS ARE ADOPTING POLICIES TO SUPPORT REDUCED DIRECTOR TENURE. FAILURE TO ADHERE TO THESE POLICIES MAY RESULT IN WITHHOLD VOTES AGAINST DIRECTORS AND SPECIFIC GOVERNANCE COMMITTEE MEMBERS. HERE ARE SOME NOTABLE EXAMPLES:

British Columbia Investment Management Corporation (Proxy Voting Guidelines, April 2015)

- Boards should establish a maximum length of service for directors. A fixed director term will contribute to board vitality while allowing for a mix of seasoned and new directors.
- Where average tenure of the board exceeds ten years, bcIMC will consider voting against individual nominees on a case-by-case basis considering the overall composition of the board to encourage board refreshment.

California Public Employee's Retirement System (Statement of Investment Policy for Global Governance)

- Boards should consider all relevant facts and circumstances to determine whether a director should be considered independent – these considerations include the director's years of service on the board – extended periods of service may adversely impact a director's ability to bring an objective perspective to the boardroom.
- Believes director independence can be compromised at 12 years of service – in these situations a company should carry out rigorous evaluations to either classify the director as non-independent or provide a detailed annual explanation of why the director can continue to be classified as independent. Additionally, there should be routine discussions as part of a rigorous evaluation and succession planning process surrounding director refreshment to ensure boards maintain the necessary mix of skills, diversity, and experience to meet strategic objectives.

State Street Global Advisors (Proxy Voting and Engagement Guidelines United States, March 2016)

- When overall average board tenure is excessive and/or individual director tenure is excessive, SSGA may withhold votes from directors.

- In assessing excessive tenure, SSGA gives consideration to factors such as the preponderance of long tenured directors, board refreshment practices, and classified board structures.

- SSGA's director tenure policy in the US and UK is multi-layered and takes into consideration the average market-level board tenure. Companies are screened on three criteria—average board tenure, preponderance of very long-tenured nonexecutive directors and classified board structures. Companies are considered to have excessive average board tenures if they exceed one standard deviation above the average market-level board tenure. Directors are considered to have long-tenures if their tenure is in excess of two standard deviations above the average market-level board tenure. Initially, companies are screened on their average board tenure. Companies with long-average board tenures are then further screened for a preponderance of non-executive directors that have long tenures; and classified board structures. SSGA's tenure policy for companies domiciled in Western European markets classifies directors as non-independent based on the recommendations of the European Commission.

Legal & General Investment Management (2015 Corporate Governance Report)

- In 2017 and beyond, LGIM will vote against:
 - The chair of the Nomination Committee if the average tenure of the board is 15 years or more
 - The chair of the Nomination Committee if there have not been any new board appointments for five years or more
 - Key board committee members and/or the Lead Independent Director if they have been serving for 15 years or more

{ SECTION THREE }

Recommendations

Define the Activists from the Ankle-biters

PROXY FIGHTS ARE LIKE POKER GAMES, AS MUCH AS YOU ARE PLAYING YOUR CARDS YOU SHOULD ALWAYS BE PLAYING THE PERSON ACROSS THE TABLE FROM YOU.

We regularly make the point that not all activists are equal and nuance is required when handling them. Success breeds success and it also inspires imitators with a new crop of activists popping up.

Universities are now offering courses that focus on activism and one even runs a competition in collaboration with Pershing Square Capital to identify investment ideas. Gone are the days where the top business school graduates wanted to be investment bankers, now they are seeking the quick money and public notoriety that comes with shareholder activism. Even traditional arbitrageurs are recasting themselves as activists looking to capitalize on the trend and attract more investments.

For issuers set to encounter an activist, as part of your SWOT process, it is important to assess and understand how credible the shareholder posing a challenge really is. Are they a credible activist in the stratosphere of Ackman and Ichan or are they simply an ankle-biter? Here are some factors to consider:

1 LOOK AT THEIR FAMILY TREE.

Credible activists—even the new ones—have learned the craft from another activist firsthand. Ankle-biters tend to have read about activism, attended some activist conferences, concluded it doesn't look that hard, and are now doing their best impersonations of how they think an activist acts. A fundamental question is do they have the credentials to run a public company vs. have an equity position in one. This is important if an activist aims to have representation on the board. Will they have the ability to recruit a dream-team for the board or will they simply put their 'friends and funders' on the slate?

If there are a couple of people at the activist fund, look at who each of them are and if there is anything you can glean about their personalities and past experiences. Funds run by a team of inexperienced ankle-biters will not all see the endgame in the same way and have different off-ramp scenarios in mind for their investment. For example, some may want to simply hit a certain rate of return within a defined time period while a colleague may actually want that seat on the board.

2 HOW HAVE THEY BEHAVED IN THE PAST?

Have they been successful in accomplishing their stated goals such as winning board seats or affecting an asset sale? Have they ever gone all the way to a proxy fight? Have they shown a propensity to align themselves with other shareholders and form 'wolf-packs'? Do they like to use the media to apply pressure?

Not only should an issuer be looking for patterns and historical success rates but an indication that the activist is willing to change its approach to fit the unique circumstances of a company, its shareholder base makeup, and industry. Credible activists will have shown they can vary their approaches and engage in different manners while ankle-biters will follow a cookie cutter formula such as starting friendly, move to antagonizing, then write a letter and go public, all during a defined timeline that suits their needs.

3 WHAT DO THEY SAY?

Rather than just criticize in a few letters, credible activists will put forward thoughtful analysis and recommendations based on considerable research in white papers and presentations that can have close to a hundred pages. They often make suggestions related to business strategy beyond calls for governance changes and balance sheet engineering, almost operating as free investment bankers.

4 HOW BIG IS THEIR WALLET?

While an activist can run a withhold campaign relatively cheaply by issuing some press releases and putting up a website, posing a legitimate threat to force change if an issuer resists is expensive. Even ankle-biters who have the money needed to mount a meaningful campaign need the inclination to spend it.

A common mistake these junior activists make is to put their legal advisor and proxy solicitor on a budget, essentially saying "I want \$20,000 of activism". The problem this creates for them is that they are not on top of the little things like when to file and what conversations are necessary to disclose. Mistakes an issuer can easily exploit.

Knowing their cost base, the length of time they have held their position, how they acquired it and what other positions they may hold on the debt side or in other companies, and assets under management, will also provide issuers with important clues about an ankle-biter's financial wherewithal.

5 WHO ARE THEIR FRIENDS?

Real activists will have the power to approach and attract friends to help their cause. Activists with a track record under their belt will find the bigger institutions willing to at least hear them out. In fact, credible activists will conduct an analysis of institutional voting policies before they launch their campaigns and may have well syndicated their investment thesis to larger shareholders to gauge its validity.

When a credible activist discloses their position they can also drive turnover of an issuer's stock attracting similar activists and arbs. Once a proxy fight becomes public, issuers are well served to remember that a portion of their shareholders will no longer be theirs.

6 DO THEY HAVE THE STOMACH FOR IT?

Being an activist these days means having to get used to a lot of public attention. Even if the mainstream media doesn't catch on, the blogosphere, bullboards and online world will follow every utterance in a proxy fight. Just as activists will make their case against the board, the board must make its case forcefully against an activist, including past failures and losses.

In addition, the fact an activist is even choosing to mount a public campaign against a company will attract the scorn of some shareholders and media. This means activists need to not only have thick skin, but the ability to remain focused on the messages that matter and not get emotional. Ankle-biters tend not to have this ability and often get defensive, find the need to respond to every utterance, and resort to mud throwing that in no way reinforces their key message and primary thesis.

Properly assessing and understanding a potential activist can make the difference in avoiding a public proxy fight and the costs that go along with it. Proxy fights are like poker games, as much as you are playing your cards you should always be playing the person across the table from you.

A BATTLE FOR THE HEARTS AND MINDS OF MOM AND POP:

SUNCOR VS. CANADIAN OIL SANDS

On Oct. 5, 2015, Suncor launched a \$4.3 billion hostile bid to acquire all of the outstanding shares of Canadian Oil Sands for 0.25 of a Suncor share, a 43% premium at the time of launch. This offer followed an informal proposal from Suncor of 0.32 in March 2015. Because of its close leverage to the collapsing price of oil, COS had seen its stock drop from approximately \$13 to \$6 during the year. COS' board recommended shareholders reject the offer deeming it "substantially undervalued".

Compounding the challenge of fending off a hostile bid in and of itself, a number of external factors colluded against COS including the crash of the oil market and production outages that underscored concerns shareholders already had about a lack of reliability. COS correctly recognized that with a collapsing oil market, a single unreliable asset, and growing fear in the market, an aggressive and proactive communications and shareholder outreach strategy was needed to fend off Suncor and provide the COS board with leverage.

We advised that to achieve an unexpected outcome –having Suncor bid against itself in a declining oil market or, even more unlikely, for them to walk away–COS needed to be unconventional in its approach, especially given its significant retail base. Simply talking in legalese and business jargon wasn't going to win over the hearts and minds of small investors when panic in the oil market was starting to set in. Strategically, if retail could be kept from tendering it would be mathematically impossible for Suncor to obtain not only the 66.6% support required, but even a majority.

COS designed a highly effective strategic communications campaign to convince shareholders not to tender: Convince them the long-term value of COS was sound; that Suncor, as much as it protested, was willing to pay more; and create an image, that despite being the target, momentum was on COS' side. In observing the PR strategy, the Financial Post remarked: "Canadian Oil Sands, the hunted turned hunter". Tactics to implement this strategy included a unique website to capture shareholder information

Why I'm not selling to Suncor at this price.

And why you shouldn't either.

To My Fellow Canadian Oil Sands Shareholders:

My name is Seymour Schulich. I am a Chartered Financial Analyst (CFA) specializing in Oil and Gas and was a senior partner for 22 years at one of Canada's largest investment counselling firms. I also worked for Shell Oil early in my career and have been a merchant banker to the Oil and Gas Industry for over 46 years.

I've made a good living making smart investment decisions and thinking long term.

I also know when someone is trying to pull a fast one on me and Suncor is trying to pull a fast one on all of us.

Quite simply, they're offering an unacceptable price for an irreplaceable asset.

Let me tell you why.

Suncor is hoping we are thinking short term, ignoring the benefits we are about to see from recent capital investments at Syncrude, and overlooking the inescapable reality that oil prices will go up.

I am energized by the fact Syncrude has reduced costs in a lower oil price environment, completed major projects on time and under budget, and is generating enough cash flow under a USD \$40 per barrel WTI price assumption to fully fund all costs, including capital expenditures and our dividend.

I like that Canadian Oil Sands is closely levered to the price of oil so our investment here will slingshot when – and they will – oil prices rebound and in a way Suncor's broader portfolio prevents. Sure there have been challenges at Syncrude, but there have also been solutions. Suncor knows this because they sit at the table and participate in making the decisions. If they really had a silver bullet that would achieve maximum production efficiency all day, every day, 365 days a year, I assume they would have shared it by now.

Suncor is hoping you don't realize they are willing to pay more. But the facts speak for themselves: In addition to our valuable upgrader and 1.6 billion barrels of reserves, Lease 29 presents an especially attractive opportunity for Suncor. Not only is it closely located to their existing operations but Suncor's North Steepbank mine is nearing the end of its life. That means they need to build a new mine much further away at a much greater cost, or acquire Lease 29 and extend the operations of their existing mining equipment and defer billions of dollars in capital spending.

When you add in the fact that with our shares Suncor would have a 49% de-facto controlling position in Syncrude, there is more than enough evidence that Suncor should – and I believe is willing to – pay more.

The fact is Suncor needs Canadian Oil Sands more than we need them. I have been involved with Canadian Oil Sands for over 13 years. I know what this business can do for its shareholders when oil prices recover. I am confident in my investment in a reliable, viable, standalone Canadian Oil Sands.

I'm not selling at this price and you shouldn't either.

Your fellow shareholder,

Seymour Schulich, OC

and contact in real time; a new 'corporate trailer' video that operated as an ad to showcase the long-term value of the company; media relations; and advertising campaign from COS and major shareholder Seymour Schulich.

When Suncor's original offer expired on Jan. 8, 2016, it was clear the strategy had worked. In a matter of 48 hours Suncor had gone from telling the market they were 'slightly ahead of where they wanted to be' to refusing to disclose the tender result to the market. Based this retail focussed strategy, COS was able to extract an extra half a billion dollars from Suncor in a \$20 a barrel oil price environment. Suncor approached COS and increased its bid to 0.28 a Suncor share, which the Board accepted



Ignore Retail Shareholders at Your Own Peril

Much of the thought leadership these days, including our own, is focused on managing the relationship with and engaging institutional investors. But those who do so exclusively, do so at their own peril.

The moms and pops in your stock can be the difference makers in a contested situation and act as a deterrent for activism or a hostile bid. Strong turnout of your retail holders on an ongoing basis can help ward off potential activist advances by signaling the strength of health of your company and ensures they are available and adept at voting when you need them the most... If you can convince them.

The fact is the vast majority of retail shareholders don't vote. Most don't even know what the issues are they are being asked to vote on or have the tools to properly evaluate the choice in front of them. Their go to source for information is the internet which is full of trading tips but nothing provides them with advice about how to properly assess proxy items about governance or compensation alignment – if they even care at all.

Having a comprehensive retail investor relations program, with the goal of broadening and diversifying an issuer's investor base, can put in place a structural defense that makes it hard (or at least expensive) for an activist to overcome. In many cases a few percentage points can make the difference and that may mean getting thousands of small retail shareholders onside.

HOW TO REACH RETAIL SHAREHOLDERS

While issuers with products and services that are known to and easily understood by the moms and pops are best suited for a retail focused IR program, as they can cross leverage their name recognition and brand loyalty to help with IR, it is important all issuers utilize the channels at their disposal.

It is essential to realize retail holders won't discern between the messages your PR, IR and marketing departments are sending. What you are saying through one will impact their investment decisions. Surveys have found investors tend to be more loyal to the brands they own. As such, it is important to ensure these three verticals within your organization are integrated and reinforcing a strong core narrative.

Individual investors are less sophisticated than the investors an IR professional may deal with on a day-to-day basis. On top of that, they are busy and have other things to worry about, especially when you need them to take actual physical steps to vote.

In light of this, it is important to communicate to them a simple story in plain English about value creation or, in a contested situation, that clearly polarizes the choice in front of them and the consequences of not voting. While this may sound like common sense, the problem is that what is mailed to shareholders too often looks like it is meant to confuse not convince.

Everything a company sends to shareholders should be treated as an opportunity to influence their thinking and decisions and persuade them to your point of view. Simply checking a box and sending out what your lawyers and bankers tell you to without critically reviewing it from the perspective of a mom or pop shareholder is a missed opportunity. We are amazed at the number of Q&A's in circulars we see that require shareholders to sift through references to multiple acts when a simple yes or no might be all that is required. It's important not to confuse disclosure with communication.

To further underscore our point about the importance of the clarity and simplicity of your message, it is important to remember that your retail shareholders may not all be the stale, male and pale retirees you picture. The online world has given direct trading access to younger investors as well as ones from emerging markets in South America and Asia where English will not be a first language. No one has ever complained something is too easy to understand.

It is important that an issuer is considering ways to keep their story in front of retail holders outside of the annual proxy circular. This may include stratifying their shareholder base on the basis of what information is most appropriate and what channel is most effective to reach them. Technology presents all kinds of ways to reach shareholders in a cost-effective manner in addition to traditional financial media. The goal should be for a regular communication of trusted and understandable information that will keep an issuer's investment case top of mind to retail shareholders.

Issuers should also be aware that retail holders will ask Google before they ask you so a strong online presence and website with easily understandable information is a must. Many companies are still underutilizing email in terms of collecting addresses and driving information to shareholders, not to mention tools like twitter that require no effort on the part of an investor to receive your message. You should be the go to source for information about

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THE MOST.

your company and answers to key –even difficult questions– not seekingalpha.com or stockhouse.com.

But understanding your story is only part of the equation. Getting retail shareholders to cast a proxy is something completely separate as it requires some effort –however minimal– on their behalf. Getting shareholders off their couches and voting their proxies takes effort and strategic thinking. While many of the initiatives we have pioneered at Kingsdale are exploited most often in contested situations we would encourage more companies to adopt them annually to increase their retail participation and signal the health of the company. In addition to the customary legal elements in your circular, we recommend:

- A visually arresting cover page designed to help the document avoid the recycling bin.
- An easy to understand letter from the Chair that reiterates how the company is creating value for shareholders. Many retail shareholders will not read past the letter to shareholders so its importance should not be underestimated. Like the cover, this letter should be visually appealing to read including graphics, colour, key highlights, and short paragraphs, similar to a common direct mail letter.
- A clear call to action and very clear instructions about who to contact for help doing so if this is their first time.

Some companies are even going so far as to incentivize retail shareholder participation. In the US, CSX Corp. is encouraging otherwise apathetic shareholders to vote by offering to plant a tree if they do.

While historically retail holders have supported management, activists have done a good job of rebranding themselves and demonstrating they can deliver results, opening the eyes of moms and pops to the benefits of their approach. With more institutional investors being open to supporting activist causes, issuers cannot afford to cede their retail shareholders to activists as well.

Director-Shareholder Engagement

Despite increasing pressure to improve shareholder engagement at the board level, many companies still continue to drag their heels. The most common points of resistance we find are questions about “how common is this” and “I haven’t heard from my shareholders, do they want this?”

In the next three years we expect virtually all of the S&P/TSX 60 and a significant portion of the TSX will have an active shareholder engagement program involving their directors. Already some 40 issuers in the S&P/TSX 60 discuss their engagement with shareholders in their information circular and we expect that number increases when you consider those who have not disclosed.

answering tough questions and provides access to independent directors.

THE ROLE OF DIRECTORS

Traditionally it has been common for a company’s investor relations team to engage with investors, involving management as appropriate. Rarely have directors had to respond directly to shareholders.

Now, directors are expected to engage with shareholders on a regular basis. A heightened emphasis has been placed on building and maintaining strong relationships with long-term shareholders. Not only is this helpful in earning their

SAMPLE BOARD LEVEL ENGAGEMENT:

<p>ELDORADO GOLD: Disclosed that board and management engaged -30% of shareholder base</p>	<p>CRESCENT POINT ENERGY: Disclosed that executives and the IR team engaged within top 25 shareholders</p>	<p>KINROSS GOLD CORP.: Disclosed that board and senior management engaged over one-third of shareholder base and the two proxy advisory firms</p>	<p>TRANSCANADA CORP.: Disclosed that the board, executive and senior management, and IR team engaged more than 50% of shareholder base</p>	<p>YAMANA GOLD INC.: Disclosed that the Compensation Committee engaged with -40% of shareholder base</p>
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With the expectations of shareholders rising, companies cannot ignore the importance of engaging them on issues related to strategy and governance, even when there appear to be no immediate issues. Effective shareholder engagement is becoming a pre-requisite for high shareholder support. Companies slow to move toward board level shareholder engagement will find that the bar is being set for them by the companies who have done so and their shareholders will compare them –and hold them accountable– on that basis.

Even if they see the merits of engagement, many companies still struggle to understand exactly what effective engagement looks like in today’s demanding shareholder environment. Investors expect a new approach to engagement – one that is proactive in

early support in the event of a proxy fight, but more importantly it socializes investors to the company’s long-term strategy and showcases the expertise at the board level. Both of these dramatically increase the confidence shareholders have in the board and in their investment.

In addition, and of value to the board, this open discussion with shareholders will help them understand their expectations going forward. Some of the key questions a director should be asking when meeting with shareholders include: What motivates you? What factors are you using to assess the company?

Making the effort to reach out to shareholders before they come to you is still not a practice we see often, but one that can greatly benefit both parties.

WHEN DIRECTORS
TAKE THE TIME
TO MEET WITH
SHAREHOLDERS AND
LISTEN TO WHAT THEY
HAVE TO SAY, THEY
CAN WALK AWAY
WITH INSIGHT WHICH
WILL ALLOW THEM
TO STRATEGIZE AND
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WITH THIS VALUABLE
INFORMATION IN MIND.

Companies are mistaken when they believe talking to shareholders may inadvertently draw their attention to an issue, and instead believe it's best to 'let sleeping dogs lie'.

This approach can and often does backfire. If a question or issue arises from meeting with a shareholder, when would you prefer to deal with that? Before your circular is mailed so you can address and solve it, or after when the only option may be to vote against you? At Kingsdale we are big believers that proactive crisis prevention is a much better approach than reactive crisis response.

It is important that directors are well prepared before engaging with shareholders and responding to tough questions they will undoubtedly have. Despite all the objections we hear about why directors should not engage, the only downside we have seen is when an unprepared team encounters a sophisticated investor and the meeting backfires because they are not ready.

WHAT SHAREHOLDERS ARE LOOKING FOR

Large investors make a point of engaging with many of their portfolio companies every year. Lately, they have been more vocal in their demand for access to directors and desire for a clear process for regular interaction.

There are a number of reasons why shareholders want to meet with management and the board. Sometimes they think management has not adequately responded to their concerns or they feel management is in fact part of the problem. They want to share their perspectives with directors and feel like something is actually being done to address their concerns. Other times, they are lacking confidence in the long-term strategic direction of the company or want to discuss company performance, key risks in the sector, the board's role in overseeing management or governance.

While your IR team and CEO may speak regularly with the portfolio managers, it is the in-house governance teams who will make the decisions on key proxy items. As such, a more holistic approach to engagement is needed. They will be concerned less with the company's quarterly numbers and more with governance issues and oversight.

To be specific, shareholders will often want details regarding governance that won't necessarily be in your circular – like how decisions were made and what level of discretion was exercised. They will also want to verify and ensure they are comfortable with your statements around the issues like succession planning and director education. Too many companies mistake a passive investment style for a passive approach to governance. In reality, if a shareholder is going to be with you for the long term, then good governance is critical to ensuring returns.

Shareholders aren't looking solely for information, they are looking to provide their point of view as owners of your company, many of whom plan to be with you long term. In fact, some large investors have been so explicit as to indicate they want a company to consult with them before responding to an activist or settling.

When directors take the time to meet with shareholders and listen to what they have to say, they can walk away with insight which will allow them to strategize and make decisions with this valuable information in mind. Self-awareness and feedback are good. Just as more boards are conducting board and director evaluations, it is important to understand how your largest shareholders see your leadership.

This is why it is so important shareholder engagement isn't a one-off visit. It is crucial there is a relationship that is formed that provides the opportunity for the company to follow up on actions that have been taken to address concerns and, if they haven't, the reasons as to why. Shareholders want to know their opinion matters and voices are being heard. Without this important report back step, a trusting relationship cannot flourish.

WHEN YOU HEAR 'SHAREHOLDER ENGAGEMENT' THINK 'SHAREHOLDER TRUST'

Effective shareholder engagement practices can help build your company's credibility and the level of trust shareholders have in your board. When shareholders trust the source of their information, they are more likely to be on your side should any issues arise.

Gaining the trust of your shareholders doesn't happen overnight. It's a process that comes slowly through transparency and openness. You can build shareholder confidence not only by meeting with them individually but publicly disclosing and committing to this best practice: What directors are involved? What issues are being addressed? What plans are there in place to deal with those issues and what progress has been made since they were brought up? This shows that your company is serious about improvement and cares about shareholder concerns.

Having effective shareholder engagement practices in place also helps to build personal capital, which will work in your favour when issues arise. If you have a trusting relationship with your key shareholders, they are less likely to assume you are downplaying the severity of a problem at the company or spinning the truth to make yourself look good. They are more likely to believe you are being honest and up front with them about any issues the company is facing.

HOW CAN COMPANIES PREPARE?

1 It's important to know who you will be talking to, how many shares they own and which directors would be best suited to speak with each shareholder. Think about which directors have the natural skills to interact effectively. Make sure this person is able to articulate how the board works and how it collaborates with management.

2 Have responses prepared for tough questions you anticipate from shareholders. These discussions will not only help you to improve your relationship with your key shareholders, but also help you to understand where they believe you are vulnerable. From here, you can decide to respond to these concerns and how to explain the reasoning behind your past decisions.

3 Your company should consider adding investor-savvy talent to the board. Having someone on the board who has a deep understanding of the investor viewpoint and who can help train boards how to respond is an invaluable tool to ensure effective shareholder engagement practices at the board level. A director who knows how investors think will be able to offer a fresh take on issues you may have not even considered.

The advice often given to boards seeking to be proactive on shareholder issues is to think and act like an activist. We think the advice should be to think and act like an independent director representing shareholders to management, not the other way around.

Kingsdale has launched "The Definitive Guide to Director-Shareholder Engagement", available at kingsdaleshareholder.com

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Being the best in our field means reliably delivering the results our clients want – no matter the challenge.

Our track record of success is backed by our unparalleled expertise and culture of 24/7 client service.

Regardless of what your needs are – from governance advisory, corporate communications, shareholder identification, depositary, to full proxy solicitation for any type of voting matter – Kingsdale has the complete solution for you.

There's a reason why we're engaged on more proxy contests than all other combined:

We win

OUR SERVICES INCLUDE:

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Governance Advisory	Voting Analytics
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Debt Services	

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