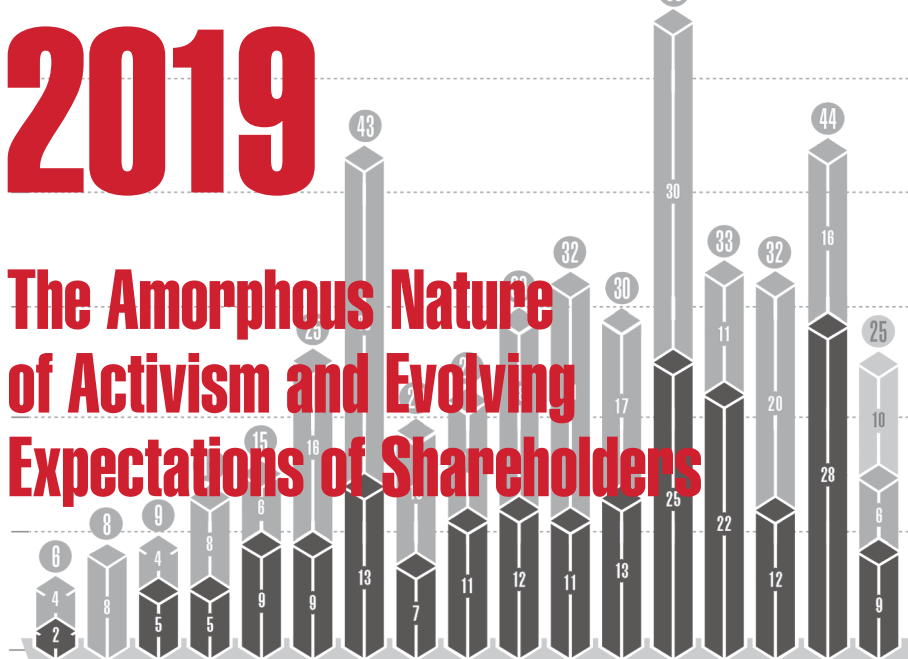


PROXY SEASON REVIEW 2019

**The Amorphous Nature
of Activism and Evolving
Expectations of Shareholders**



60%
2019
Management Win Rate

64%
2018
Management Win Rate

16
First-Time Activists

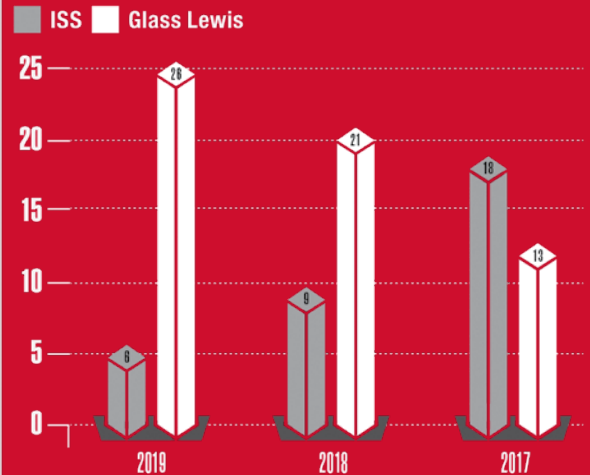
4
Proxy Fights At Cannabis Companies

Median Say-on-Pay Support Levels Dropping

2010
96.7%
2019
93.8%

With the exception of one year, Glass Lewis is more aggressive than ISS on say-on-pay recommendations.

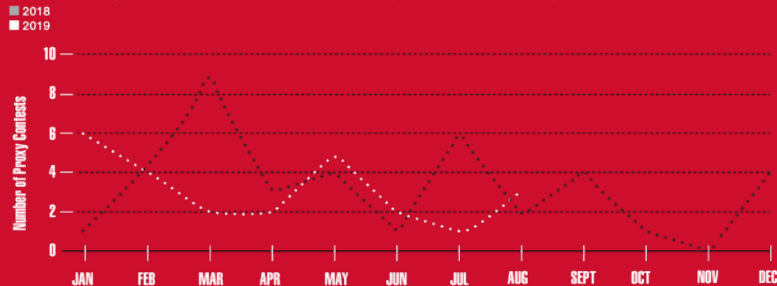
Number of "Against" Recommendations On Say-On-Pay



'19 First year settlements outpace votes in activist situations

Shareholder proposals on pace to double:
2018—53
2019—88

No Such Thing as Activist Season: Number of Proxy Contests Initiated by Month

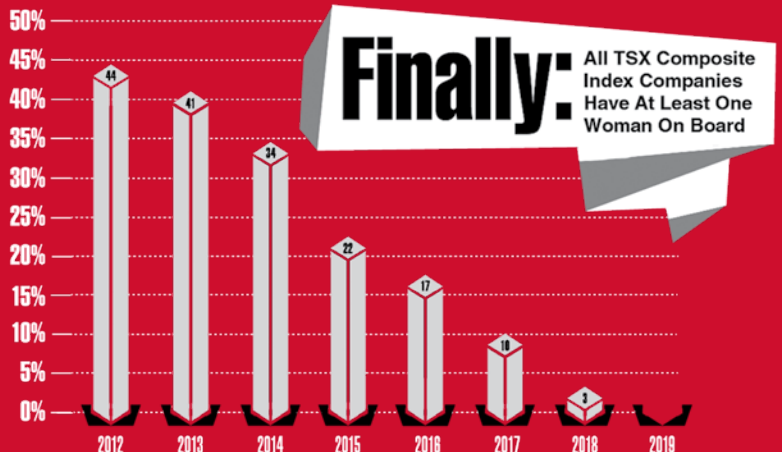


approx.

40%

of top 100 global investors support activists when given the chance

92% of TSX 60 companies issued ESG or sustainability reports



38%

Highest
Proportion
of Minority
States Used

Since 2015

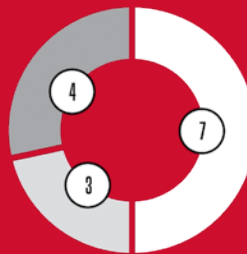
40%

37%

**2019 Activist Win Rate in
Canada Higher Than U.S.**

Gold Sector: Proxy Contest
Outcome (2017-2019)

■ Management Win
■ Activist Partial Win
■ Activist Win



60%
2019

**Management
Win Rate**

64% of activist targets are companies <\$300 million



64%
2018

**Management
Win Rate**

16

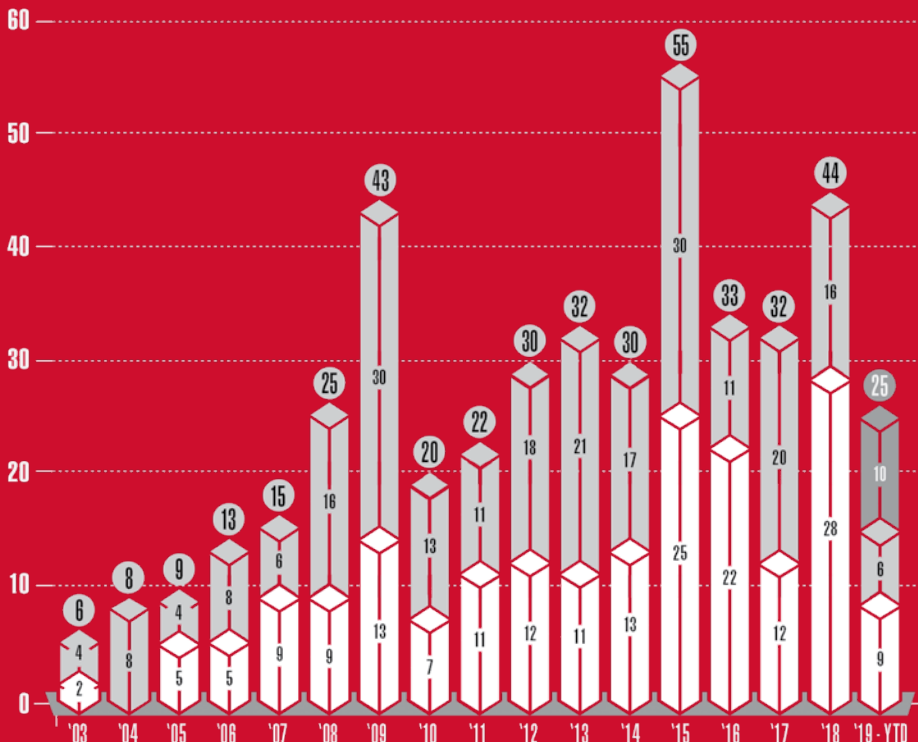
**First-Time
Activists**



Number of Proxy Contests in Canada

2003-2019 YTD

■ Management Win
■ Activist Win or Partial Win
■ TBD



FIN TRENDS

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Unless otherwise stated, the source of data used in tables and charts in this report is Kingsdale Advisors, August 15, 2019.

Some percentage charts may not sum to 100% due to rounding.

All dollar figures are expressed in Canadian dollars unless otherwise specified.

Sector data displayed in tables and charts in this report are framed in reference to respective company's four-digit GICS (Global Industry Classification Standard) Code.

We are very pleased to present to you our 2019 Proxy Season Review – an annual publication that we take great pride in – which includes contributions from our whole team based on our observations and first-hand experiences as North America's leading strategic shareholder advisory firm.

Since Kingsdale's beginning in 2003, activism has evolved into a necessary component of a functioning capital market where corporations take investments from outside stakeholders and appoint representatives to steward their capital. While some still view the term "activism" with a negative connotation, the root of activism is accountability for actions taken and decisions made that impact shareholder value.

In the pages that follow, we present and analyze the activism statistics that everyone craves: the wins, the losses, and the change in numbers. But these numbers don't tell the whole story and may not lead to the certainty that management, boards, and shareholders are always trying to seek out. Why? Because Canada remains unique. We are not home to the "activist" funds like Elliott Management, Triun Partners, Third Point, and others whose sole focus is identifying undervalued opportunities and dedicating a tremendous amount of time and resources to a potential campaign. Unlike the U.S., Canada is more of a situational marketplace – where any investor at any given time can become an "activist" and any company in any sector, regardless of size, can become a target.

While we look for patterns and key takeaways to give us certainty, all we can be sure of is that shareholders of all types are holding boards and management accountable for performance, from both an operational and governance perspective. These shareholders may include retail investors, institutions or what many used to think of as "passive" accounts. While there is no telling where the call for change may come from, should your company's financial performance or actions fall short of expectations, expect your shareholder base to feel emboldened to force change.

Put another way, activists in Canada are now undefinable, targets are unlimited, and too many directors are unsuspecting. Not all change is

warranted, and boards need to continue to invest in relationships with their stakeholders, spend time challenging the company strategy and thesis, and be prepared for the possibility of confrontation.

Last year, to help directors with exactly this, we identified a number of key issues and made predictions to the benefit of our clients:

- We emphasized that passive investing no longer means passive voting. This year, we continue to see the expansion of in-house governance teams at the largest funds, with custom voting policies designed and refined to reflect underlying client appetites and to create a competitive advantage. This means proxy advisors ISS and Glass Lewis have moved from being considered "vote deciders" to data aggregators.
- We highlighted the growing number of former insiders and CEOs who launched proxy contests against their own companies. This is a trend that has since continued in 2019, with insider contests launched at five companies – four of which were micro- or nano-cap companies. In fact, of the 25 proxy fights this year, only four were run by what can be considered traditional activist funds.
- We predicted continued consolidation through M&A activity in the cannabis industry and warned cannabis company boards about how rapid growth had left the industry's governance practices wanting. This year, there have been four proxy contests involving cannabis companies and significant governance deficiencies publicized.

While the data on whether activism truly creates value is still somewhat inconclusive, what we can conclude is that activism, in whatever form, is here to stay. Our advice to companies: Have the courage both to defend against change when it may do more harm than good, and to welcome change when it demonstrates real advantages.

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

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

Best regards,



Wes Hall, ICD.D
Executive Chairman & Founder



Amy Freedman
Chief Executive Officer

01

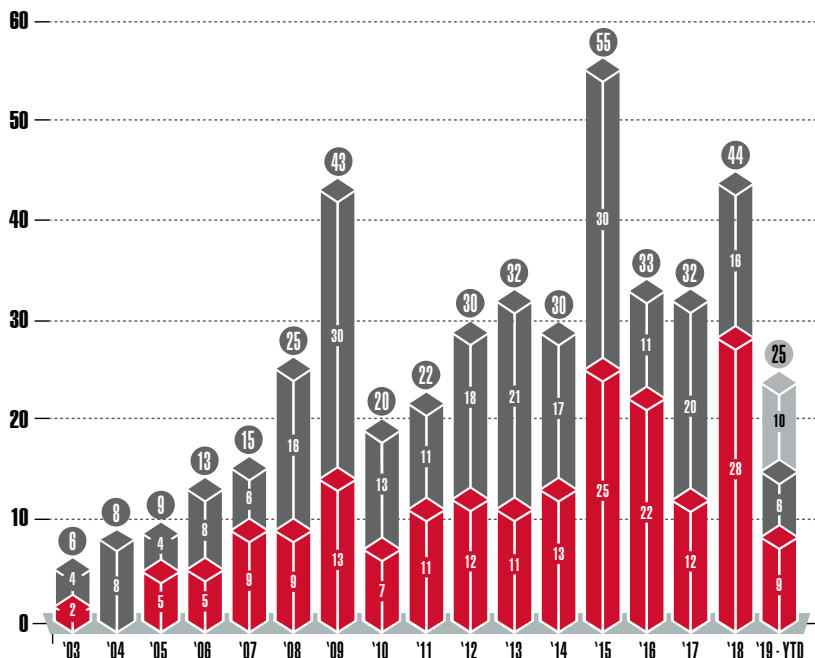
Proxy Season Review

PROXY CONTEST OVERVIEW

Figure A

Number of Proxy Contests in Canada 2003–2019 YTD

■ Management Win
■ Activist Win or Partial Win
■ TBD



More than halfway through 2019, there have been 25 public proxy contests launched in Canada, compared to 29 this time last year, 21 in 2017, 23 in 2016, and 19 in 2015. This suggests that, after the second busiest year on record, activism is on pace to return to its “new normal” in Canada: an elevated level of shareholder antagonism that boards of directors cannot ignore.

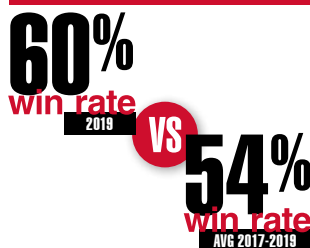
Today’s activists are, for the most part, not the traditional brand name activist hedge funds you would suspect when looking for activism. In 2019, 16 out of the 25 activists were first-timers, ranging from traditional long-term investors to current and former insiders to groups of concerned shareholders with the ability and drive to organize. On top of this, only four were launched by what would be considered traditional activist funds. For companies, this means that just because you don’t have a traditional activist name on your shareholder list doesn’t mean you are safe from activism.

Directors’ need to remain vigilant is further compounded by the fact that boards are by no means guaranteed to hang onto their seats, maintain

their current direction, or execute their recommended transactions if they run into an activist.

Of the proxy fights that have concluded to date, management has won in 60% of cases, down from 64% last year, certainly making a confrontation with activists far from a sure thing. This is roughly in line with the average win rate for management over the past three years of 54%, suggesting that despite continued attempts to brand activists as short-term extremists with self-serving agendas and underqualified candidates, often from the U.S., the broader shareholder universe has not been swayed and sides with activists almost as often as management.

Proxy Fight Success Remains Only Slightly Better Than a Coin Flip for Management



What Counts as a Proxy Contest?

We take a very comprehensive view as to what is considered a proxy fight, as only a small number of activist actions see a mailed circular and an even smaller number actually go to a meeting.

We at Kingsdale consider a proxy fight to have been initiated when an activist shareholder (or group of shareholders) in opposition to management makes a public filing of its activist intent (through a planted news story or a press release or a 13D), requisitions a shareholder meeting, publicly announces an intention to nominate alternate directors, solicits alternative proxies, conducts a “vote no” campaign on either the election of directors or M&A transactions, 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. In other words, if a shareholder says it has publicly targeted you, we consider the fight to be on.

Our proxy contest data captures the campaigns that served as tools to drive change for activists seeking board representation, changing board composition, catalyzing changes in strategy or in capital allocation, urging a sale or break-up of the company or other value-enhancing transactions, blocking a board-approved transaction, or making a hostile bid, among other dissenting actions.

What Counts as a Win?

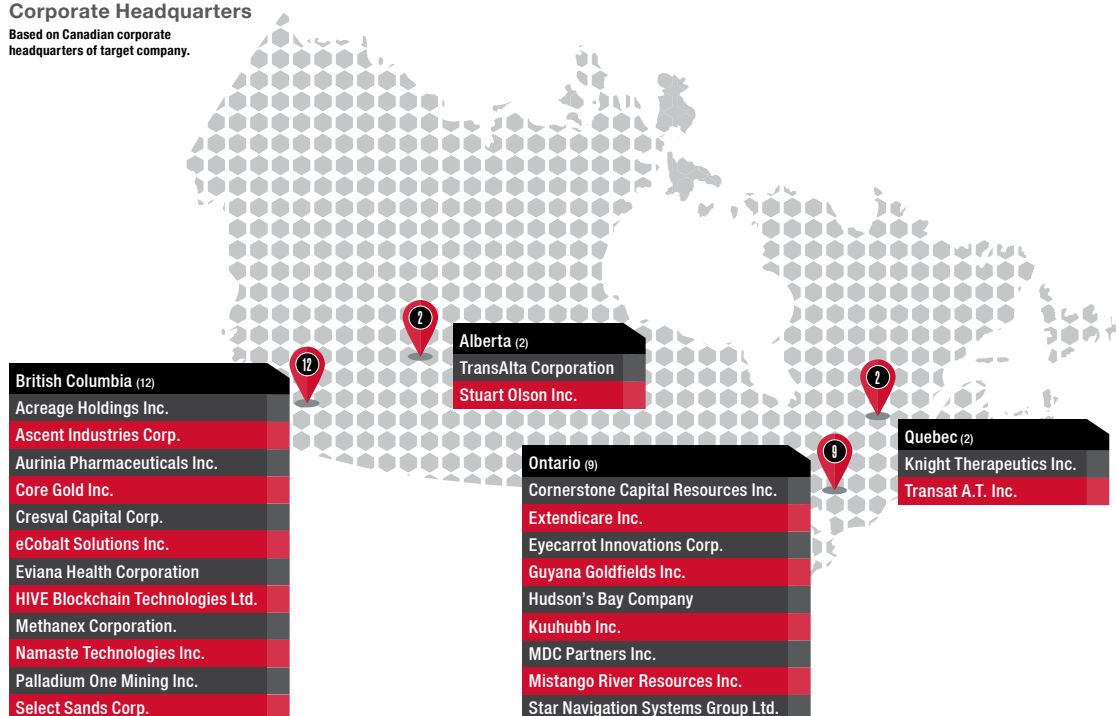
For activists seeking board representation, an activist win is defined as the activists achieving a majority of their objectives. For example, an activist asks for three board seats and receives two. If an activist receives any of its asks, it is considered a partial win for the activist. Conversely, a management win means an activist receives nothing. In cases of a hostile bid, if the target’s board is successful in fending off the bid or increasing the value of the offer and reaching a friendly deal, we consider that a win for management (and shareholders).

Figure B

2019 Proxy Contests by Geography

Corporate Headquarters

Based on Canadian corporate headquarters of target company.



Why Canada Is Returning to the “New Normal” for Activism

The return to a heightened – rather than extremely heightened – level of public activism, or “new normal”, comes as the result of a few key factors. First, generally strong financial and stock performance across all sectors of North American markets have masked and bought time for otherwise poor performers. This period of positive returns is leading to shareholders who, while they may not be perfectly happy, are willing to ride the highs to wait and see what happens.

As we will discuss in greater detail later, the sectors with some of the biggest gains year-to-date also have the biggest declines in activism: total shareholder returns (TSR) year-to-date in the materials sector has increased by 12% while activism has decreased by 42%; TSRs in the energy and real estate sectors have increased 8% and 19% respectively, while activism in these sectors has decreased by 100% – to zero proxy fights – in both sectors.

Conversely, the only sector to see an increase in activism this year was health care, which saw TSR decline by 4%. One of the drivers for this increase was the growth of activism amongst the cannabis companies, some of which fall into the health care sector. Of the four

cannabis companies involved in fights this year, three – Ascent Industries Corp. (CSE:ASNT), Eviana Health Corporation (CSE:EHC), and Acreage Holdings Inc. (CSE:ACRG.U) – fall under the health care sector category while the other, Namaste Technologies Inc. (TSXV:N), falls into the consumer discretionary sector.

Despite improvement in the overall market and the generally good mood of shareholders, directors should remain cautious as the veil of strong market performance that masks underlying concerns can only last so long. While the market may be providing demand-driven or commodity-priced tailwinds, if you are underperforming your peers, shareholders will eventually take notice. Activists are hiding in the weeds watching for the next opportunity, buying time and accumulating positions as they wait for apparent weaknesses – many of which they will have already identified – to become more broadly exposed.

Secondly, both directors and activists increasingly understand the value of keeping confrontations behind closed doors. For the company, where costs are less of a concern, reputations are at risk and public activism can cause a significant distraction. For activists, where costs are more of a concern,

2019 Activist Win Rate in Canada Higher Than U.S.

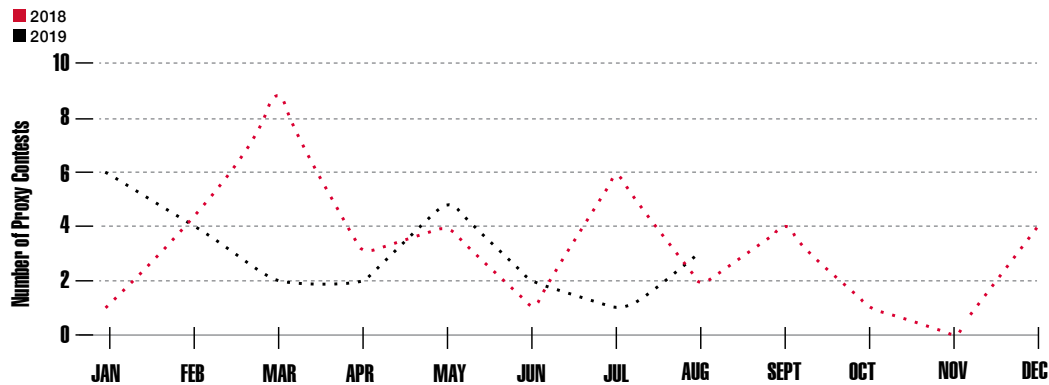
40% | **37%**

negotiating behind closed doors is the cheapest and fastest way to effect change. While activists are not afraid of a public fight, public activism is not always the goal nor the result of an interaction with a concerned shareholder. Companies and activists are finding new ways to work more constructively behind the scenes to realize what both hope to be value-enhancing solutions, while saving public reputations and corporate funds. Based on our deep industry experience, we note that only a fraction of potential proxy fights ever become public.

Finally, it is important to note that, in recent years, we have seen contest activity accelerate again in the fall and winter as the annual general meeting (AGM) season gives way to the requisitioned meeting season, making it clear that the concept of a “proxy season” is a thing of the past.

Figure C

No Such Thing as Activist Season: Number of Proxy Contests Initiated by Month



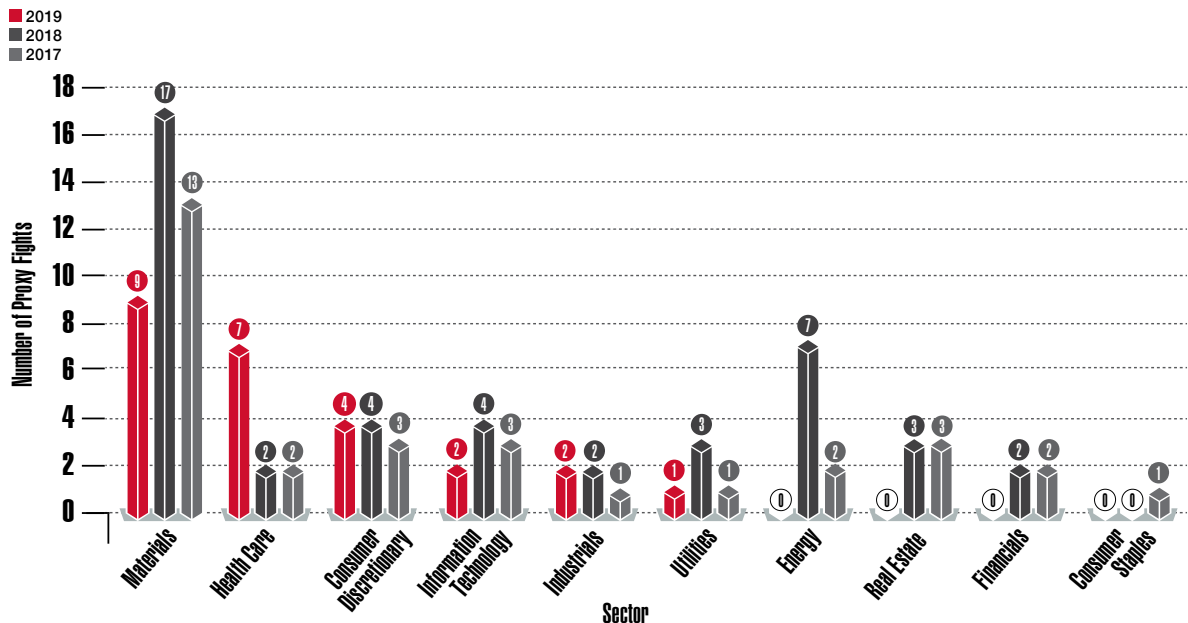
Typically, activists will not requisition a meeting until sufficient time has elapsed after the AGM. After receiving a meeting requisition, companies have 21 days to respond, and can delay a meeting for a prolonged period, sometimes as long as four to five months. Activists have also realized that institutional shareholders prefer to see a long track record of

attempts to work constructively with a company before mounting a proxy campaign and that shareholders can sometimes be leveraged to help negotiate or pressure for settlements. Consequently, activists are starting to lay down tracks well ahead of a company's 2020 AGM to show they have tried very hard to work with the company.

Based on these trends we again expect activity to accelerate in late 2019. Interestingly, we note that over the past four years, we have seen hostile bids launched in the final weeks of the year by Suncor Energy Inc. (TSX:SU), Chemtrade Logistics Income Fund (TSX:CHE.UN), Aurora Cannabis Inc. (TSX:ACB), and Green Growth Brands Inc. (CSE:GGB).

Figure D

Number of Proxy Fights by Sector



| SECTOR | SECTOR WIN RATE ANALYSIS | | | | | |
|----------------------------|--------------------------|---------------------------|----------------|---------------------------|----------------|---------------------------|
| | 2019 | | 2018 | | 2017 | |
| | MANAGEMENT WIN | ACTIVIST WIN/ PARTIAL WIN | MANAGEMENT WIN | ACTIVIST WIN/ PARTIAL WIN | MANAGEMENT WIN | ACTIVIST WIN/ PARTIAL WIN |
| Consumer Discretionary | 100% | 0% | 25% | 75% | 67% | 33% |
| Industrials | 100% | 0% | 50% | 50% | 100% | 0% |
| Consumer Staples | nil | nil | nil | nil | 0% | 100% |
| Health Care | 60% | 40% | 50% | 50% | 100% | 0% |
| Financials | nil | nil | 50% | 50% | 50% | 50% |
| Information Technology | 0% | 100% | 75% | 25% | 0% | 100% |
| Telecommunication Services | nil | nil | nil | nil | nil | nil |
| Utilities | 100% | 0% | 67% | 33% | 100% | 0% |
| Energy | nil | nil | 100% | 0% | 50% | 50% |
| Materials | 40% | 60% | 65% | 35% | 20% | 80% |
| Real Estate | nil | nil | 33% | 67% | 33% | 67% |

Most-Active Sectors: Historical Analysis

| | YEARLY INDUSTRY CONTEST TOTALS | | | | | | | | | | |
|----------------------------|--------------------------------|------|------|------|------|------|------|------|------|-------|--|
| Sector | 2019 | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 | Total | |
| Consumer Discretionary | 4 | 4 | 3 | 2 | 2 | 2 | 1 | 2 | 2 | 22 | |
| Industrials | 2 | 2 | 1 | 2 | 1 | 2 | 2 | 3 | 1 | 16 | |
| Consumer Staples | 0 | 0 | 1 | 1 | 1 | 1 | 0 | 0 | 3 | 7 | |
| Health Care | 7 | 2 | 2 | 1 | 3 | 0 | 1 | 1 | 0 | 17 | |
| Financials | 0 | 2 | 2 | 3 | 5 | 4 | 1 | 0 | 2 | 19 | |
| Information Technology | 2 | 4 | 4 | 3 | 4 | 0 | 1 | 2 | 3 | 23 | |
| Telecommunication Services | 0 | 0 | 0 | 0 | 2 | 0 | 0 | 2 | 0 | 4 | |
| Utilities | 1 | 3 | 1 | 0 | 1 | 1 | 0 | 1 | 0 | 8 | |
| Energy | 0 | 7 | 2 | 5 | 15 | 7 | 8 | 3 | 1 | 48 | |
| Materials | 9 | 17 | 13 | 16 | 23 | 13 | 17 | 16 | 10 | 134 | |
| Real Estate | 0 | 3 | 3 | 0 | 0 | 0 | 0 | 0 | 0 | 6 | |
| Total | 25 | 44 | 32 | 33 | 57 | 30 | 31 | 30 | 22 | 304 | |

What's the Same This Year?

Once again, the materials sector is the most active for proxy battles in Canada, reflecting the large number of resource companies listed on the TSX.

One of the most highly publicized fights in this sector was launched by M&G Investments against Methanex Corporation (TSX:MX) – M&G's first proxy fight. M&G asked for four of 11 board seats and argued against Methanex's capital spending strategy, specifically against a new processing plant under consideration.

The battle ultimately ended in a settlement agreement, with M&G receiving one board seat at the meeting, and an additional seat being mutually agreed to through future board refreshment.

Another high profile proxy battle this year was at TransAlta Corporation (TSX:TA) which falls into the utilities sector. That proxy contest was launched by Mangrove Partners and Bluescape Energy Partners, which owned 10% of TransAlta's shares, on the same day the company announced

a \$750 million investment from Brookfield Renewable Partners (TSX:BEP.UN). Mangrove and Bluescape petitioned securities regulators to stop the transaction and announced their intention to nominate five activist nominees for election at the company's AGM. Ultimately, Mangrove and Bluescape did not end up soliciting proxies, and all of the company's nominees were elected to the board at the AGM.

What's New This Year?

In 2019, the health care sector garnered increased attention, with seven companies engaged in proxy battles, including notably Knight Therapeutics Inc. (TSX:GUD).

At Knight Therapeutics, disgruntled director Meir Jakobsohn (through his private company, Medison Biotech Ltd.) sought six of seven board seats and a more aggressive capital spending strategy. Mr. Jakobsohn also introduced a shareholder proposal designed to remove founder and CEO Jonathan Goodman from the company (*a tactic we discuss further on page 22*). Ultimately, all of management's director nominees

were elected and, embarrassingly, Mr. Jakobsohn himself was not re-elected and the shareholder proposal was defeated.

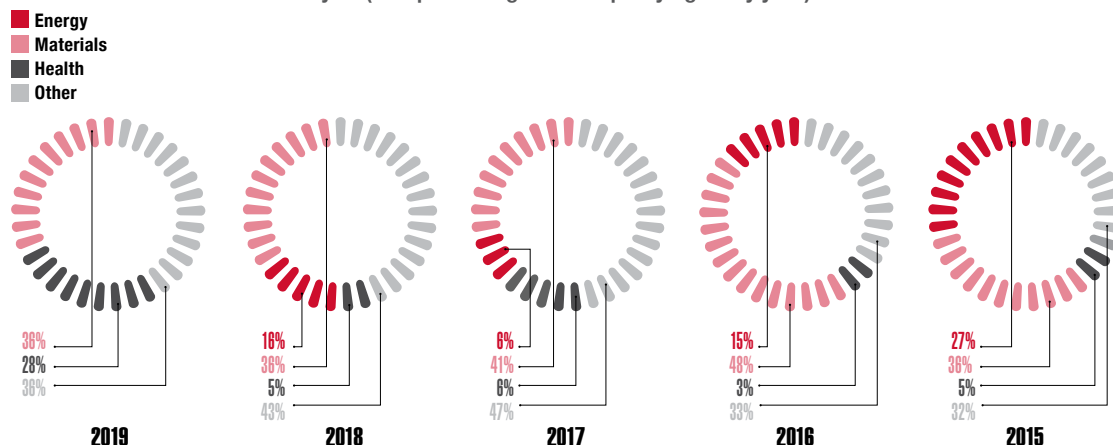
Meanwhile, the energy industry, a sector with a long history of shareholder activism, has yet to see a public proxy fight in 2019. We view the decline as a result of the continued depression of oil prices compared to five years ago, when activists thought there was more opportunity in the space, and an indication many would-be activists have learned a lesson about targeting a company in an industry with significant structural challenges. Given the volatility of oil prices, political risk associated with pipelines and

environmental issues, and the continued deterioration of the balance sheet position of many energy companies, a potential activist's ability to identify viable methods to turn energy sector companies around is significantly impeded.

An activist's ultimate goal is still to pursue a strategy that maximizes shareholder value. Activists may not be willing to deploy capital in a sector where companies are significantly levered to continually depressed oil prices and their share price is based predominantly on the commodity cycle – there are few to no pathways to success.

Figure E

Most Active Sectors Trend Analysis (as a percentage of total proxy fights by year)



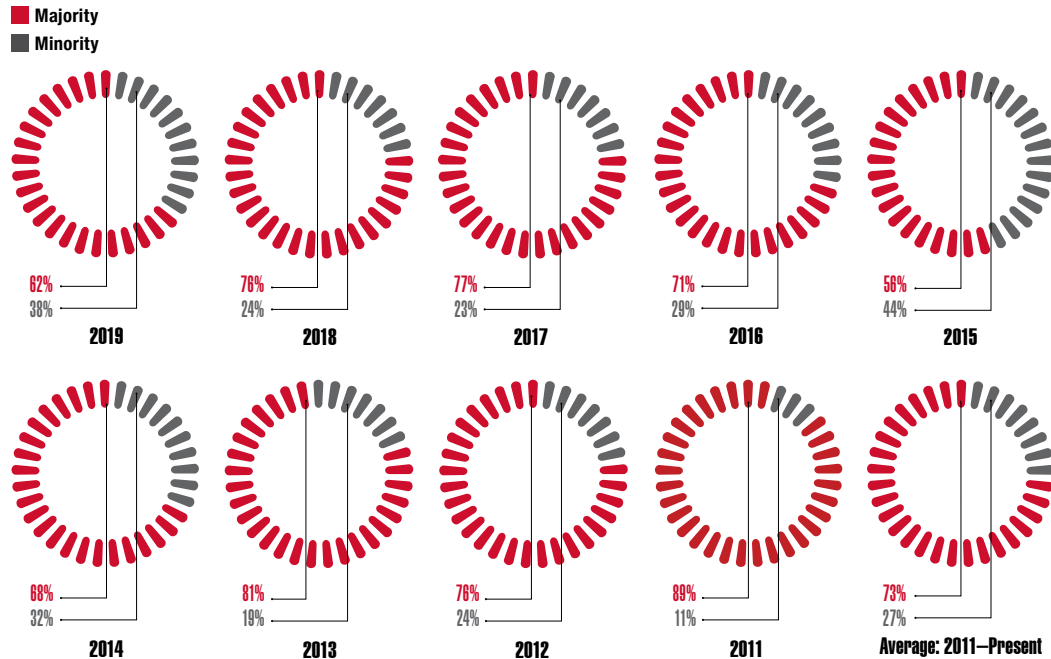
PROXY CONTEST HIGHLIGHTS AND SHOWCASE

Activist Slate Types

Over the past decade, Kingsdale has been tracking the number of times an activist in a board-related fight has put forward a majority slate versus minority slate. This year, we witnessed the highest proportion of minority slates since 2015, while majority slates were still the most common ask.

Figure F

Activist Slate Types (as a percentage of board-related proxy fights)



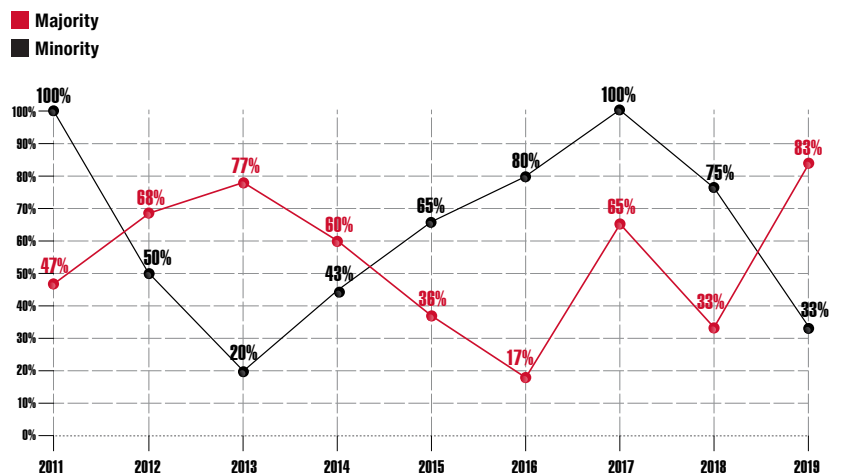
Deciding which slate type to use is pivotal to an activist's strategy. In cases where there is a large institutional shareholder base, activists need to consider the proxy advisory firms' frameworks when building their slates. For example, a majority slate will require a detailed activist business plan as well as a management transition plan, whereas a minority slate will require a less stringent threshold.

On numerous occasions, we've also observed that, as a starting point, an activist will request the majority of the available board seats and then reduce that number as the proxy contest progresses, especially if a settlement option is available.

Historically, activists have had greater success when using a minority slate. (We note this year's data is somewhat skewed as there are only two concluded instances where a majority slate was used. The others remain outstanding.)

Figure G

Relationship Between Activist Slate Type and Activist Win (as a percentage of instances where each slate type was used)



Board- vs. Transaction-Related Proxy Contest Count

Consistently, over the past five years, board-related proxy contests have remained the most common form of activism. In 2019, 64% of the public proxy battles in Canada were built on a demand for board representation and/or removal of directors or officers.

The consistent proclivity towards board-related fights is, in part, due to the recognition by activists that the easiest path to forcing a transaction or improving

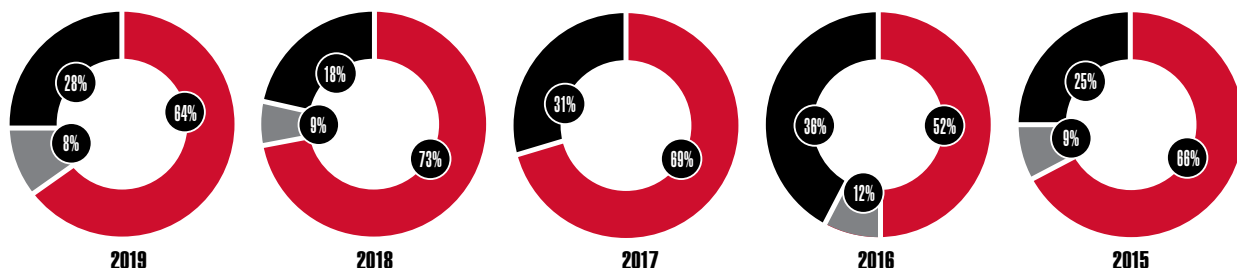
the finances of a company may be through first replacing the board.

In 2019, we saw seven activist campaigns launched against or for a transaction (i.e. a hostile bid). Over the past five years, companies in the materials and energy sectors have been the prime targets for transaction activists.

Figure H

Activist Objectives

- Board-Related (including campaigns that seek both board changes and transactions)
- Transaction-Related Only
- Other

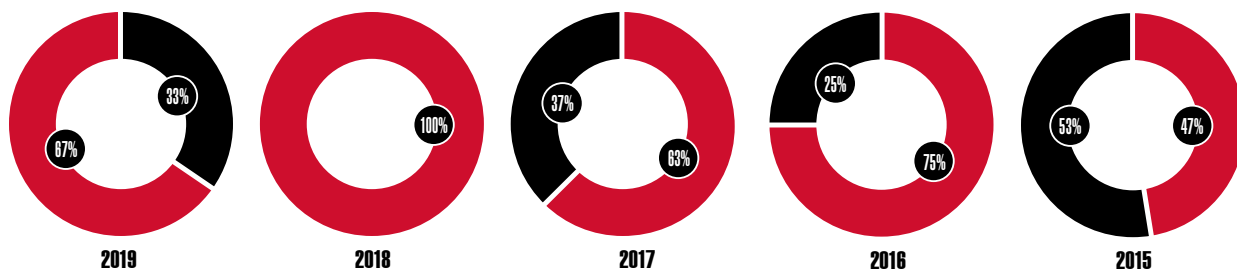


Note: "Board-related" contests represent the following campaign types: board control and representation, remove director(s), and remove officer(s). "Transaction-related" contests represent only vote/activism against a transaction, excluding campaigns that seek for both transaction and board changes. "Other" contests include withhold campaigns and other campaigns seeking to enhance corporate governance and maximize shareholder value.

Figure I

Win Rates in Transaction-Related Proxy Contests

- Management Win Rate
- Activist Win Rate



Settlements Outpace Votes

2019 was the first year in the past five that the proportion of public proxy battles ending with a settlement was greater than the number of contests going to a vote. It is important to note, however, that our numbers only track announced contests and settlements, with many other settlements being reached quietly behind closed doors, which would drive this number even higher.

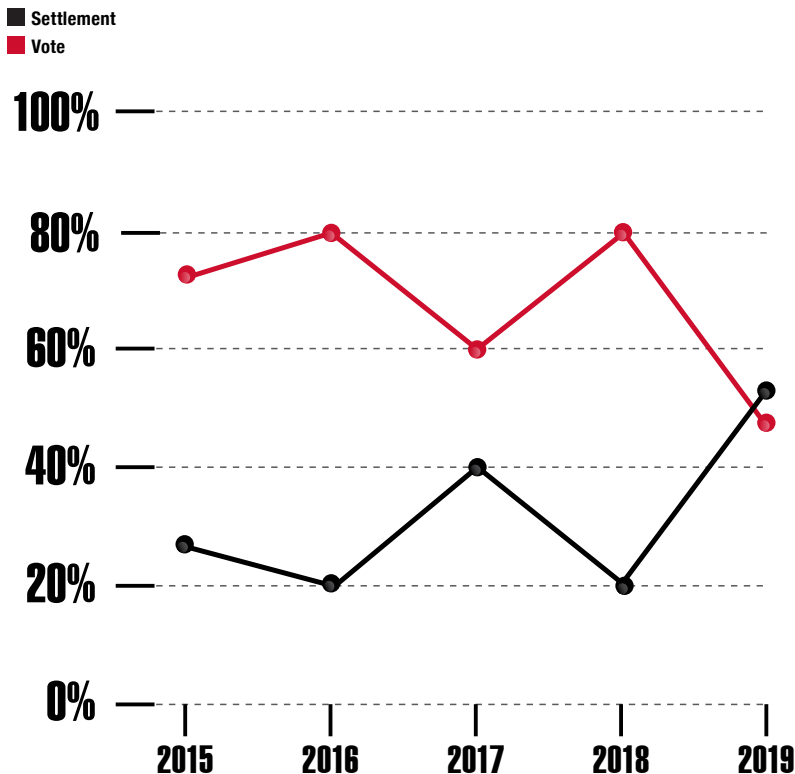
The jump in settlements comes as a result of boards increasingly recognizing the financial and reputational damage that proxy contests can cause, and becoming more open to change and less willing to blindly go along with underperforming management. Importantly, we note that directors are more inclined to settle with an activist if they think a shareholder vote might produce a worse outcome.

This year, settlements were reached in the following contests:

- Ascent Industries Corp. (CSE:ASNT)
- Extendicare Inc. (TSX:EXE)
- Guyana Goldfields Inc. (TSX:GUY)
- Kuuhubb Inc. (TSXV:KUU)
- MDC Partners Inc. (NASDAQ:MDCA)
- Methanex Corporation (TSX:MX)
- Namaste Technologies Inc. (TSXV:N)
- Palladium One Mining Inc. (TSXV:PDM)

Figure J

Proportion of Contests Ending in a Settlement vs. Vote



Institutional Investors – Whose Side Are They On?

It used to be that, in contested situations, we could expect the top investment funds to automatically support management. In recent years, however, we've noticed that, increasingly, investment funds are supporting activists.

While detailed statistics for Canada are not available, we thought it would be useful to note that in 2019, the top 100 investment managers globally voted for management approximately 58% of time. Notably, of the 40% who chose to support the activists, roughly about half supported the entire activist slate.

| TOP 100 GLOBAL INVESTMENT MANAGERS' VOTING RECORDS | | | | | | | |
|--|--------------------------|--|--|---------------------------------------|---------------------------|-----------------------------------|------------------------|
| Investment Managers | Total Number of Meetings | Number of Meetings Voted with Management | Number of Meetings Voted Partially with Activist | Number of Meetings Voted All Activist | Voted with Management (%) | Voted Partially with Activist (%) | Voted All Activist (%) |
| Top 10 | 1,753 | 1,171 | 321 | 261 | 66.80% | 18.31% | 14.89% |
| Top 25 | 3,623 | 2,219 | 784 | 620 | 61.25% | 21.64% | 17.11% |
| Top 50 | 5,908 | 3,436 | 1,380 | 1,092 | 58.16% | 23.36% | 18.48% |
| Top 100 | 8,868 | 5,114 | 2,081 | 1,673 | 57.67% | 23.47% | 18.87% |

Source: Proxy Insight

Insiders as Activists

In 2018, we wrote about a growing trend of activist campaigns launched by former insiders – a trend that continues in 2019.

These events represent unique challenges for issuers, given that former insiders have access to information and relationships that an outside activist would not, including the identity of shareholders as well as operational and financial knowledge. This year, we've seen five contests launched by former insiders and founders:

- **Core Gold Inc.**

ACTIVIST WIN

Director and former CEO Keith Piggott against Core Gold Inc.

- **Knight Therapeutics Inc.**

MANAGEMENT WIN

Medison Biotech Ltd. (controlled by Director Meir Jakobsohn) against Knight Therapeutics Inc.

- **Namaste Technologies Inc.**

MANAGEMENT WIN

Former CEO Sean Dollinger against Namaste Technologies Inc.

- **Palladium One Mining Inc. (formerly Nickel One Resources)**

ACTIVIST WIN

VP, Exploration, and Director Scott Jobin-Bevans, Director Ray Straehl, former President, CEO, and Director Vance Loeber, CFO Robert Scott, and others against Palladium One Mining Inc.

- **Guyana Goldfields Inc.**

ACTIVIST WIN

Former CEO and Chairman Patrick Sheridan and a group of concerned shareholders against Guyana Goldfields Inc.

The Costs of Activism

One of the most frequent questions we hear at Kingsdale is, “How much do proxy fights cost?” While the answer includes a heavy dose of “it depends on a variety of factors”, we can provide some historical guidance (with the caveat that disclosure is scant on an absolute basis, and the lack of associated regulation or rules regarding transparency prevents sophisticated data gathering and analysis).

It’s important to note that proxy fight expenses are not just limited to advisor and lawyer fees, but include significant hidden fees including those for intermediaries and for printing and mailing circulars and other shareholder materials during the course of a campaign.

Disclosure related to activist interactions is not standardized – companies do not highlight these costs uniformly, and may provide them through any number of documents, including: management discussion and analysis forms or letters, annual information forms, and interim or annual financial statements. Based on our analysis of companies where we know an activist interaction occurred, costs associated with proxy fights typically remain unstated, or are bundled with administrative, advisory, or general expenses.

The good news is transparency does seem to be on the rise, with eight cases of disclosure from 44 public proxy fights in 2018, compared to three cases of disclosure following 32 public fights in 2017.

While the largest companies, namely Detour Gold Corp. (TSX:DGC) and Granite Real Estate Investment Trust (TSX:GRT.UN), spent the most money (in terms of dollars) on their respective fights, the lower market cap companies, such as Glance Technologies Inc. (CSE:GET) and GrowMax Resources Corp. (TSXV:GRO), spent proportionally more.

Based on these disclosures, however, even the highest-profile proxy fights in Canada don’t compare to what we see in the U.S. Detour Gold, with a market cap of approximately \$2 billion, for example, recorded an expense approaching \$20 million. By comparison, Proctor & Gamble Co. (NYSE:PG) predicted expenses that approached US\$100 million for its 2017 proxy fight, a large amount of money even considering Proctor & Gamble’s significantly higher market cap of US\$230 billion.

| PROXY FIGHT COSTS BY MARKET CAP *(based on public disclosure) | | | | |
|---|---|------------|---------------|--|
| YEAR | COMPANY | MARKET CAP | FIGHT COSTS | |
| 2017 | Granite REIT (TSX:GRT.UN) | \$ 2,418M | \$ 5,866,000 | |
| 2018 | Detour Gold Corp. (TSX:DGC) | \$ 2,069M | \$ 19,800,000 | |
| 2018 | DIRTT Environmental Solutions Ltd. (TSX:DRT) | \$ 417M | \$ 2,700,000 | |
| 2018 | Guyana Goldfields Inc. (TSX:GUY) | \$ 278M | \$ 2,068,000 | |
| 2018 | DavidsTea Inc. (NASDAQ:DTEA) | \$ 125M | \$ 3,593,000 | |
| 2017 | Espial Group Inc. (Acquired by Enghouse System Ltd. (TSX:ENGH)) | \$ 86M | \$ 677,897 | |
| 2018 | Glance Technologies Inc. (CNSX:GET) | \$ 84M | \$ 1,451,712 | |
| 2018 | GrowMax Resources Corp. (CVE:GRO) | \$ 24M | \$ 1,908,000 | |
| 2018 | Synex International Inc. (TSX:SXI) | \$ 16M | \$ 350,000 | |
| 2017 | Rapier Gold Inc. (Acquired by GFG Resources Inc. (CVE:GFG)) | \$ 9M | \$ 841,115 | |

*As of date proxy fight was launched

The Rise of the Universal Proxy

In Canada, 2019 and 2018 have been record years for the use of universal proxies – proxy ballots that include all management and activist nominees listed on the same card.

This year, we saw four instances of a universal proxy being used in three battles (both Methanex and M&G used a universal proxy). In the two instances that went to a vote (Knight Therapeutics and Aurinia Pharmaceuticals (TSX:AUP)), the activist using the universal proxy lost. While there are numerous factors that can affect an outcome, as the chart below indicates, there is no immediate correlation between the type of ballot and the selected outcome.

This year we also saw the first successful use of a universal proxy by an activist in the U.S. in the contest between EQT Corporation (NYSE:EQT) and the Rice group of shareholders. EQT agreed to use a universal ballot in response to a lawsuit by the activist to prevent the company from unfairly using the activist's nominees' consents to place some, but not all nominees, on the company ballot. Rice matched this tactic by adopting a universal proxy of its own, with the only difference between the two cards being how each highlighted the way each side wanted shareholders to vote. In the end, a board of 12 was elected including Rice's seven nominees as well as five supported by both EQT and Rice.

Notable Universal Proxy Examples

Waterton Global Resource Management vs. Hudbay Minerals Inc.

In Waterton Global Resource Management's proxy contest to gain ten, later reduced to four, board seats on Hudbay Minerals' board, Waterton used a universal proxy card while Hudbay used a blended card, which included their nominees and only two Waterton nominees.

For activists like Waterton, who were seeking minority representation on a board, using a universal proxy gave them the advantage of being able to target specific incumbent directors while, at the same time, garnering the support of the proxy advisors. In Waterton's case, both ISS and Glass Lewis recommended that shareholders vote on Waterton's universal proxy, not Hudbay's blended proxy. The contest was eventually settled with three of Waterton's nominees added to the board and a commitment by Hudbay to find a successor to the long-tenured board chair.

Methanex Corporation vs. M&G Investments

In the proxy fight between Methanex and their largest shareholder, M&G Investments, both sides issued a universal proxy card. Methanex had first filed a management-only proxy card with their annual meeting materials, before M&G launched a proxy campaign to elect four directors.

Following M&G's announcement and filing of a universal proxy card, Methanex issued their own universal proxy card. This provided Methanex with an increased opportunity to garner support from the proxy advisors and provided shareholders with the ability to elect those whom they perceived to be the strongest candidates. The dispute concluded in a settlement, with M&G receiving one board seat at the meeting, and an additional seat being mutually agreed to through future board refreshment.

HISTORIC USE OF UNIVERSAL PROXIES IN CANADA

| YEAR | COMPANY | ACTIVIST | PROXY TYPE (MANAGEMENT) | PROXY TYPE (ACTIVIST) | OUTCOME |
|------|---|--|-------------------------|-----------------------|----------------|
| 2019 | Aurinia Pharmaceuticals Inc. | ILJIN SNT Co., Ltd. | Management Only | Universal | Management Win |
| 2019 | Methanex Corporation | M&G Investments | Universal | Universal | Management Win |
| 2019 | Knight Therapeutics Inc. | Medison Biotech Ltd. (Meir Jakobsohn) | Management Only | Universal | Management Win |
| 2018 | Synex International Inc. (TSX:SXI) | Daniel Russell | Management Only | Blended | Management Win |
| 2018 | Hudbay Minerals Inc. (NYSE:HBM) | Waterton Global Resource Management Inc. | Blended | Universal | Activist Win |
| 2018 | Current Water Technologies Inc. (TSXV:WATR) | Jacqueline Boddaert, Ron Hrynyk, Amar Bhatia, Boddaert Family Trust and 2386337 Ontario Inc., "The Concerned Shareholders" | Management Only | Blended | Management Win |
| 2018 | Detour Gold Corp. | Paulson & Co. Inc. | Universal | Universal | Activist Win |
| 2018 | Crescent Point Energy Corp. (TSX:CPG) | Cation Capital Inc. | Management Only | Universal | Management Win |
| 2018 | DavidsTea Inc. | Rainy Day Investments Ltd. (controlled by co-founder and former director of DavidsTea, Herschel Segal) | Management Only | Universal | Activist Win |
| 2018 | Alexandria Minerals Corp. (TSXV:AZX) | Mr. Eric Owens, a founder, director, and former CEO of Alexandria, and NHP Asset Management AG | Universal | Activist Only | Management Win |
| 2017 | Granite REIT | FrontFour Capital Group LLC and Sandpiper Group | Universal | Activist Only | Activist Win |
| 2017 | Espial Group Inc. | Vantage Asset Management Inc. | Management Only | Blended | Activist Win |
| 2017 | Power Corp. of Canada (TSX:POW) | Graeme Rouston | Universal | N/A | Management Win |

Universal proxies were first used in Pershing Square Capital's (LN:PSH) proxy fight against Canadian Pacific Railway Ltd. (TSX:CP) in 2011. Since then, the use of these ballots, often referred to as the "most democratic" ballot, has increased.

Universal ballots can be especially advantageous to activists who are seeking minority representation, because they enable disgruntled shareholders to support all activist nominees, while preserving their ability to vote for select incumbent directors.

In addition, a universal ballot can provide both sides with greater visibility on support levels throughout the campaign, given that shareholders are more likely to vote on a universal ballot. This visibility on shareholder votes is essential as it can guide strategy and outreach efforts.

ISS and Glass Lewis are big supporters of universal ballots, and their use could lead to a positive recommendation to vote on your ballot.

The use of a universal proxy does, however, pose some risks for both sides: A universal ballot could lead to a split board, with shareholders voting for some but not all of your nominees. Additionally, a universal proxy could dilute support as shareholders can only vote for a select number of nominees and may vote for different directors, dispersing votes between nominees.

As such, before adopting a universal proxy, careful consideration should be given to the number of seats sought, the ability of management to manipulate the board size, the activist's objectives, the influence of the large proxy advisors, and other specifics unique to the campaign. Companies must also consider cost and timing issues: given that most companies will have printed and perhaps even mailed their circulars ahead of their advance notice by-laws (which typically expire 30 days prior to an AGM), switching to a universal ballot can lead to considerable reprinting and mailing costs.

DOES SHAREHOLDER ACTIVISM DRIVE SHAREHOLDER VALUE?

Shareholder activism has increased significantly over the past decade, but have these interventions been effective in creating long-term value for shareholders?

It's a question that has been widely debated and researched, with many academic studies examining the impact of shareholder activism to date.

Unfortunately, despite the extensive research, there's no consensus on whether activism is a boon or a curse to the long-term prospects of a target company.

2015 HARVARD STUDY: ACTIVIST INTERVENTIONS DO IMPROVE A TARGET COMPANY'S PERFORMANCE

One of the more comprehensive and widely cited studies, a 2015 study from Harvard (Bebchuk, Brav, and, Jiang 2015), supports the thesis that activism can improve performance. The authors reviewed the post-activist intervention performance of more than 2,000 U.S. companies targeted by activist hedge funds between 1994 and 2007, and found that activist interventions improved a target company's performance in each of years 3, 4, and 5 following an intervention. The report also notes that an initial bump in a targeted company's stock, of approximately 6%, precipitated by the launch of an activist action, isn't reversed in subsequent years.

"We find no evidence that activist interventions, including the investment-limiting and adversarial interventions that are most resisted and criticized, are followed by short-term gains in performance that come at the expense of long-term performance."

—Bebchuk, Brav, and Jiang, 2015

2016 UNIVERSITY OF WASHINGTON AND VILLANOVA UNIVERSITY STUDY: IMPACT OF ACTIVISM IS GROWING

A 2016 literature review, from researchers at the University of Washington and Villanova University (Denes, Karpoff, and McWilliams, 2016) reinforces the findings of the Harvard study and claims that the impact of activism is growing. The researchers note that the recent activist interventions have yielded greater improvements in target firms' values and operations compared to examples cited from studies in the 1980s and 1990s.

"This suggests that activists have learned and adapted their strategies, particularly through the development of hedge fund activism."

—Denes, Karpoff, and McWilliams, 2016

2018 REPORT: NO EVIDENCE ACTIVISM ENHANCES SHAREHOLDER WEALTH

A more recent report underlines the real challenges of measuring the impact of activism. There seems to be little consensus on what defines "success" (especially operational success) and, importantly, any research on the topic is likely to be blurred by the many micro- and macroeconomic factors that affect a targeted company's long-term prospects.

"On a value-weighted basis, which likely best gauges effects on shareholder wealth and the economy, we find that pre- to post-activism long-term returns are insignificantly different from zero."

—deHaan, Larcker, and McClure, 2018

KINGSDALE'S TAKE

At Kingsdale, we believe the divergent opinions on the positive impact of activism are a result of the differences in the definition of success, along with a plethora of micro- and macroeconomic factors that impact a company's long-term prospects. Success, it is important to note, is in the eye of the beholder, with shareholders considering their own entry and exit point in a stock.

While the academics can't agree on activism's impact, we have identified several findings for which there is agreement (or at least not disagreement):

- Activist interventions are accompanied by an initial bump in share price (though the amount of that bump and how long it will last remains an open question)
- There is no evidence that activist interventions significantly destroy value or impair a target company's long-term performance
- Activism has a larger impact on smaller companies than on larger ones
- Activism related to corporate takeovers or acquisitions produces the largest improvements at target companies

KEY GOVERNANCE DEVELOPMENTS

Changes in ISS Policy

In 2019, ISS introduced policy updates for Canada that included changes to its gender diversity and overboarding policies.

Prior to 2019, ISS applied two separate gender diversity policies for TSX Composite Index and non-TSX Composite Index companies. However, beginning in 2019, ISS expanded its gender diversity policy from the TSX Composite Index to widely held TSX companies. Specifically, ISS will generally recommend a “withhold” vote for the chair of the nominating committee (or chair of the committee designated with the responsibility of a nominating committee) if the company has no female directors on the board and the company did not disclose a formal written gender diversity policy. In light of the new policy, this year, we saw ten negative vote recommendations on nominating committee chairs (compared to only three in 2018). While none of the TSX Composite Index issuers were impacted, ten “widely held” companies (per ISS’s

designation based on the number of ISS clients holding shares of the company) fell victim to the new policy.

With regard to its overboarding policy, ISS shifted to a single-trigger approach by removing its secondary trigger of attending fewer than 75% of board and committee meetings without a valid reason for these absences, and expanded the number of boards a CEO can sit on to two outside public company boards (from one) and non-CEO directors to five public company boards (from four).

To date, we have seen eight directors at TSX Composite Index companies receive withhold recommendations due to ISS’s updated single-trigger policy regarding overboarding. Of the eight, four were directors at controlled companies, who, as a result of the negative recommendation, saw their support levels drop marginally. Notably, two of these directors at controlled companies were “repeat offenders” who

had received negative recommendations from the proxy advisors in previous years.

The other four directors who were flagged by ISS at non-controlled companies saw their support levels decrease more significantly from an average of 86.3% in 2018 to 71.8% in 2019.

Widely Held TSX Issuers Impacted by ISS’s Expanded Gender Diversity Policy:

- Premier Gold Mines Ltd. (TSX:PG)
- ProMetic Life Sciences Inc. (TSX:PLI)
- Delphi Energy Corp. (TSX:DEE)
- Bonterra Energy Corp. (TSX:BNE)
- Trisura Group Ltd. (TSX:TSU)
- Morguard NA Residential REIT (TSX:MRG.UN)
- Morguard Real Estate Inv. (TSX:MRT.UN)
- Canacol Energy Ltd. (TSX:CNE)
- North American Construction Group Ltd. (TSX:NOA)
- Canfor Pulp Products Inc. (TSX:CFX)

Changes in Glass Lewis Policy

Glass Lewis also introduced policy changes for the Canadian market that included major updates to its board gender diversity policy, environmental and social (E&S) risk oversight, and virtual-only shareholder meetings.

As of 2019, Glass Lewis will generally recommend voting against the nominating committee chair of a board that has no female members and may also recommend voting against the nominating committee chair if the board has not adopted a formal written diversity policy. Glass Lewis may extend the adverse recommendation to other members of the nominating committee, depending on factors such as company size, industry, gender diversity on the management team, the company’s overall governance profile, and whether there are other board composition concerns.

For its E&S risk oversight update, Glass Lewis will now recommend that shareholders vote against directors who have been charged with oversight of E&S in

the absence of a separate committee with designated E&S risk oversight functions.

Finally, for its virtual-only shareholder meetings policy update, Glass Lewis will examine a company’s disclosure of its virtual meeting procedures and could recommend voting against members of the governance committee if the company does not provide disclosure assuring that shareholders will be afforded the same rights and opportunities to participate as they would at an in-person meeting. Glass Lewis will be looking for examples of effective disclosure, including the procedures for posting shareholder questions and the company’s responses after the meeting, addressing technical and logistical issues concerning access to the platform, and procedures for accessing technical support in the event of any difficulties joining the virtual meeting.

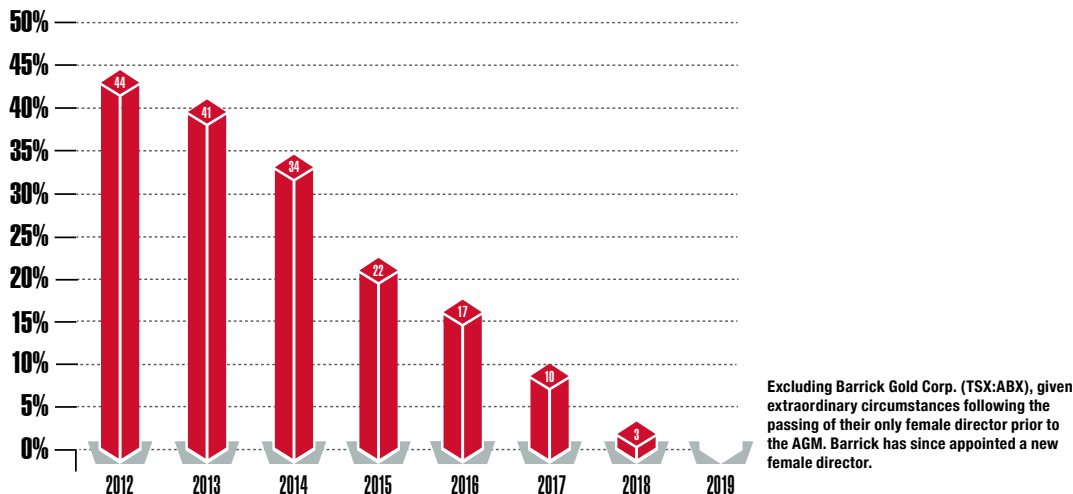
Diversity: Almost There?

Unfortunately, board diversity remains a challenge in Canada, with a few noteworthy recent developments. In addition to the new policies from proxy advisors, the federal government has enacted new legislation, Bill C-25, which requires federally incorporated public companies to release figures on board diversity.

In 2018, all TSX 60 constituents came to their AGMs with at least one woman on the board. In 2019, 92% (55 of 60) of the TSX 60 constituents entered their meetings with at least two women on the board.

Figure K

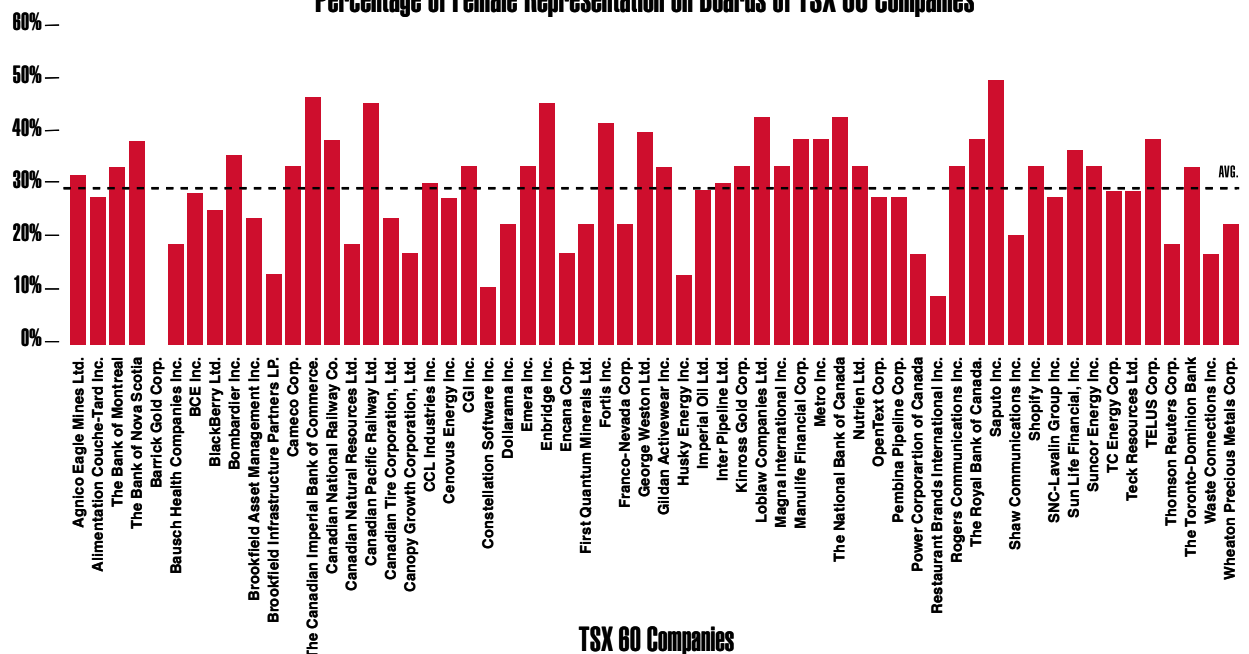
Percentage of TSX Composite Index Companies with No Women on Board (as of most recent meeting date)



Source: ISS Analytics

Figure L

Percentage of Female Representation on Boards of TSX 60 Companies



TSX 60 Companies

Majority Voting

The application of majority voting policies, whereby a director is required to immediately tender their resignation if he or she receives less than 50% support at a special or annual general meeting, continues to be a rare

occurrence in Canada. The policy requires that absent “exceptional circumstances”, the board must accept the resignation within 90 days, with the resignation becoming effective upon acceptance by the board.

In 2018, we observed only four instances where majority voting policies were applied. However, so far in 2019, we have seen that number almost double to seven instances where a director received more “withhold” votes than “for” votes.

| DIRECTORS TRIGGERING MAJORITY VOTING POLICIES | | | |
|--|---------------|--|--|
| COMPANY | AGM DATE | VOTE RESULT | OUTCOME |
| Baylin Technologies Inc. (TSX:BYL) Market Cap: \$121M | May 14, 2019 | David M. Gelerman – 29.13% | <ul style="list-style-type: none"> While the director is required to submit his resignation, the company has not yet disclosed any resignation. |
| Jaguar Mining Inc. (TSX:JAG) Market Cap: \$166M | June 04, 2019 | Richard Falconer – 32.28% Edward Reeser – 32.28% | <ul style="list-style-type: none"> As both directors are members of the company's governance, compensation, and nominating committees, the board has created a special committee to review. The directors have tendered their resignations. Mr. Falconer's resignation has been accepted but Mr. Reeser's is still pending. |
| Street Capital Group Inc. (TSX:SCB) Market Cap: \$82M | June 19, 2019 | Duncan Hannay (President and CEO) – 35.73% | <ul style="list-style-type: none"> Mr. Hannay tendered his resignation. Street Capital was subsequently acquired by RFA Capital Holdings Inc. |
| Trez Capital Senior Mortgage Investment Corp. (TSX:TZS) Market Cap: \$17M | June 19, 2019 | Stewart J.L. Robertson – 49.46% Gregory S. Vorwaller – 49.51% | <ul style="list-style-type: none"> Mr. Robertson failed to be elected, as a resolution to increase the board size from five to six was not approved, while Mr. Vorwaller received less than 50% support. Mr. Vorwaller has tendered his resignation and the board has accepted the resignation. |
| Steppe Gold Ltd. (TSX:STGO) Market Cap: \$41M | June 28, 2019 | Lewis Marks – 40.22% | <ul style="list-style-type: none"> Mr. Marks refused to tender his resignation. As a result of his refusal to comply with the company's majority voting policy, the TSX may conduct a review of his suitability to be a director or officer of a TSX or TSX Venture Exchange listed company. An ordinary resolution for removing him as a director was approved by shareholders at a special meeting held on August 23, 2019. |

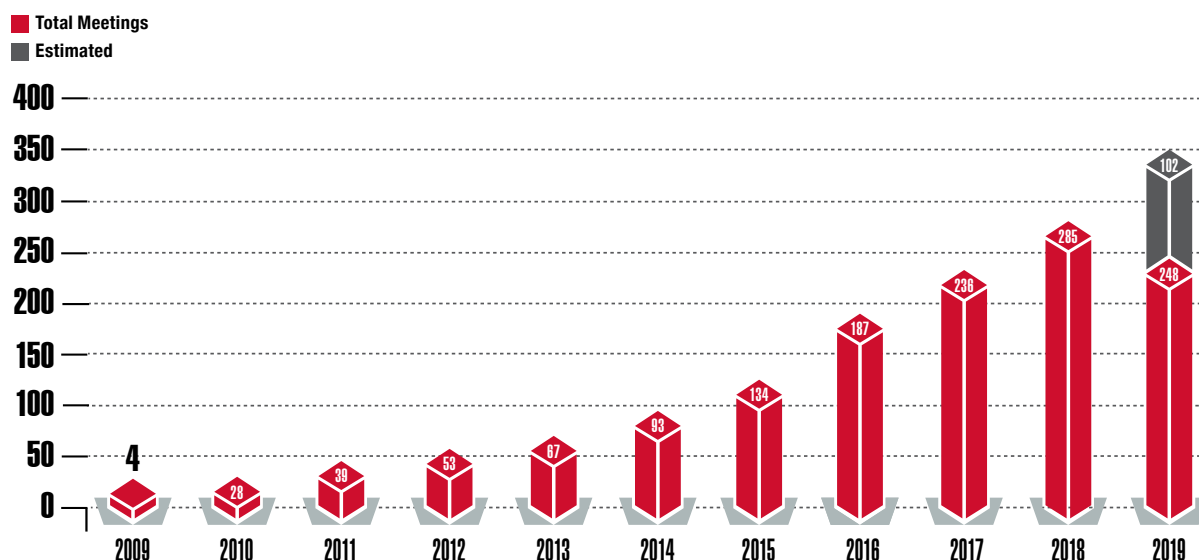
The Snail's Pace of Virtual AGM Adoption

Virtual meetings continue to be a rising phenomenon within the U.S., but Canada has been remarkably slow to keep pace, with more companies willing to explore

a hybrid option, wherein a traditional meeting format is augmented by the addition of a virtual component, rather than a virtual-only option.

Figure M

Virtual Meetings Hosted in the U.S.



Source: Broadridge Financial Solutions (to June 30, 2019)

During the 2017 proxy season, Kingsdale assisted Concordia International Corp. (TSX:CXR) in the first virtual-only meeting in Canada. Since then, just one virtual-only meeting occurred in 2018 and two occurred in 2019, at Goose Holdings Inc. (TSX:GOOS), and Imperial Metals Corp. (TSX:III).

Canadian companies' hesitance towards virtual-only meetings may be related to concerns about hindering shareholder communication and the uncertainty around real-time shareholder votes. To address

this, hybrid meetings have become an increasingly appealing option. Three hybrid meetings took place in 2017, with four occurring in each of 2018 and 2019.

We note that Broadridge Financial Solutions only introduced its virtual AGM options for Canada in 2018. As companies become comfortable with these options, we expect more to get on board with at least the hybrid meeting option.

DO WE REALLY NEED IN-PERSON AGMs ANYMORE?

Of course, the AGM is a necessary convention that allows shareholders to exercise their democratic rights to vote for the election of directors, appoint auditors, consider financial statements, and any other special matters. But, with the introduction of virtual AGMs, coupled with enhanced governance practices that boards should be enforcing, is it time to do away with the traditional in-person meeting?

As we've noted, virtual-only AGMs have been almost non-existent in Canada. In our view, the case for making the shift to virtual meetings is a strong one.

MORE THAN 95% OF SHARES ARE VOTED WELL IN ADVANCE OF THE MEETING

In our experience, most shares that are going to be voted are done via proxy in advance of a meeting. Why? In Canada, the deadline for shareholders to vote is typically 48 hours prior to an AGM. Only registered shareholders (who make up a small percentage of overall share count) and those who actually take the time to formally appoint themselves to vote are able to vote at the meeting itself. Moreover, there is really no advantage to voting at the meeting (other than to reserve one's right to a last-minute decision or to surprise a company with a negative vote).

A SHAREHOLDER'S ABILITY TO RAISE QUESTIONS, INTRODUCE SHAREHOLDER PROPOSALS IS LIMITED

At an AGM, the chairperson's role is to run through the items on the agenda allowing shareholders to only ask questions as they pertain to those matters and to the extent an answer may impact a shareholder's vote. While proxy holders or registered holders may bring forward other matters, shareholder proposals must be submitted in advance of a meeting. Further, if a company has adopted an advance notice by-law, as has become common practice, nominations of directors must also be received in advance of the AGM.

INVESTOR DAYS, ONE-ON-ONE MEETINGS ARE MORE APPROPRIATE VENUES FOR INVESTOR PRESENTATIONS

Once voting and other technical portions of an AGM are completed and the formal meeting is adjourned, then what? Many companies proceed to a more formal investor presentation, often to an empty room or a room filled with advisors who are networking. It is sometimes embarrassing when the CEO runs through a 20-minute presentation with no new information to no "real" shareholders. While we feel that it's appropriate for a chairperson or CEO to make a few comments at the beginning of an AGM to comment on the company's performance, an AGM is not an investor day or a media event.

We believe that AGMs are important events to uphold the fundamental rights of shareholders, and that they can be satisfied by the virtual-only meeting solution or the hybrid meeting. The latter has been deemed to be the most shareholder-friendly, as it enhances participation and still maintains the tradition of the in-person meeting.

Notable Shareholder Proposals: Diversity, Compensation, and Activist Games

The number of shareholder proposals in Canada has drastically increased this year, soaring from 53 in 2018 to 88 so far in 2019. Of the 88 proposals, 31% were withdrawn and only one proposal passed. The significant increase can be largely attributed to shareholders' heightened scrutiny of executive compensation and board-related governance matters, as we have seen 16 and 13 more proposals in 2019 on these two topics, respectively.

The successful proposal, to adopt a formal written diversity policy and report regarding the representation of women at Waste Connections Inc. (TSX:WCN), received 65% support. The British Columbia Teachers' Federation submitted the proposal, and both

ISS and Glass Lewis endorsed it, in part because Waste Connections Inc. has only one female director on its board (14% female representation). Cascades Inc. (TSX:CAS) also received a similar shareholder proposal to adopt a policy to increase gender diversity and female representation on the board and senior management, from Mouvement d'éducation et de défense des actionnaires (MÉDAC), but it only garnered 40% support. Part of the reason why this proposal found less support could be that Cascades already has 33% female representation on its board, despite the lack of a formal policy.

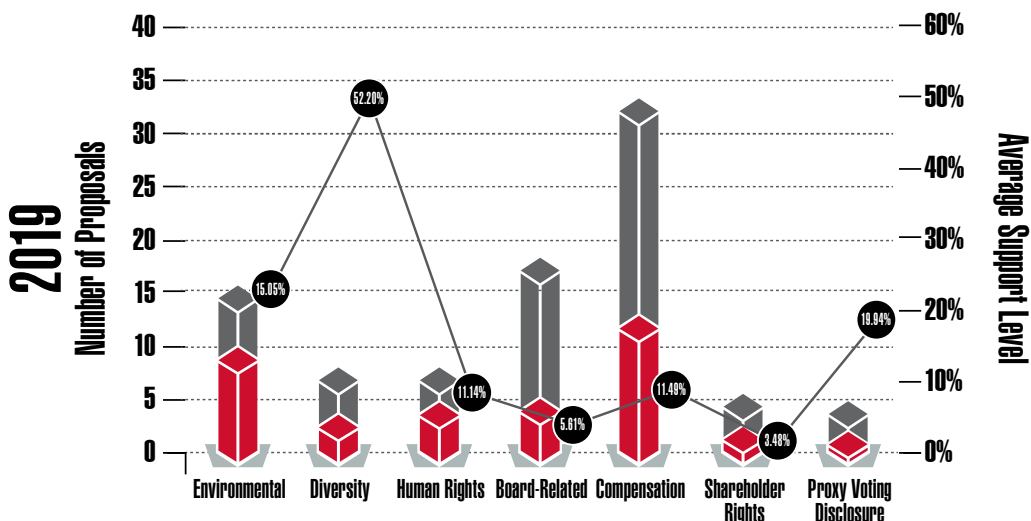
Compensation-related shareholder proposals remain dominant this year,

with 34 so far. The two most common proposals are the integration of ESG criteria into executive compensation and the disclosure of pay ratio, both of which are primarily advocated by MÉDAC. As well, institutional shareholders continued to exert pressure on companies that have not yet adopted a say-on-pay vote. Based on our observation, this continued pressure is having an impact, even at controlled companies (*a topic we discuss in greater detail on page 38*). Loblaw Companies Ltd. (TSX:L) and Onex Corp. (TSX:ONEX) received shareholder proposals on say-on-pay in 2018, and Saputo Inc. (TSX:SAP) received one back in 2017; all adopted say-on-pay resolutions this year.

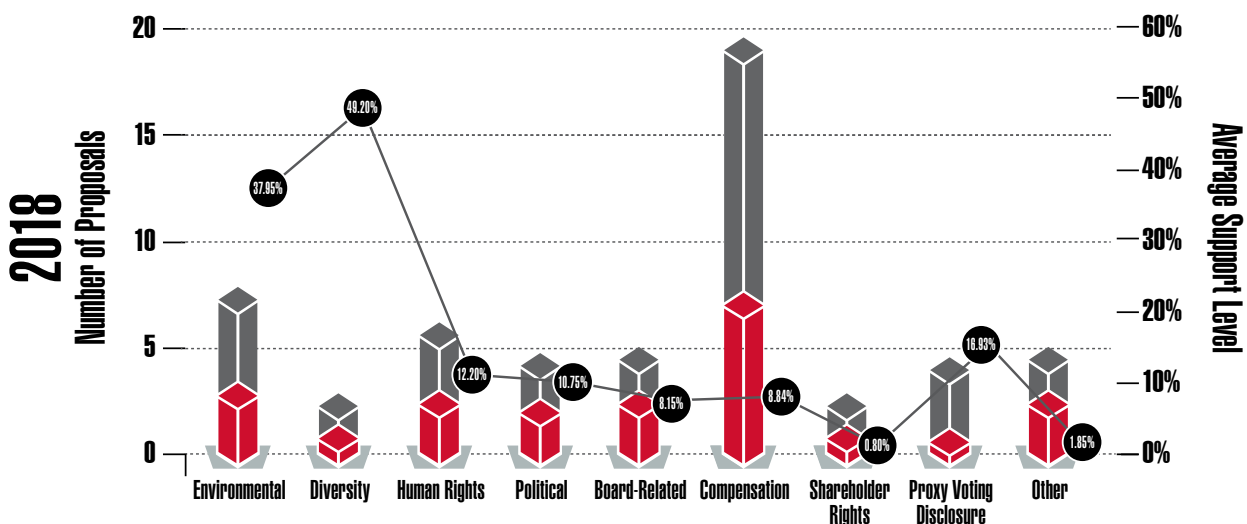
Figure N

Number of Shareholder Proposals by Type

■ Number of Proposals Withdrawn
 ■ Number of Proposals Voted
 ■ Average Support Level



■ Number of Proposals Withdrawn
 ■ Number of Proposals Voted
 ■ Average Support Level



One notable shareholder proposal this year was an activist by-law resolution submitted by Medison Biotech Ltd. during its proxy fight against Knight Therapeutics. This proposal was brought forward as a tactic to help augment one of Medison's particular arguments. Specifically, Medison raised conflict of interest allegations claiming that Knight's CEO had a higher stake in his father's company, Pharmascience Inc., a direct competitor of Knight, than he did in Knight. While the CEO was just a non-voting minority shareholder of

a holding company with an interest in Pharmascience, Medison argued this could cause a conflict of interest and thereby proposed to amend one of the company's by-laws by specifically adding a "no conflict of interest" section.

In response to the allegations, Knight's CEO entered into a blind trust relinquishing all rights to vote his Pharmascience shares and established a firewall restricting his access to any information concerning the business of Pharmascience.

Medison's shareholder proposal was supported by Glass Lewis but not ISS, who believed the company's existing policies are "best enforced by an independent board rather than a specific by-law". The by-law was defeated, as was the activist's slate of nominees, at the company's AGM.

ESG Disclosure and Evaluation Trends

The days of companies taking advantage of unlimited carbon emissions, commoditized labour, and excessive waste production seem to be numbered. ESG has become a critical component in the decision-making process for institutional investors and has been ingrained in a culture of responsible

financial management. As such, investors are looking for increased disclosure on these topics and an opportunity to engage with boards.

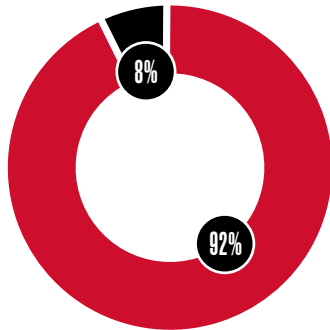
A research study conducted by the Responsible Investment Association (RIA) indicates that ESG has become

mainstream among TSX 60 companies, with 92% issuing ESG or sustainability reports and 39% of all TSX companies reporting their ESG practices. We note that, of the disclosure reviewed from TSX 60 companies, ESG disclosure is mostly limited to the E&S categories.

Figure O

Percentage of TSX 60 Companies Issuing ESG or Sustainability Reports

■ Companies Issuing ESG or Sustainability Reports
■ Companies That Do Not Issue ESG or Sustainability Reports



ISS and Glass Lewis responded to investor demands by launching their own ESG evaluation tools in 2018. ISS publishes its E&S QualityScore to help standardize these factors and to provide certainty by “number value” for investors. ISS considers approximately 240 factors when evaluating a company’s rating, giving them the most thorough evaluation test to date.

Glass Lewis, on the other hand, has partnered with the Sustainability Accounting Standards Board (SASB) to provide sector-based ESG material factors after including Sustainalytics research and ratings. Additionally, companies use the Global Reporting Initiative (GRI) standard to help shareholders understand the company’s impact on climate change. In a notable

example of how companies have been seeking to improve reporting, during an investor day in April hosted by Teck Resources Ltd. (TSX:TECK.B), the company held a one-hour sustainability session led by its CEO, who updated investors on how E&S issues are strategic to the business.

Vote Buying: IIROC Guidance Puts an End to Its Usage in Proxy Fights

Following last year’s request by the Canadian Securities Administrators for comment on the use of soliciting dealer arrangements, the Investment Industry Regulatory Organization of Canada (IIROC) provided guidance on the usage of such arrangements, specifically limiting their use in contested director elections.

The use of soliciting dealer arrangements has attracted a lot of criticism within the context of proxy fights, where it has been dubbed “vote buying” and seen as an entrenchment tactic by incumbent directors who will pay for votes in favour of their slate and in the event that their slate is successful.

While some, including Kingsdale, had called for an outright ban on soliciting dealer arrangements within the context of a proxy fight, IIROC has provided guidance to Dealer Members (Dealers) that will essentially end their participation

in such arrangements in contested meetings. IIROC has provided direction to Dealers about how they can avoid or manage conflicts of interest arising from the arrangements, particularly with regards to votes solicited for a contested meeting (vs. an acquisition or transaction) that can raise concerns about a Dealer’s ability to comply with IIROC’s conflict rules and related guidance.

IIROC provides guidance on the types of conflicts in contested elections that can’t be managed and should be avoided. Specifically, if fees are paid only for votes in favour of one side and if that side is successful, then it is unlikely that the Dealer would be able to provide objective advice and should therefore avoid participation. IIROC notes that in the case of contested director elections, qualitative assessments related to future business strategy and the ability of different nominees to implement the

We believe that in some cases the conflicts of interest arising from these arrangements can be addressed, for example, by, appropriate policies and procedures. However, there are other arrangements where the conflicts are, in our view, unmanageable and therefore should be avoided.

- IIROC

strategy are required, and it is unlikely that the Dealer would be able to provide objective advice in this area if their payment was tied to a specific outcome.

In other situations that involve a shareholder vote and are more related to a quantitative assessment of details related to deal terms (e.g. a plan of arrangement), IIROC notes

these situations are fact- and context-specific, including the fact the situations themselves could become contested. As such, it is up to the Dealer to consider if it can address any conflicts of interest that may arise on a case-by-case basis, such as by disclosing the conflict. Such disclosure must be timely, understandable, and prominent to allow for a fully informed decision and

should include who is paying the fee, the amount, and whether it is contingent on a certain outcome. Importantly, IIROC notes that disclosure alone is an inadequate way to address a conflict because of the limited impact it may have on a client's decision-making process. As such, the Dealer should also identify how it has addressed the conflict in the best interest of the client.

CONCENTRATION ON COMPENSATION

Say-on-Pay Snapshot

2019 marks almost a decade of say-on-pay in Canada. While at Kingsdale we've seen 24 new companies voluntarily adopt a say-on-pay vote this year, the overall rate of adoption, as a percentage of all TSX issuers, has all but levelled off in the last few years. Overall, 72% of TSX Composite Index companies and

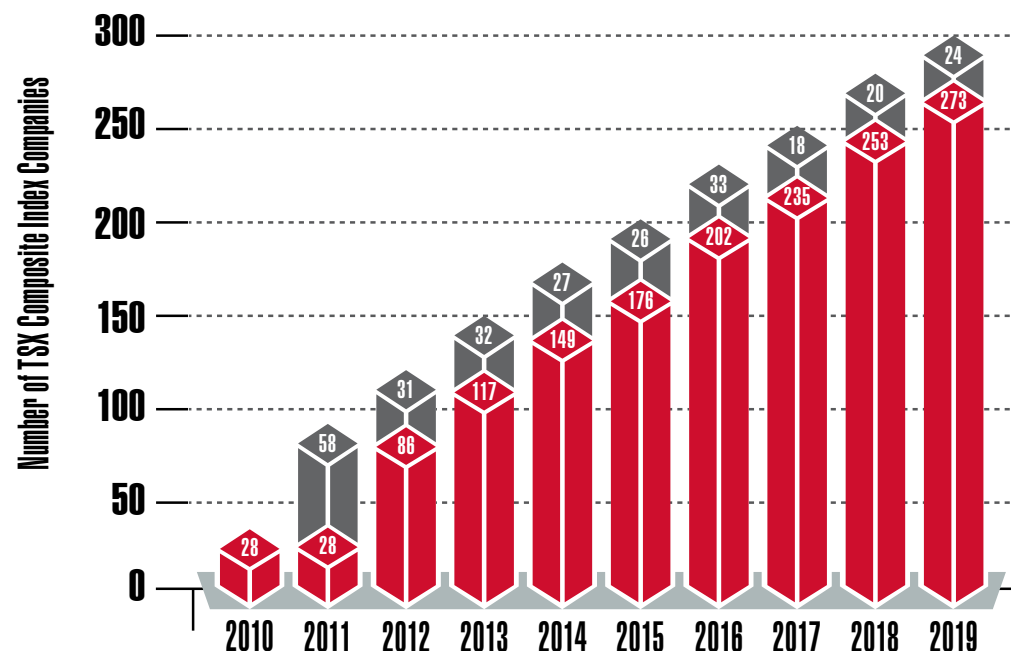
13% of TSX issuers hold say-on-pay votes. It should be noted that the vast majority of TSX adopters have provided an annual vote, the few outliers being Richards Packaging Income Fund (TSX:RPI.UN), Secure Energy Services Inc. (TSX:SES), and Trilogy Metals Inc. (TSX:TMQ), which hold bi-annual or

tri-annual votes. For those companies that have not yet adopted a say-on-pay resolution, we continue to advise in favour of it, both as a best practice and as an added protection from negative recommendations by proxy advisors for compensation committee members.

Figure P

Say-on-Pay Adoption Trends of All Canadian Companies

■ Adopted in Respective Year
■ Adopted Previously



Shareholder Support Levels

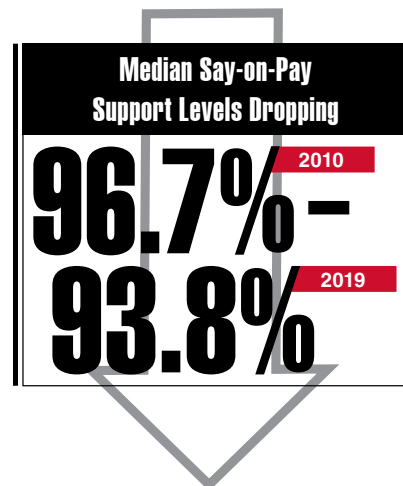
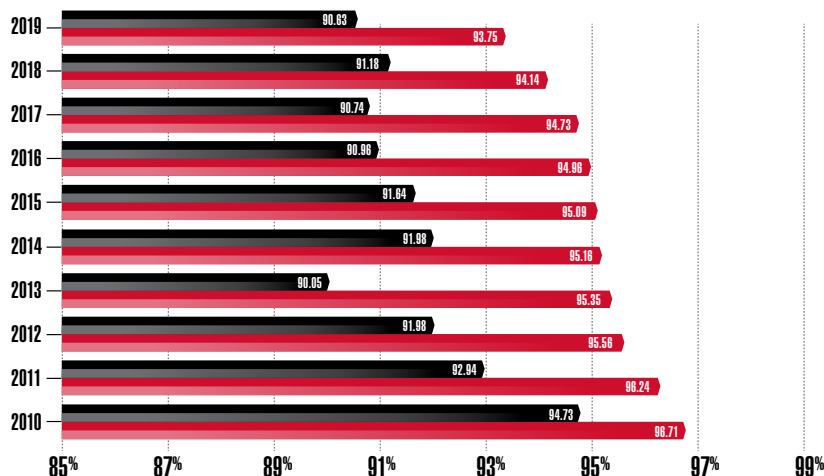
Similar to prior years, the average say-on-pay support level in 2019 hovers in the 90% to 91% range. With almost a decade of data, it is interesting to note that, since coming to Canada in a meaningful way, say-on-pay votes have seen their average and median support

levels subtly but steadily decline. We attribute this to increased scrutiny on executive compensation, more stringent proxy advisor guidelines, and institutional shareholders' maturing internal proxy voting policies.

Figure Q

Say-on-Pay Support Level (Percentage)

■ Average
■ Median



Companies That Failed Say-on-Pay

Year-to-date, three companies – none of which are composite index issuers – have failed say-on-pay votes.

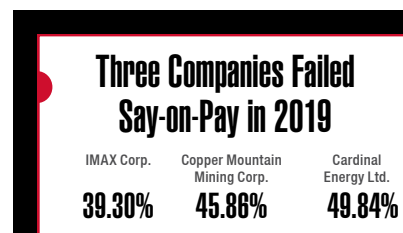
IMAX Corp. (NYSE:IMAX), which was dual-listed on both the NYSE and TSX until 2015, received “against” recommendations from both ISS and Glass Lewis, and only 39.30% support from shareholders in its third consecutive year of failing say-on-pay (43.17% support in 2018 and 29.98% support in 2017), marking the longest streak of failed say-on-pay votes in the world. In fact no TSX issuer has failed their say-on-pay votes in consecutive years.

The other two companies, Copper Mountain Mining Corp. (TSX:CMMC) and Cardinal Energy Ltd. (TSX:CJ), received “against” recommendations from Glass Lewis on say-on-pay but “for” recommendations from ISS.

Over the past three years, Copper Mountain had an average support level of 63.90% but, for the first time, failed

this year with only 45.86% support. While both proxy advisors have recommended “against” say-on-pay at Copper Mountain in the past, this year only Glass Lewis provided a negative recommendation. We suspect this year’s failed vote, despite support from ISS, is the result of lacklustre one-year performance and shareholders wanting to send a message to management.

Cardinal Energy first adopted its say-on-pay vote in 2018 and garnered 91.80% support, a stark difference from this year, with support falling to 49.80%. What changed? Glass Lewis’s negative recommendation cited some red flags on executive compensation, including a lack of objective, formulaic, and performance-based incentives under short-term incentive plan (STIP) awards; lack of performance-based long-term incentive plan (LTIP) awards; and immediate payout of cash severance upon change-in-control (single-trigger change-in-control provision).



Diverging Approaches for ISS and Glass Lewis

In analyzing proxy advisors’ recommendations this year, we note that ISS and Glass Lewis seem to have adopted different approaches to say-on-pay. Notably, of the 30 companies that received negative recommendations in 2019, only two – Hudson’s Bay Co. (TSX:HBC) and IMAX – received negative recommendations from both proxy advisors.

Two of the three companies that failed say-on-pay received an “against” recommendation from Glass Lewis but not ISS.

ISS and Glass Lewis also differed in their voting recommendations on 11 of 21 say-on-pay votes that ended up garnering support of less than 80%.

ISS AND GLASS LEWIS RECOMMENDATIONS AT COMPANIES EARNING LESS THAN 80% SUPPORT

| | COMPANY NAME | MARKET CAP** | ISS RECOMMENDATION | GLASS LEWIS RECOMMENDATION | SUPPORT LEVEL |
|--|---------------------------------|--------------|--------------------|----------------------------|---------------|
| | IMAX Corp. | \$1,623M | Against | Against | 39.30% |
| | Copper Mountain Mining Corp. | \$158M | For | Against | 45.86% |
| | Cardinal Energy Ltd. | \$277M | For | Against | 49.84% |
| | Sherritt International Corp. | \$77M | For | For | 53.99% |
| | Yamana Gold, Inc. | \$3,155M | For | Against | 54.49% |
| | Baytex Energy Corp. | \$1,130M | Against | For | 58.09% |
| | Chemtrade Logistics Income Fund | \$868M | Against | For | 60.86% |
| | Encana Corp. | \$9,049M | Against | For | 61.04% |
| | Crew Energy, Inc. | \$123M | Against | For | 61.20% |
| | Bellatrix Exploration Ltd.* | \$36M | For | For | 70.98% |
| | Agnico Eagle Mines Ltd. | \$15,909M | For | Against | 71.77% |
| | Hudson's Bay Co.* | \$1,360M | Against | Against | 73.54% |
| | CI Financial Corp. | \$5,030M | For | For | 73.61% |
| | Denison Mines Corp. | \$413M | For | Against | 74.72% |
| | Pengrowth Energy Corp.* | \$274M | For | Against | 74.90% |
| | The North West Co., Inc. | \$1,380M | For | For | 75.00% |
| | Kinross Gold Corp. | \$6,338M | For | For | 75.44% |
| | Laurentian Bank of Canada | \$1,796M | For | For | 75.74% |
| | Pretium Resources, Inc. | \$2,416M | For | For | 76.72% |
| | PrairieSky Royalty Ltd. | \$4,296M | For | For | 78.29% |
| | Endeavour Mining Corp.* | \$2,347M | For | Against | 79.58% |

* Controlled or quasi-controlled companies, whereby a stake of 20% or greater is held by a single person, entity, or group.
 ** Market Cap as of Q2 2019 or most recent reporting period.

As in previous years, with the exception of 2017, Glass Lewis has taken a substantially more aggressive approach than ISS, recommending “against” 26 say-on-pay votes versus six from ISS. This compares to 21 “against” recommendations from Glass Lewis versus nine from ISS in 2018.

Some of the common compensation features that Glass Lewis took issue with included: a single-trigger change-in-control provision; similar metrics used under STIP and LTIP; discretionary short-term incentive awards; lack of a clawback provision; insufficient disclosure of STIP performance goals; short performance period under LTIP; excessive reliance on STIP payout; and substantial severance payments.

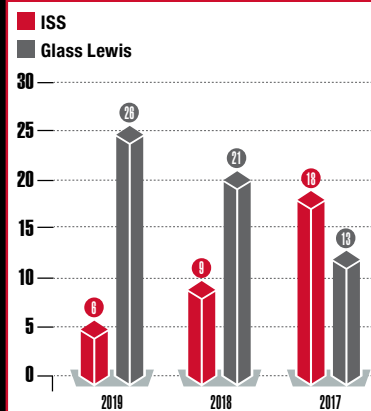
Qualitative discretion has continued to play a critical role in influencing the proxy advisors’ final recommendations, particularly in the case of ISS, where we noted that several of their recommendations were reversed based on qualitative analysis. (This means that an initial “pass” was reversed to “fail” due to negative over-riders, and an initial “fail” reversed to “pass”, thanks to positive factors.) One example is Crescent Point Energy, for which ISS lowered its initial “high” concern derived from

quantitative pay-for-performance tests to “medium” concern after conducting a qualitative analysis, resulting in a positive recommendation. ISS also noted that the company’s new CEO’s pay for the year was 41% lower than that of the former CEO in his last full year and that the total Named Executive Officer (NEO) pay declined 20% from last fiscal year.

Another example is Sherritt International Corporation (TSX:S), where ISS’s initial quantitative pay-for-performance screen also yielded a “high” concern, which was then reduced to a “medium” concern after ISS considered qualitative factors. ISS noted that the company had been reducing its debt and strengthening its balance sheet over the last year despite struggling TSRs and poor operational performance in 2018; that after active shareholder engagement, the company further improved its executive compensation structure to better align CEO pay with performance, as evidenced by significantly lower realized/realizable pay versus granted pay; and that the company also explicitly stated in its circular that it is committed to simplifying the short-term incentive plan to better reflect its 2019 strategic objectives and to replace option awards with restricted share units while it continues to assess alternatives to options in fiscal 2019.

With the exception of one year, Glass Lewis is more aggressive than ISS on say-on-pay recommendations.

Number of “Against” Recommendations On Say-On-Pay



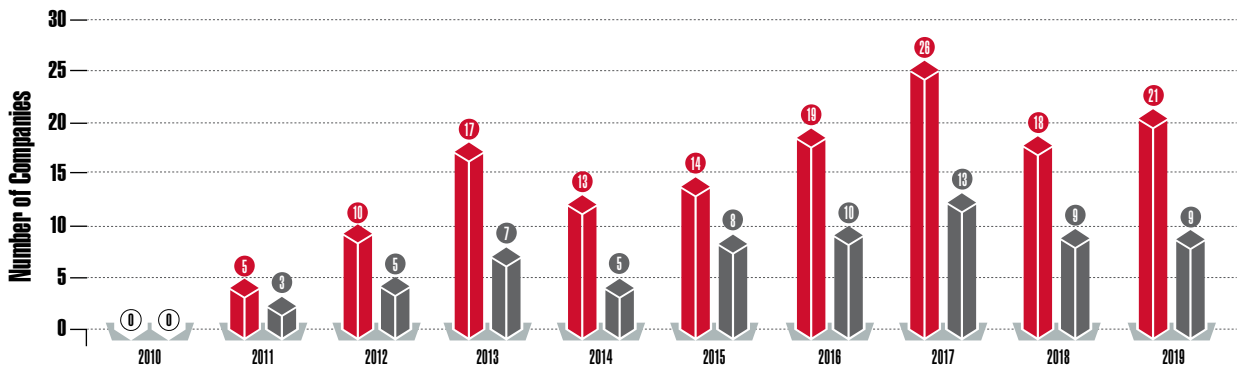
Companies with Less Than 80% / 70% Support

ISS expects companies to demonstrate reasonable “responsiveness” in addressing shareholders’ concerns if their say-on-pay proposals receive less than 70% of shareholders’ support, while Glass Lewis’s line is 80%. In 2019, we have seen a slight increase in the number of sub-80% companies, but the number of sub-70% companies remains the same as the year prior.

Figure R

Companies with Say-on-Pay Votes Receiving Less Than 80% and 70% Support

■ Less Than 80% Support
■ Less Than 70% Support



Companies with Less Than
80%
Support

21 companies with less than 80% support vs. 18 in 2018

Key Themes

Problematic severance payments

Need for robust performance metrics disclosure

Discretionary one-time payments

Red Flags in CEO Compensation

Of the 21 companies that received sub-80% say-on-pay shareholder support, 81% have a pay and performance disconnect concern, primarily due to underperformance along with pay practices that are not in line with best practices. Discretionary one-time payments, problematic severance arrangements upon change-in-control, and insufficient disclosure of incentive award metrics are three prominent concerns raised by proxy advisors and institutional shareholders that can lead to say-on-pay failures.

Discretionary one-time payments:

Discretionary one-time payments such as a sign-on bonus and retention grants to NEOs are generally viewed as problematic pay practices by shareholders and proxy advisors. From their perspective, a rigorously designed executive compensation scheme should be robust enough to incentivize and reward outstanding performance. For those companies that have already granted a one-time bonus or award, they need to consider disclosing the amount and the compensation committee’s rationale for the grant in the management circular, rather than burying the figures in the summary compensation table or with blanket statements.

Problematic severance arrangements

upon change-in-control: Single-trigger and/or excessive severance payouts are also attracting scrutiny. From the proxy advisors’ perspective, severance is intended as a protection against involuntary job loss, and therefore should not be paid under voluntary retirement or “performance termination”. Best practice is to adopt double-trigger provisions that require the termination of executives without cause following a change-in-control before receiving the full severance package.

Insufficient disclosure of incentive

award metrics: Proxy advisors traditionally examine the performance metrics and performance periods of companies’ performance share units (PSUs) to determine their robustness. Problematic practices include the use of similar performance metrics under both STIP and LTIP, short performance measurement periods (i.e. less than three years), discretion in granting performance equity awards, and insufficient disclosure of long-term performance metrics. In recent years, institutional shareholders have also been increasingly calling for a greater proportion of performance-based equity awards in a CEO’s long-term incentive

awards. At the same time, we are seeing more companies that received low support for say-on-pay in previous years committing to introducing or increasing their use of PSUs as a positive remedy practice to show responsiveness. For companies that make such commitments to shareholders in their circular, it is equally important to communicate clearly the concept and timeline of the new program.

Say-on-Pay by Sector

In 2019, the energy and materials sectors both witnessed similar gaps between average and median say-on-pay support levels, as the two sectors had the lowest support levels compared to other sectors as well as two of the three failed

companies. While the communication services sector also had a low level of support for say-on-pay, we note this was mainly driven by the failed vote at IMAX.

Figure S

Say-on-Pay Sector Profile

■ Average Support
■ Median Support



Companies That Failed in 2018 – Where Are They Now?

One of the things we look at annually is how companies that fail say-on-pay respond to their failures and regain the trust of shareholders. Maxar Technologies Inc. (TSX:MAXR), IMAX, and Crescent Point Energy were the three companies that failed say-on-pay in 2018. At their AGMs this year, Maxar and Crescent Point Energy's say-on-pay resolutions received overwhelming support, while IMAX's resolution, once again failed.

Crescent Point Energy failed its say-on-pay last year with 38.52% support. This year, the company received 87.54% shareholder support and was supported by both ISS and Glass Lewis. It should be noted that last year the company was trapped in a heated proxy fight against Cation Capital, which attacked the company's misalignment of pay and performance. Under this spotlight, the company's executive compensation was highly scrutinized by proxy advisors and disgruntled shareholders. Following the victory in the proxy contest, however,

Crescent Point Energy appointed a new CEO and held an uncontested AGM in 2019. Despite the legacy CEO pay issues, proxy advisors acknowledged the transition to a new senior leadership team and the enhanced pay and performance linkage for the new CEO, thus downgrading their concerns upon qualitative analysis and issuing "for" recommendations.

Maxar Technologies held a special meeting in November 2018, seeking shareholders' approval of U.S. domestication. Maxar U.S. became the parent company of Maxar Canada and its subsidiaries. At its 2019 annual meeting, Maxar received 75% shareholder support for its say-on-pay.

IMAX, as noted earlier, again failed its say-on-pay for the third consecutive year. As in 2017, both ISS and Glass Lewis recommended against its say-on-pay. IMAX's support fell from 43.17% in 2018 to 39.3% in 2019. While the

company made several changes to its compensation programs, including a new benchmarking peer group and a decrease in the discretionary component of its bonus program from 50% to 20% of the overall target opportunity. Despite these changes, the CEO received twice the bonus he was granted in fiscal 2017 and the company had poor short-term performance, resulting in a significant pay-for-performance misalignment.

It is worth noting that several other companies that received low levels of support in 2018 have substantially improved their say-on-pay support levels in 2019 by addressing shareholder concerns. Qualitatively, as a vast majority of these companies are Kingsdale clients, we can tell you that the two factors that lead to higher levels of support are: director-led engagement with shareholders that includes the chair of the compensation committee; and active adoption of, and commitment to, executive compensation best practices.

| NOTABLE SAY-ON-PAY TURNAROUNDS | | | | |
|---|--------|--------|--------|--|
| COMPANY | 2018 | 2019 | Change | |
| Crescent Point Energy Corp. | 38.52% | 87.54% | 49.02% | |
| Alacer Gold Corp. (TSX:ASR) | 60.36% | 98.08% | 37.72% | |
| TransGlobe Energy Corporation (TSX:TGL) | 62.43% | 94.19% | 31.76% | |
| Canadian Pacific Railway Ltd. | 70.11% | 95.82% | 25.71% | |
| Pretium Resources Inc. (TSX:PVG) | 57.97% | 76.72% | 18.75% | |
| Atlantic Power Corp. (TSX:ATP) | 77.62% | 95.40% | 17.78% | |
| ECN Capital Corp. (TSX:ECN) | 76.07% | 86.13% | 10.06% | |
| Aimia Inc. (TSX:AIM) | 77.39% | 84.09% | 6.70% | |
| NOVAGOLD Resources Inc. (TSX:NG) | 77.77% | 83.41% | 5.64% | |

Largest improvements for say-on-pay results amongst companies that failed say-on-pay or fell below engagement thresholds.

Rules on Stock Options

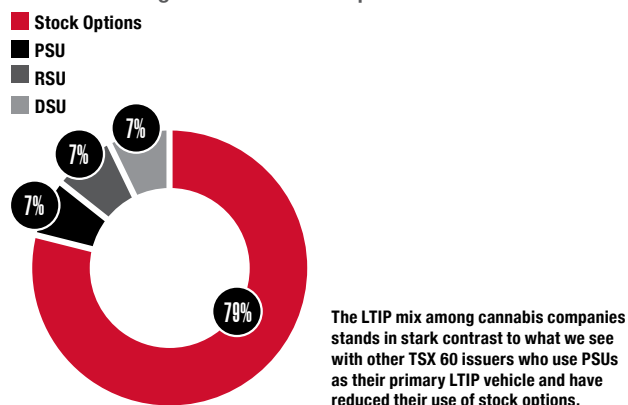
With the rise of PSUs – and, to a lesser extent, restricted share units (RSUs) – we are continuing to see a steady decline in the use of stock options, especially among mid- and large-sized companies. The exception, not surprisingly, is the

cannabis industry, where the largest companies still use stock options as the primary equity instrument. Of the TSX-listed cannabis companies, Village Farms International (TSX:VFF) is the only one to adopt a PSU program tied

to their 2017 cannabis strategy, which involved “identifying and partnering with an existing public Licensed Producer (“LP”) who was willing to enter into a joint venture with the company”.

Figure T

LTIP Mix Among the Cannabis Companies



One of the reasons stock options have been a popular equity instrument among Canadian issuers is the tax advantage, which essentially provides capital-gain-like tax treatment to the proceeds realized from the exercise of option awards. However, the proposed changes to stock option taxation, as tabled in Canada’s 2019 federal budget, will likely

limit the use of stock options, as most of the current preferential tax treatment will be taken away.

Given the uncertainty related to the timing of new stock option tax rules, discussions around the implications and possibility of doing an off-cycle grant prior to the effective date (January 1, 2020) will

certainly be on the agenda in many boardrooms this fall. Having said that, the very notion of re-introducing stock options and making a one-time grant off the regular cycle will be viewed very negatively by shareholders and proxy advisors. We have seen a few cases this year where ISS highlighted these practices in their benchmark reports.

ISS's 2020 Policy

ISS conducts an annual survey among its key stakeholders as part of its policy development process, with the objective of looking at potential policy changes for 2020 and beyond. With the commentary period for the survey having ended in August, we expect ISS to publish its final proposed changes to the existing guidelines later this year.

In the meantime, the survey provides us with a sneak peek at what the proxy advisor might be focusing on in developing its voting policies for the 2020 proxy season. The key questions affecting Canadian issuers include:

1. Board gender diversity: Through its survey, ISS is asking stakeholders to comment on gender diversity. Starting in 2020, ISS, under its U.S. proxy voting guidelines, will recommend against the chairs of nominating committees at Russell 3000 and S&P 1500 companies that have no female director representation on the board, subject to certain mitigating factors.

2. Director overboarding: In its survey, ISS is revisiting this issue, given that “some large institutional investors have recently tightened their limits on director overboarding”. For CEOs, ISS is asking stakeholders to choose an option of up to three boards, and for professional directors, they are asking them to choose up to a maximum of six boards. In our view, the maximum number of boards on which directors can serve will likely remain the same as 2019, where independent directors can be on five boards in total and a CEO can be on a total of three boards, including his or her home board.

3. Director accountability related to climate change risks: Recognizing the increasing importance to investors of climate change risks, ISS is asking participants for their views on appropriate actions in response to failure to address related risks. The survey provides alternatives including board/management engagement, supporting related shareholder

proposals, and voting against board members as appropriate.

4. Adopt economic value added (EVA) as a secondary quantitative performance measure: For context, ISS included EVA for information purposes in its 2019 benchmark research reports, and is planning to incorporate EVA metrics into the secondary Financial Performance Assessment (FPA) test moving forward. ISS may continue to display the previously used generally accepted accounting principles (GAAP) metric separately as a point of comparison. (We explore EVA in greater detail on page 46.)

It is worth noting that, in 2018, for the first time, Glass Lewis publicly sought comments to its guidelines from all market participants as part of its increasingly transparent policy formulation process. However, contrary to ISS’s approach, Glass Lewis relies on voluntary submission rather than conducting an annual formal survey.

PROXY FIGHT



- With 7% ownership, disgruntled director Meir Jakobsohn (through his private company Medison Biotech), sought six of seven board seats and a new strategic direction at Knight Therapeutics Inc.'s AGM
- Jakobsohn also introduced a shareholder proposal designed to remove the founder and CEO from the company
- With Jakobsohn launching a social media and PR campaign, Kingsdale's strategic communications, media, and shareholder outreach strategy highlighted Knight's strong performance, track record, and risk of change
- Resulted in all management's director nominees being elected, Jakobsohn not being re-elected, and the shareholder proposal being soundly defeated

PROXY FIGHT



- The Concerned Shareholders of Guyana Goldfields Inc. requisitioned a meeting of shareholders after the former chairman was removed and the incumbent board oversaw a period of significant value destruction
- Kingsdale won early support from shareholders and dominated the media agenda with a pro-active strategy – including a comprehensive press release strategy and digital campaign – designed to pressure the company
- Resulted in a settlement, with the CEO who had been targeted leaving as well as a new board, with five of seven directors replaced since the proxy fight was launched

PROXY FIGHT



- Waterton Global Resource Management, the second largest investor in Hudbay Minerals Inc., nominated ten (later revised to four) individuals at the company's AGM, criticizing board entrenchment and poor performance vs. peers
- Kingsdale advised on the use of a universal proxy, organized an aggressive top shareholder outreach strategy, and prepared Waterton for critical meetings with ISS and Glass Lewis
- Hudbay and Waterton entered into a settlement agreement whereby both parties agreed on 11 nominees – including three Waterton nominees – and Hudbay committed to finding a successor to the long-tenured board chair

PROXY FIGHT



- Mangrove Partners and Bluescape Energy Partners, together owning approximately 10% of TransAlta Corporation's shares, announced their intention to nominate five out of 11 directors at the company's AGSM, attacking TransAlta's share performance
- On March 25, 2019 TransAlta announced a strategic investment by Brookfield Renewable Partners which the activists publicly opposed; the agreement provided for the appointment of two Brookfield nominees to the board
- Mangrove announced its intention to withhold votes from TransAlta's special committee members
- Through the development of a white paper for ISS and Glass Lewis and a proactive outreach campaign, Kingsdale helped ensure all of management's director nominees were elected and a high-water mark for shareholder turnout was reached

PROXY FIGHT



- Just weeks before Methanex Corporation's AGM, M&G Investments, the company's largest shareholder with 16.5%, nominated four individuals to the board as a means of thwarting a potential new project
- M&G targeted long-tenured directors, arguing that they lacked independence
- Kingsdale led the process of engaging ISS and Glass Lewis, developing shareholder communication assets and getting key messages out to shareholders, garnering overwhelming support behind the scenes
- Resulted in Methanex and M&G entering into a cooperation agreement, two weeks before the meeting, whereby M&G received one out of 11 board seats at the meeting, and an additional seat being mutually agreed to through future board refreshment

CONTESTED M&A



- Ensign Energy Services Inc., a 9.8% shareholder of Trinidad Drilling Ltd., made an unsolicited all-cash bid for Trinidad Drilling
- Trinidad rejected the offer, instead opting for Precision Drilling's white knight all-stock offer
- Kingsdale advised on a strategy whereby Ensign shortened the bid period to ensure shareholders tendered before a vote on Precision Drilling's offer
- With the shortened bid period, Kingsdale mounted a fire-drill outreach and PR campaign and reached a majority of shareholders, who tendered before Trinidad could vote on Precision's offer
- Resulted in Ensign owning almost 90% of the outstanding shares of Trinidad, subsequent to the mandatory extension, and completion of the amalgamation

AN UNMATCHED BREADTH OF EXPERIENCE

Select Recent Client Wins

CONTESTED M&A



- Canopy Growth Corporation and Acreage Holdings, Inc. announced a plan of arrangement as part of a first-of-its-kind cross-border deal whereby Canopy would acquire Acreage upon federal permissibility of cannabis in the U.S.
- The initial announcement was met with confusion from the market and public opposition from Marcato Capital Management
- Following the initial announcement, and given the complexity of the deal, both companies hired Kingsdale
- Kingsdale developed a comprehensive traditional and digital communications strategy to clear up the confusion in the market, and implemented an aggressive, retail-heavy outreach campaign
- Resulted in shareholders of both companies voting overwhelmingly in favour of the deal

CONTESTED M&A



- In January 2019, Newmont Mining Corp. announced plans to buy Goldcorp Inc. in a US\$10 billion acquisition, a deal that would create the world's largest gold company
- Paulson & Co., a major shareholder of Newmont, publicly opposed the merger and, in March, Barrick Gold attempted to scuttle the deal with an unsolicited takeover bid for Newmont
- Kingsdale advised on a strategy for ISS and Glass Lewis which resulted in both proxy advisors recommending that shareholders vote for the Newmont transaction
- Kingsdale successfully launched an aggressive outreach campaign to Goldcorp shareholders that resulted in more than 97% of the shares being voted in favour of the deal

BALANCE SHEET RECAPITALIZATION



- Jupiter Resources Inc. proposed a recapitalization plan by way of a corporate plan of arrangement to exchange US\$1.1 billion 8.5% senior notes for equity in a new private company
- Kingsdale was engaged as Jupiter's exchange and escrow agent and created a system for holders to provide beneficial ownership details through the custodian network, established a process to enable creditors to elect whether to participate in a subscription for additional equity, captured registration instructions for new private equity, maintained the participation records, calculated all netted entitlements, and settled entitlements with creditors
- The settlement occurred without any operational issues with 99.67% of US\$1.1 billion of senior notes providing registration instructions

RESTRUCTURING SUPPORT



- Three years after filing for credit protection, Essar Algoma Steel received a credit bid whereby noteholders and term lenders would acquire the assets of the company
- After failed attempts to work with the trustee to move the credit bid forward, Kingsdale was retained as an exchange and escrow agent to facilitate the bid in a short period of time, as agreements with the federal government and labour unions were set to expire
- Since the new securities were held on the books of a Luxembourg registrar, Kingsdale worked with counsel to create a process to facilitate exchange for considerations under Luxembourg law
- Kingsdale expedited DTC processing to ensure smooth settlement and convinced the trustee to process what was a one-off transaction deviating from their standard processes
- Credit bid was successfully completed within required timeframe

PLAN OF ARRANGEMENT AND RECAPITALIZATION TRANSACTION



- In March 2019, Bellatrix Exploration Ltd. announced a recapitalization plan involving the consolidation of common shares, the exchange of convertible debentures for new common shares, exchange of senior unsecured notes for new third lien notes and new common shares
- Kingsdale was engaged as the company's proxy, information, and exchange agent, and worked seamlessly with the transaction's two trustees, one transfer agent, and three depositories, to develop a straightforward process for implementation and settlement
- The transaction was supported by 88.47% of the common shareholders, 99.51% of the convertible debenture holders, and 100% of the senior secured noteholders, with vote turnout at 88.13% for the convertible debentures and 99.50% of the senior unsecured noteholders

Issues on the Horizon

UNDERSTANDING THE IMPACT OF AMERICA'S CLAMPDOWN ON PROXY ADVISORS

In 2003, the U.S. Securities & Exchange Commission (SEC) put forward a rule that required institutional investors to disclose their votes and provide an explanation as to why they voted the way they did. This paved the way for the rapid growth and influence of proxy advisors such as Institutional Shareholder Services, Inc. (ISS) and Glass Lewis, & Co. (Glass Lewis), which quickly became a cost- and time-effective resource for funds seeking to rationalize their vote decisions.

Today, the SEC has once again shifted the paradigm by declaring that proxy voting advice provided by proxy advisory firms generally constitutes a “solicitation” under U.S. federal proxy rules and by issuing guidelines for investment advisors to follow when voting for their clients. When the SEC started its process, it was

clearly interested in reforms that would “rebalance” the role of the proxy advisors and “protect the interests of the broader shareholder universe”. U.S. politicians had previously advanced this agenda by introducing bills – such as House Bill 4015, introduced in 2017 and passed in 2018, and Senate Bill 3614, introduced in fall 2018 – requiring proxy advisors to register with the SEC, among other things. While none of these bills became law, they have helped to fan the flames of public attention on an issue most average investors know nothing about.

It is estimated that ISS and Glass Lewis have more than 97% market share in the proxy advisory space, with Egan-Jones, Segal Marco Advisors, and ProxyVote Plus making up the balance, with many investors subscribing to more than one. As establishing a proxy advisory firm

takes not only a significant financial investment but also a tremendous knowledge base, it is unlikely any new entrant or even one of the smaller players will shift this balance any time soon. From routine annual meetings to contested situations to a rapidly increasing focus on environmental, social, and governance (ESG) issues, ISS and Glass Lewis are seen by critics as being able to impose on corporate America the will of certain shareholders, especially those with special or activist interests, which may or may not be aligned with the best interests of the company and other shareholders. By their subscribers, they are seen as an irreplaceable partner in helping to ensure high governance standards and an accountability check on companies that might otherwise go unchecked and become another Enron.

How Did We Get Here?

While calls to regulate or “crack down” on proxy advisors are not necessarily new – indeed, they have flared up from time to time over the last 15 years – the present debate has been stoked by a confluence of combustible factors. A series of high-profile, controversial decisions from proxy advisors, complaints from well-funded companies about “mistakes”, a business-friendly administration in the White House, and a general populist mood in the U.S. led SEC Commissioner, Elad Roisman, to call the vote recommendation process led by proxy advisors “complex” and “unreliable”.

Critics argue that unless you have spent years in the industry, and inside the proxy advisors themselves, there is little transparency about how they construct their analysis and resulting vote recommendations. Once you figure it out, chances are they’ll change their

approach, adding a new, hidden layer of complexity to their formula. This can be massively frustrating for boards that are trying to thread the needle by formulating shareholder proposals that are both the right thing for the business and will win over ISS and Glass Lewis.

When you add in so-called robo-voting (where shareholders are set to auto-vote their proxies based on a proxy advisor’s recommendation) and the challenges of correcting what is seen as incorrect commentary, the frustration related to the inability to alter an influential but opaque process is compounded.

We do not believe curbing independent research that is entirely paid for by subscribers is the most urgent matter that securities regulators on either side of the border should be focused on. Proxy advisors play an important role in the capital markets by providing a check and balance on the evolution of governance practices and, at the end of the day, shareholders are free to follow or not follow their advice as they see fit.

Kingsdale Advisors

The Case for Regulation

Led by high-profile organizations such as the U.S. Chamber of Commerce, the National Association of Manufacturers, NASDAQ, and the New York Stock Exchange, the campaign against proxy advisors hinges on fairness to corporate America and the small retail shareholders whose interests they have co-opted to validate their cause.

Specifically, these groups argue that companies should have more ability to address proxy advisors’ recommendations before they are handed to shareholders, and perceived conflicts of interest and a lack of transparency must be openly addressed. For example, ISS has been singled out because it sells consulting services to companies via ISS Corporate Solutions (ICS) while also providing vote recommendations on the same companies.

Proponents for regulation even launched a million-dollar ad campaign and website (www.proxyreforms.com) designed to put the spotlight on proxy advisors and their purported shortcomings, positioning them as unregulated, secretive entities prone to mistakes and conflicts of interest that “put the retirement savings of hardworking Americans at risk”.

Numerous solutions to these concerns have been presented, including registering with the SEC, establishing an ombudsman and compliance officer

at each proxy advisor, requiring the filing of documents with the SEC, and a general prohibition on “unfair, coercive, or abusive practices”.

At the very least, supporters of regulation have suggested that providing voting guidance should be considered as proxy solicitation and should follow applicable SEC rules and that proxy advisors should disclose and protect against conflicts of interest – a view the SEC has taken heed of.

In the end, whether or not you subscribe to this view depends on whether or not you believe a proxy advisor has the capability to sufficiently evaluate the issues they are presented with and whether or not you believe the investors who subscribe have the time, resources, and competency to analyze the recommendations given.

Anecdotally, at Kingsdale, we know, from our conversations with shareholders and from witnessing the expansion of in-house governance teams, that shareholders are taking back the decision-making process (to the extent it ever really left) as governance is increasingly seen not only as a risk mitigation screen but also as a lever to create value. Custom voting policies are being designed and refined to reflect underlying client appetites and to create a competitive advantage.

While ISS and Glass Lewis have become data points for further internal analysis, they are no longer seen as the ultimate decision-makers on how shareholders vote.

It is worth noting that for all the talk of conflicts of interest, a lack of transparency, and factual errors in their analytical processes, most of it does not appear to be coming from the most important part of the proxy advisor and shareholder voting equation: those who are actually paying for the vote recommendations. At an SEC roundtable held in November 2018, investors expressed general satisfaction with the service provided by proxy advisors.

SEC Clampdown: Guidelines, Not More Regulation

On August 21, 2019, the SEC issued two sets of new guidelines to address these issues and clarify how various entities can comply with existing laws or regulations that it believes apply. Specifically, the SEC issued an interpretation clarifying why it believes proxy advisory firms' advice is considered "solicitation", or a "communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy". As such, existing regulations require such entities to provide underlying facts, reasoning, and assumptions to demonstrate that their advice is not misleading. The SEC also clarified that proxy advisors cannot share recommendations that are materially false or misleading under the applicable federal rules.

In addition, the SEC issued guidance to assist investment advisors in fulfilling their proxy voting responsibilities. The guidance did not impose any new requirements on asset managers but provided ways they can oversee proxy advisory firms and fulfill their fiduciary duty to their clients. Of note, they offer guidance for investment advisors on how to judge whether retaining a proxy advisor is appropriate, actions to take if they believe a proxy advisor has made an error of fact or omission, and how to evaluate the service provided on an ongoing basis.

SEC Guidelines for ISS and Glass Lewis

Proxy advisors should consider disclosing:

- Methodology used to formulate advice and deviations from previous guidelines
- Third-party sources used
- The extent to which third-party materials were factored in
- Conflicts of interest
- That such conflicts of interest be explained in "reasonably sufficient detail"

What Do the Statistics Say?

Unfortunately for the advocates of regulation, the statistics do not back up their thesis of blind voting, with evidence that shareholders make their own decisions, especially in contested situations when the stakes are presumably higher.

Large Fund Adherence to ISS and Glass Lewis

| HOW THEY VOTED ON BOARD SEATS | | | |
|-------------------------------|--------------------------|------------------|--------------------------|
| | % Supports Management | % Matches ISS | % Matches Glass Lewis |
| BlackRock | 91.00% | 93.20% | 85.80% |
| Vanguard | 93.90% | 94.90% | 85.10% |
| Charles Schwab | 87.80% | 88.40% | 98.30% |
| State Street | 88.50% | 93.00% | 84.40% |
| Fidelity | 90.00% | 91.70% | 86.90% |
| PIMCO | 89.10% | 96.10% | 86.40% |
| Invesco | 92.20% | 96.40% | 90.70% |
| Northern Trust | 90.40% | 96.50% | 86.10% |
| First Trust | 93.10% | 99.90% | 92.90% |
| Van Eck | 83.10% | 85.30% | 98.60% |

| HOW THEY VOTED ON SAY-ON-PAY | | | |
|------------------------------|--------------------------|------------------|--------------------------|
| | % Supports Management | % Matches ISS | % Matches Glass Lewis |
| BlackRock | 91.00% | 86.10% | 79.90% |
| Vanguard | 93.90% | 89.20% | 83.80% |
| Charles Schwab | 87.30% | 85.10% | 97.80% |
| State Street | 88.50% | 91.00% | 82.00% |
| Fidelity | 90.00% | 85.60% | 82.80% |
| PIMCO | 89.10% | 96.90% | 83.50% |
| Invesco | 92.20% | 94.00% | 87.00% |
| Northern Trust | 90.40% | 88.30% | 81.90% |
| First Trust | 93.10% | 99.70% | 87.90% |
| Van Eck | 83.10% | 81.90% | 99.10% |

| HOW THEY VOTED ON CONTESTED SITUATIONS | | | |
|--|--------------------------|------------------|--------------------------|
| | % Supports Management | % Matches ISS | % Matches Glass Lewis |
| BlackRock | 70.77% | 64.77% | 69.35% |
| Vanguard | 75.44% | 64.94% | 70.30% |
| Charles Schwab | 57.48% | 79.17% | 93.50% |
| State Street | 76.79% | 64.19% | 67.68% |
| Fidelity | 70.83% | 66.18% | 71.83% |
| PIMCO | 75.00% | 62.50% | 37.50% |
| Invesco | 65.22% | 84.44% | 68.89% |
| Northern Trust | 73.48% | 71.52% | 62.29% |
| First Trust | 50.00% | 100.00% | 66.67% |
| Van Eck | 68.42% | 81.25% | 86.84% |

Companies listed in order of AUM

As the tables above show, the largest deviations from ISS and Glass Lewis occurred in contested situations where there is more choice and more analysis required.

In the high profile example of the 2018 proxy battle between Cation Capital and Crescent Point Energy Corp. (TSX:CPG), Crescent Point's full management slate was elected despite ISS's recommendation for two activist nominees, while say-on-pay was defeated in line with ISS's recommendation "against".

Even on routine matters where the voting is presumably much more straightforward, the world's largest investors still demonstrate their independent mindset. To the extent there is vote alignment, it does not mean blind adherence, just agreement on the right voting decision between multiple entities – including, in many instances, management. We also don't know if this is simply a correlation or causation.

Kingsdale's Take

As critics of proxy advisory firms have called the SEC's guidelines a "first step" and expressed the desire to see it and other regulators take further action, we do not believe this issue has gone away. Yes, it may quiet down as the market digests the impact, but once a controversial decision again comes into the spotlight, it is likely business groups will again drive forward for full regulation.

If further, more formal changes were to be made in the U.S., maintaining the status quo in Canada would be challenging, as Canadian regulators would likely come under pressure to enact similar reforms and proactively move to adopt the new practices in this market.

In our view, the key issue is not the proxy advisors themselves but whether or not a company believes a shareholder is capable of making a fully informed decision, regardless of what ISS and Glass Lewis might say. It is akin to an athlete lamenting one call by a referee in the final seconds of the fourth quarter when the team did nothing to help its chances of winning for the first 99% of the game. Don't put yourself in a situation where someone else can decide your fate.

The most common mistake we see is a lack of – or imprecise – disclosure by the issuer leading to analysis by the proxy advisors that the issuer deems unfair. Make your case thoroughly and clearly.

Proxy advisors have a role to play in the capital markets by providing a check and balance on the evolution of governance practices and, at the end of the day, shareholders are free to follow or not follow their advice as they see fit. Weakening the proxy advisors won't result in weakening the votes for a company, only those against a company.

We do not believe shareholders are looking for politicians to dictate a structure that tells them how to interact with a private service provider they have contracted. Regulating or restricting an independent third party from providing voting advice would be like regulating the editorials of newspapers during political elections who espouse their views on how people should vote. We believe shareholders are more than capable of making their own judgments and critically reviewing the analysis they receive – if they choose to.

To the extent further change is demanded, that change should be within the purview of the subscriber and those

who they have contracted to provide services. Presumably, if the service providers are getting it wrong, their clients will take them to task and policies will be updated via their respective annual survey processes.

Proxy advisors are providing what their subscribers have requested – advice that fits within the scope they have defined for how they want to vote on certain matters. They are not looking for additional commentary or arguments from management – that is already available to them in the company's proxy solicitation materials and from direct engagement with management itself. If a company wants to ensure ISS and Glass Lewis provide clarity beyond the proxy materials they have filed, they have the opportunity to discuss it with them and to file additional information at any point prior to, or after, the release of the proxy advisors' reports.

We indeed note the sensitivities around this topic, given that a small number of auto-votes can greatly impact the outcome of a proxy battle.

Anecdotally, we have found that in certain situations, such as a contested vote or a questionable say-on-pay recommendation, subscribing shareholders are willing to hear an alternative argument from the company on why their circumstance should be considered unique. After all, with hundreds of millions if not billions invested, why wouldn't they want to ensure they get it right?

We would be more inclined to give credence to the concerns raised if there were evidence that "passive" investing meant more passive voting and deferral to the proxy advisors alone, without sober second thought, but that does not appear to be the case.

It is incumbent on companies concerned about ISS and Glass Lewis to take accountability for ensuring their shareholders are fully informed before a vote – in fact, well before. Here is what we recommend:

- Actively engage shareholders so the voices of ISS and Glass Lewis are not heard in isolation
- Understand ISS and Glass Lewis policies and to what extent the unique circumstances of your company will be considered in their analysis

- Understand how shareholders make their voting decisions, what their internal voting policies are, and the extent to which they deviate from the proxy advisors
- Seek to engage the proxy advisors outside of proxy season to ensure their analysts are well versed in your company and its industry
- Make use of ISS's draft review process (for TSX Composite Index companies) and the pre-publication review of annual meeting reports
- Sign up for the Glass Lewis issuer data report to review certain displayed data (but not the analysis of the report)
- Make clear disclosure (mainly via proxy materials) to justify the decisions made by your board

A GOLD RUSH FOR ACTIVIST INVESTORS

If you are part of the board or management of a Canadian gold company this year, chances are you have been discussing industry consolidation and/or unhappy shareholders.

Over the past year, we've seen behemoths Barrick Gold Corp. (TSX:ABX) and Newmont Mining Corp. (now Newmont Goldcorp Corp. (TSX: NGT)) grab headlines with acquisitions of Randgold Resources Ltd. and Goldcorp Inc., respectively, and the junior and intermediate space has seen a flurry of deals as well. In fact, since Q4, 2018, we have seen over \$27 billion in deals involving Canadian-listed companies announced in the gold industry.

At the same time, shareholders have launched high-profile campaigns against

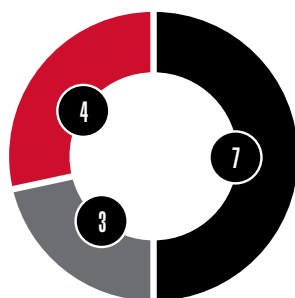
struggling gold miners, with part of the shareholders' basis for change related to the viability of M&A opportunities. Over the past 28 months, there have been 15 proxy battles in this sector, launched by activists who claim to have suffered through years of value destruction, failed acquisitions, mismanaged permitting, and misaligned compensation schemes. High-profile proxy contests included Detour Gold Corp. (TSX:DGC), Guyana Goldfields Inc. (TSX:GUY), and Hudbay Minerals Inc. (TSX:HBM), an integrated mining company with some exposure to gold that is nonetheless instructive.

More often than not, activists are winning these battles. Of the 14 proxy contests completed since 2017, activists have earned at least partial victories in ten battles.

Figure U

Gold Sector: Proxy Contest Outcome (2017–2019)

- Management Win
- Activist Partial Win
- Activist Win



Gold Miners Beware: Activists May Still Be Lurking

Even as share prices have recently improved, directors and management cannot afford to be complacent. An improved share price can only serve to buy them time to address ongoing underlying issues that range from operational to governance – it cannot appease a shareholder with a taste for change.

Today's gold activists are, for the most part, unclassifiable. They can be anyone – from a well-known fund to a former insider to an average shareholder willing to organize. What they have in common is the ability to engage other shareholders, industry expertise, media savvy, and the resources and stomach to embark on a lengthy proxy contest.

Late last year, we saw the formation of the Shareholders' Gold Council (SGC), a group of 17 gold investors including New

York-based hedge fund, Paulson & Co. Inc., and activist funds, Coast Capital and Livermore Partners, established with a mandate to monitor and report on the governance and performance of gold miners. The group has fired public relations salvos against gold companies for their perceived governance weaknesses, in particular, executive compensation and the lack of stock ownership among board members.

Despite this increased scrutiny, too many miners remain unprepared to deal with potential activists because of a misguided presumption of shareholder support, a lack of awareness about what they could be doing proactively to prepare, or an erroneous belief that they could never become a target.

Kingsdale's Take

For years, we have heard shareholders voice a growing list of concerns that too often fall on deaf ears. The persistence of what shareholders see as repeated and avoidable errors, either in operations or judgment, are leading more and more investors to a breaking point.

Over and over, we have heard shareholders complain – first privately and now, increasingly, publicly – about sustained poor performance vs. peers or the index; poor market guidance; project delays; capital overruns; inability to secure “routine” permits and negotiate licences; and excessive compensation.

When you layer onto these frustrations a series of performance issues, concerns about boards with little to no share ownership, long tenures, “entrenchment”, and a cozy relationship between too many directors, it is no wonder that shareholders have grown restless. Put another way, investors have lost faith in the ability of the boards of gold mining companies to manage risk and are seeking out ways to push for change.

The good news is that there are proactive steps boards can take to defend against activists.

- **Undertake a deep and critical self-analysis.** Activist investors are calling out gold companies and their boards for a lack of “skin in the game”, prolonged value destruction, missed guidance, failed life-of-mine plans, and, ultimately, a lack of director accountability. Go beyond a simple

SWOT analysis and put your company in a constant state of internal review, with an eye towards identifying flashpoints that could attract activists.

- **Don't underperform on the things you can control.** Leverage to the commodity price means gold companies gain more when the gold price increases and lose more when the price decreases. It is also why missing production guidance, delayed project timelines, and mine cost overruns hurt more, as they consume valuable capital and delay the all-important free cashflow. In the past, management has been able to use leverage to the commodity price of gold to take credit for share price increases during market upturns and defer responsibility on the downturns. That era is over; management needs to be seen as building value in a down cycle by being proactive on securing social licence, investing in technology and processes to drive down all-in sustaining costs, and increasing reserves, while remaining prudent on capital decisions by setting stringent hurdle rates for capital investment.

- **Understand your shareholders.** Knowing who your shareholders are is one thing, but understanding their concerns is quite another. Shareholders want to know you are listening – which means demonstrating you have considered and acted on their concerns to the extent they are consistent with the company's strategy and path to value creation. Companies must place renewed importance on

communicating their strategy with institutional investors and appealing to their unique preferences.

- **Ensure alignment with shareholders.** Pay-for-performance and performance share units initiatives for executives remain the best way to hold board members accountable and align their goals with shareholders' goals. Total shareholder return (TSR) also remains a popular vesting criterion due to its objectivity and simplicity. In a leveraged industry where critics accuse management of hiding behind commodity prices, these measures reinforce management's commitment to shareholder value.
- **Ensure the right directors for the right time.** Shareholders view an ongoing commitment to board refreshment as an indication the board has the up-to-date technical expertise and fresh thinking it needs. ISS and Glass Lewis will likely look negatively on companies with more than one-third of their board having a tenure of nine or more years, and some shareholders have even more stringent views. Having directors experienced in each stage of the mining lifecycle can align with prudent refresh timelines.

What the recent activist campaigns have proven is that any gold company, no matter its profile, size, or asset base, can be an activist target. Our advice to boards across Canada is simple: Be prepared; the decisions you make today can have long-lasting consequences.

FALL OF THE IVORY TOWER: WHY CONTROLLED COMPANIES ARE NOT IMMUNE FROM SHAREHOLDER ACTIVISM

Despite longstanding complaints about governance and the tyranny of a few who may or may not hold a meaningful economic interest in the company they founded and/or now control, investors have continued to choose to put their money in controlled or quasi-controlled companies. What has changed is that minority shareholders are no longer content to sit quietly and go along for the ride, increasingly demonstrating they are willing to pull on the few levers of activism and change available at these companies.

Companies that were set up to inoculate themselves from the whims of shareholders have now become targets. Even if directors aren't at risk of losing their seats in a vote, they are at risk of losing their reputations and being embarrassed into change.

While governance concerns usually provide the thin edge of the wedge to begin the advancement of change, the underlying driver for a minority shareholder is usually a dissatisfaction with the way the controlling entity is

running the business – not just in terms of current performance, but also in a lack of willingness to explore other accretive opportunities that may impact the controller's vision for the company and status quo.

Many of today's controlled and quasi-controlled companies found their genesis in family enterprises that grew beyond the bounds of private ownership to embrace the opportunities of external capital and diversified ownership, for better or worse.

Given strong, centralized leadership from proven entrepreneur-managers, senior management, and closely aligned directors, the boards of these companies have traditionally seen themselves as only marginally accountable to minority shareholders that held slivers of “their company”. But all of this is starting to transform as shareholders have begun testing the waters for change. The fact is, controlled companies are no longer impenetrable. But will they realize this? And if not, at what cost?

A general awareness of the tools of shareholder activism, the advent of advocacy and advisory groups who target ESG issues at public companies (especially those who are seen as governance laggards), and advancing regulations related to disclosure and transparency have created an environment where controlled companies are exposed, at least from a reputational perspective. While it is unlikely a shareholder proposal related to something like executive pay disclosure would pass, it could serve to embarrass the company and educate the broader

shareholder base and market about the actions of the current management.

So far, 2019 has seen the greatest frequency of say-on-pay proposals received by controlled issuers. Furthermore, 2019 has seen an unprecedented level of shareholder support, with an average of 24.95%, compared to 20.65% in 2017 and 17.68% in 2015, years that had comparable volumes of proposals.

As the year has yet to end, we expect further say-on-pay proposals, which could break the high-water mark for shareholder support seen at Linamar Corporation’s (TSX:LNR) 2019 AGM, where almost 39% of shareholders voted in favour of implementing say-on-pay.

Activists have developed an appetite and motivation for chasing difficult targets.

How We Define Control

A controlled company is commonly defined as a corporation where more than 50% of voting power is held by a single person, entity, or group. This may be facilitated through a dual-class share structure or outright ownership of the majority of an issuer’s common shares outstanding.

A wider concept of control may also include quasi-controlled companies, wherein a stake of 20% or greater is held by a single person, entity, or group.

Both types of controlled groups are largely comprised of enterprises that were once family-operated or those that have a strategic partner with a large ownership stake. Despite partially divesting their significant ownership stakes, these families and stakeholders still maintain extraordinary influence over operating facets of these companies, from day-to-day strategy to overarching governance, largely influencing how the board is constituted, and the respective board and committee mandates.

Why Controlled Companies Are Vulnerable to Change: The Adapted Activist Playbook

Pursuing an activist course of action at controlled companies presents a unique set of challenges that often require some creativity on the part of the minority shareholder. Given the significant obstacles to immediate and meaningful change, these challenges result in what are often seen as “against all odds” campaigns.

Shareholders who target controlled companies modulate their campaigns with the understanding that it will often require a long, multi-staged process to advance change. Given that influencing meaningful change in a single instance of activism is likely impossible, from a pragmatic standpoint, controlled company activist tactics and goals differ from those of traditional activists. Tactically, activists will rely on informal avenues for change while aiming for more incremental objectives.

Absent conventional proxy fight and bargaining mechanisms – such as the threat of nominating and electing an activist director or requisitioning a meeting to force change – reputational damage and exposure are the primary forces that an activist at a controlled company can use to influence change.

A single campaign tied to a shareholder proposal or a withhold campaign targeted at a specific director may not result in immediate substantive change, but can act as a disciplinary mechanism by publicly shaming the board, serve as a lightning rod to attract and expose broader shareholder opposition that would be useful in a future campaign, or be used as a bargaining chip or lever to obtain smaller, more gradual, changes, such as adding new, independent members to the board or adjusting executive pay to reflect market realities. Through this lens, a successful campaign may not be one that passes, just one that exposes a controlled company’s entrenchment and opens the eyes of the controlling entity.

As such, when private pressure fails, an activist’s strategy at a controlled company usually centres on exacting maximum reputational damage to force change. Such campaigns can become a significant distraction and headache for the board and management to deal with. At Kingsdale, we have observed that campaigns against controlled companies generally retain a number of common features, with the activist seeking to:

- Undermine the image of the current board and controlling shareholder as competent business managers
- Identify and exploit divides between independent directors and the controlling shareholder’s representatives
- Where familial relationships exist, seek to divide the family members or position them against other directors
- Demonstrate unfair and abusive treatment of minority shareholders
- Shine a spotlight on what is seen as “self-dealing” in exposing related party transactions
- Demonstrate a divide between top management and the average worker on pay issues
- Illustrate divides where board and management are out of touch with other stakeholder groups beyond shareholders such as employees, unions, and the communities in which they operate

- Inflict brand damage that will impact business relations with customers, consumers, and the general public

Turquoise Hill Resources (TSX:TRQ) – with Rio Tinto plc (LSE:RIO) as its controlling owner with a majority stake of 50.8% – is a recent example of how pressure from a minority shareholder can negatively impact a controlled company.

At the start of 2018, SailingStone Capital Partners, Turquoise Hill's second largest owner, with a 12.1% stake, submitted a letter to Turquoise Hill's board of directors, including demands revolving

around independence concerns regarding the company's executives, employee independence from Rio Tinto, and management of a development in Mongolia.

Following further exchanges between the two parties, a concession was made whereby a new CEO was appointed, with significant improvements to the position's contract and compensation structure.

SailingStone's pressures continued again through 2019, with a release stating their intention to vote against Turquoise Hill's independent directors. This effort

to rally minority shareholders against management culminated in over 40% of Turquoise Hill's minority shareholders (including SailingStone and its significant stake) opposing the independent directors. Even though management's nominees were re-elected, there's no doubt that there was some reputational damage inflicted.

Who Are the Activists at Controlled Companies?

Against this backdrop, it is rare that a traditional activist fund, which would look for a widely dispersed shareholder base as one of its initial activist investment screens, would attempt to take a run at a controlled company. Instead, what we are seeing at controlled companies are activist initiatives being undertaken by traditionally long institutional investors and the shareholder advocacy groups that represent them.

By way of example, Bombardier Inc. (TSX:BBD.B), of which the Bombardier family controls 48.43% of voting rights, has received multiple shareholder proposals over the past four years, including proposals asking for more transparency, namely separate disclosure

of voting results by class of shares. The support levels of these proposals have steadily increased over the years, exceeding 20% for the first time in 2019, with the support of many prominent institutional shareholders, including Canada Pension Plan Investment Board (CPPIB), British Columbia Investment Management Corporation (BCI), Allianz Global Investors, RBC Global Asset Management, and BMO Global Asset Management.

In 2019, Bombardier also received a proposal from Mouvement d'éducation et de défense des actionnaires (MÉDAC) to collapse its dual-class share structure, which received the support of 21.7% of shareholders.

Conflicting Perceptions on Corporate Governance at Controlled Companies

There are conflicting views between the controlling and the controlled about what should constitute not necessarily "best" but "appropriate" governance practices at controlled companies.

From the control block's perspective, control is king, and corporate governance best practices – as defined by the broader market of widely held public companies – are a limiting mechanism that often force companies to take an unnecessarily short-term perspective and increased risk. Controlled companies argue that shareholders knew the structure they were investing in and, presumably with a controlling stake discount attached, liked it enough to invest. Just because some corporate governance fad is overtaking other parts of the market doesn't mean that it is

appropriate for the controlled company they freely invested in.

From the minority shareholder's perspective, basic corporate governance standards are a mechanism to limit the wanton and destructive use of public entities for the sole benefit of those holding a control position. Unchecked, a controlled board can easily fall down a path that results in significant value destruction, as was the case at Bombardier after management's questionable gamble on commercial aircraft contracts several years ago. Bombardier's stock has subsequently collapsed, losing 66% of its value following a high in June 2018, as the company shifts towards business aircraft and a reinvigoration of its rail manufacturing.

Specialized Shareholder Organizations Targeting Controlled Companies

Where an institutional investor itself may not be ready or willing to advance change on its own, there are a number of specialized shareholder organizations that are willing to take up its cause, particularly as it relates to improving corporate governance practices.

These include numerous institutional and retail-oriented advocacy groups, with varying degrees of influence, such as Shareholder Association for Research & Education (SHARE), MÉDAC, and Équo Shareholder Engagement Services (Équo). Each of these organizations serves to rally shareholders who may be irritated by poor governance practices and previous snubs at suggested changes, and may now be even further irritated by poor company performance.

SHARE, MÉDAC, and Équo orchestrate the proposal process on behalf of these shareholders, acting as project lead and advocate during attempts to implement say-on-pay votes or popular environmental and social initiatives. By offering a unified voice for discontented shareholders, these specialists have repeatedly plagued the management teams of various target controlled companies throughout recent years. Beyond helping shareholders advance certain issues via proposals, these entities have also attempted to provide guidance for best practices for controlled companies, including yearly updates to policies crafted and endorsed by their governance teams.

As proposals are received by controlled companies with increasing frequency, it is clear the market has an appetite for this behaviour and understands the long horizon required for change. As such, SHARE, MÉDAC, and Équo will continue to push their agendas at controlled companies.

These two views – and their willingness to tolerate each other's positions – are continuously influenced by a few key situational factors. In addition to the extent and severity of governance failings and the voting power of the controlling stakeholder, the company's performance on a short- and long-term basis are also key.

First, the nature of the controlling stake, in combination with the dynamics of alignment and engagement between minority shareholders and the control block and the board, influences the perspective of minority shareholders. For example, do controlling entities retain their position based upon economic parity of ownership, or are their control positions a function of multiple share classes, which have been criticized as largely undemocratic? Recently, some companies have collapsed dual, or multiple, share class structures to provide a more egalitarian ownership structure, linking voting rights directly to economic interest in the company. However, examples still exist within

the Canadian market, such as CGI Inc. (TSX:GIB.A) or Alimentation Couche-Tard Inc. (TSX:ATD.A), whereby control is maintained through the use of multiple voting shares. This share structure effectively prevents dilution of control positions by mechanisms, such as an equity issuance or option exercise, that diminish individual minority shareholdings.

The unassailability of these control positions and the corresponding influence wielded in company-wide votes can be used as an excuse by management and the board not to engage with minority shareholders and can become, particularly during periods of poor performance, a point of disagreement around M&A opportunities or decisions regarding strategic direction.

Second, as at most companies, strong performance can increase shareholder tolerance for poor governance perspectives. But even if it doesn't and a company is attacked, controlling shareholders will use strong performance

metrics as a shield for weak corporate governance practices, leveraging the company's successes against a need to act on governance issues. In other words, what the world sees as a "best practice" may not be right for us as a controlled company and, as proof, look at our continued results. *Stop complaining and don't ruin a good thing.*

There is a belief that the level of control exerted can be of benefit to all shareholders, as it presents the opportunity for strong leadership to effectively dictate strategy, absent the many hurdles that challenge widely held companies.

In support of this argument, a September 2018 report issued by the National Bank of Canada, "The Family Advantage", found that over the last 13 years, family-controlled public companies have outperformed the TSX Composite Index, with an annualized return of 9.0% versus 6.7%.

Activist Flashpoint: Say-on-Pay

In recent years, the most significant point of contention between minority and controlling shareholders has been the implementation of a say-on-pay vote. Although say-on-pay proposals remain the dominant proposal received by controlled or quasi-controlled companies, recent years have reflected a minority shareholder desire for increased disclosure of E&S practices, anti-takeover measures, or director-related issues (proxy access or declassifying boards). This focus is understandable given the continued reluctance for controlled companies to embrace say-on-pay, requiring shareholders to take multiple runs at a company. As say-on-pay votes have become the generally accepted standard in Canada, it is becoming harder and harder for controlled companies to argue against change.

At controlled companies, say-on-pay proposals have frequently been met with cool responses from management. So far in 2019, five shareholder say-on-pay proposals have been submitted to controlled or quasi-controlled companies including CGI, Linamar, Power Corporation of Canada (TSE:POW), Saputo Inc. (TSE:SAP) and Imperial Oil Limited (TSX:IMO).

As of now, every proposal in 2019 has failed at vote, with support levels ranging from 1.13% at Saputo to 38.96% at Linamar.

Unlike other forms of activism, where activist campaigns are often isolated actions predicated by a single event, a campaign for say-on-pay has become an annually recurring event at many controlled companies.

CGI, Alimentation Couche-Tard, and Power Corporation are frequent recipients of these proposals, but minority shareholders have yet to cobble together enough support to succeed in convincing management to implement their demands, regardless of slowly increasing support levels.

In one interesting case at a quasi-controlled company, Glacier Media, Inc. (TSX:GVC), minority shareholders were able to pass a say-on-pay proposal. In 2014, Glacier received 99.89% support to implement a say-on-pay vote with a notably high turnout of 75%. This indicates near-universal support for say-on-pay at the company, an exceptional result

| 2019 SUPPORT FOR SAY-ON-PAY PROPOSALS AT CONTROLLED COMPANIES | | | |
|--|-----------------------------|---------|--|
| COMPANY | | SUPPORT | |
| | Linamar Corporation | 38.96% | |
| | Power Corporation of Canada | 23.3% | |
| | CGI Inc. | 22.9% | |
| | Imperial Oil Ltd. | 14.6% | |
| | Saputo Inc. | 1.13% | |

given the 41.1% control block comprised of Madison Venture Corporation (27.2%) (controlled by Glacier's chairman, Sam Grippo) and Franklin Resources Inc. (NYSE:BEN) (13.9%), both of which supported the proposal.

Testing the Appetite for Change: An Increase in Shareholder Proposals

Controlled companies should take note that say-on-pay proposals are just the beginning, with many other shareholder initiatives being proposed, particularly related to executive compensation, proxy voting disclosure, and other board-related matters. For example, this year we took note of the increasing trend in proposals that sought to link ESG criteria to executive pay.

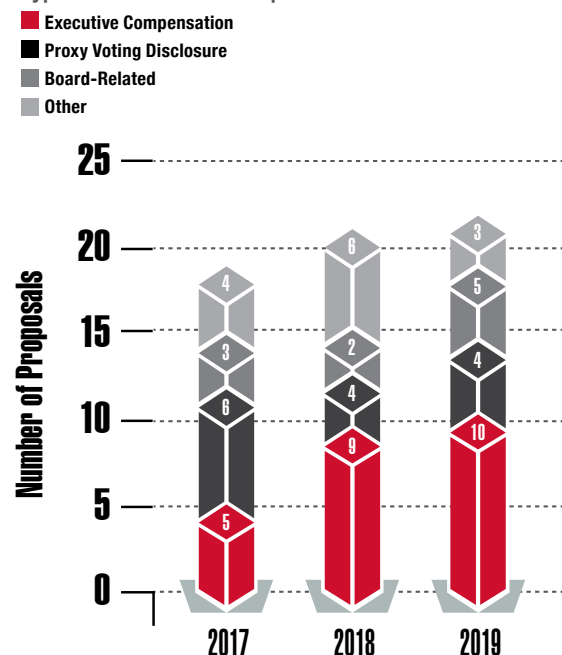
We also noted the trend around proposals calling for company disclosure of dual-class voting outcomes.

Generally, the goal of these proposals is to force the company to indicate how voting for all shareholder resolutions breaks down in terms of dual or multiple share classes in order to potentially cause the company some public embarrassment. Similarly, controlled companies like Bombardier and Saputo have received board-related proposals in 2019 suggesting that the company declare in its management proxy circular whether or not a director is independent in accordance with security regulations.

While none of these proposals passed, it is a clear indication that minority shareholders are determined to continue their push for corporate governance best practices.

Figure V

Types of Shareholder Proposals Submitted to Controlled Companies



Proxy Advisor and Minority Holder Influence

ISS and Glass Lewis have unique positions when it comes to controlled companies. While they may be highly critical, it is likely that their opinions will have minimal practical impact, other than creating a public relations issue.

Although ISS and Glass Lewis understand and endorse the concept of economic stake relative to control, and have historically supported proportional representation, neither entity condones dual-class share structures. Any occasion to collapse these structures will ultimately receive ISS and Glass Lewis support, barring egregious premiums or payouts wildly beyond the realm of sensibility. Similarly, ISS and Glass Lewis are consistent supporters of shareholder proposals revolving around say-on-pay

and remain staunch advocates of say-on-pay implementation, regardless of whether the issuer has received such a proposal.

Furthermore, the proxy advisors are harshly critical of non-independent boards and issuers that have a dual CEO/chairman. Given that these individuals are often family members of the original founder, proxy advisors are similarly skeptical of chairpersons with exorbitant payouts, as we've seen at many controlled companies throughout the years.

All in all, proxy advisors are staunch advocates of developing robust corporate governance practices at controlled and quasi-controlled companies, consistent with those of

widely held companies. Given the influence that controlling shareholders hold, proxy advisor influence is diluted to varying degrees, depending upon the company in question. The larger the controlling holder, the greater the degree of insulation the company has against negative (from management's perspective) recommendations from the proxy advisors. Depending on voter turnout, quasi-controlled companies may still need to engage with the proxy advisors in an attempt to forestall negative recommendations, or in an attempt to change ISS's or Glass Lewis's decisions. In high-turnout, low control block ownership situations, there is still a measure of uncertainty regarding the outcome of contested voting as minority holders still retain substantial influence.

Why Minority Shareholder Engagement Matters

Although many controlled or quasi-controlled companies may not appreciate the need for routine engagement with shareholders and proxy advisors, there are instances where this communication breakdown will negatively impact management initiatives. Often, changes to corporate structure or M&A actions stipulate a 66% support level for

implementation and minority shareholder approval, rather than the simple majority required for almost all other resolutions. This will not be problematic for benign cases wherein management wishes to collapse a dual-class share structure or rename the company, but it will be immensely problematic when minority shareholders are not on board with

management's proposals. If management has not met minority shareholders halfway by engaging in dialogue about their proposals and exploring palatable alternatives, what incentive does the minority shareholder have to support management when needed?

Kingsdale's Take

We believe the market has a growing appetite for shareholder activism at controlled companies and this will continue to increase in the coming years, particularly as shareholders learn to wedge independent directors against those directors loyal to the controlling entity.

As brand image and reputation become increasingly important, combined with a view that boards have a responsibility to their broader stakeholder community and not just their controlling shareholder, we expect more minority shareholder activists to be emboldened. Controlled and quasi-controlled companies must manoeuvre carefully within this rapidly changing climate and adjust to new norms, or risk becoming a victim of hubris and their own minority shareholders.

Earlier this year, the federal government introduced Bill C-97 that would require Canadian Business Corporations Act (CBCA) companies to conduct a say-on-pay vote. While it is unclear what will happen with this bill until after the

fall election, it is clear a mandatory say-on-pay vote is now on the table in Canada.

As controlled and quasi-controlled companies monitor public dialogue and appetite on this topic and try to read the regulatory tea leaves, they will have a decision to make: Will they take say-on-pay matters into their own hands by implementing a program on their own terms prior to regulatory demands demonstrating a willingness to listen to minority shareholders? Or will they wait for this decision to be forced upon them, at the behest of the government and regulators?

Boards of controlled companies should develop and execute a minority shareholder outreach program to address issues, identify potential vulnerabilities, seek feedback, and objectively assess shareholder sentiment and the extent of alignment with the controlling shareholder in order to build support for the company before it is needed.

As controlled and quasi-controlled companies monitor public dialogue and appetite on this topic and try to read the regulatory tea leaves, they will have a decision to make: Will they take say-on-pay matters into their own hands by implementing a program on their own terms prior to regulatory demands? Or will they wait for this decision to be forced upon them, at the behest of the government and regulators?

GROWING PAINS: NAVIGATING THE EVOLVING CANNABIS INDUSTRY

The Cannabis Act (Bill C-45) came into effect on October 17, 2018, making Canada only the second country in the world – after Uruguay – to fully legalize the recreational use of cannabis. At Kingsdale, we will leave it to others to debate the social impacts of the new legislation. In terms of economic impacts, however, year one of the legalization “experiment” has been a rousing success.

According to Arcview Market Research and BDS Analytics, an eye-popping \$1.6 billion was spent on legal weed in the last three months of 2018 alone. Perhaps more significantly, during the first five and

a half months of legal sales, Canadian federal and provincial governments earned tax revenues in excess of \$186 million.

Given the immense earning potential – for both entrepreneurs and the Canadian government – it is no surprise that the cannabis market has been flooded with a large number of companies attempting to stake their claim. As of August 15, there are over 200 publicly listed cannabis companies in Canada. With the legalization of edibles, beverages, and extracts slated for mid-December 2019, and a potential market for this next category of cannabis forecasted at \$2.7 billion annually, we can expect to

see even more companies entering the market over the next few years.

As the industry continues to grow rapidly, cannabis companies and their boards must be aware of the potential governance opportunities and pitfalls that lie ahead.

Over the past year, we have witnessed three recurring trends that provide a good indication of what to expect in the coming months for the cannabis industry: increasing M&A activity, accelerated turnover at the senior management level following IPO, and early-phase cannabis companies struggling to implement sound corporate governance practices.

Early Consolidation Fuels Growth and Speculation

Over the past year, the cannabis sector has been subject to four instances of public activism, a fervour of M&A activity, and takeover speculation. The consolidation activity has been fuelled by companies' desires to bulk up and a growing competition for funding – especially as legalization spreads across the U.S.

Many of the M&A actions we've seen to date haven't constituted full buyouts, with the more common approach being large equity positions with pre-emptive rights or additional equity convertibles.

For example, in March of this year, Altria Group Inc. (NYSE:MO) closed on its \$2.4 billion investment in Cronos Group Inc. (TSX:CRON) for an approximate 45% interest. Beyond signalling Cronos's legitimacy as a leader within the cannabis industry and boosting the company's expansion efforts, the deal also represents a watershed moment for participants in so-called "vice" industries. Altria, one of the world's largest producers of tobacco products,

had previously made moves to diversify its product mix, taking a significant stake in Juul Labs (leading manufacturer of electronic cigarettes) and a 10% stake in Anheuser-Busch InBev (EBR:AB).

Transactions within the cannabis space haven't all been without hurdles, however, particularly given the structural and legal issues associated with cross-border and cross-jurisdictional M&A. Canopy Growth Corporation's (TSX:WEED) recent plan of arrangement with Acreage Holdings, Inc. (CSE:ACRG.U) illustrates these challenges and the companies' creative endeavours to work around the accompanying red tape.

Canopy and Acreage struck an innovative deal whereby Canopy would pay Acreage shareholders US\$300 million in cash (US\$2.55 per subordinate voting share) as an immediate upfront option premium payment and, at such time as cannabis production and sale become federally permissible in the U.S. but within 90 months, would be required to acquire

each Acreage share for 0.5818 of a Canopy share. Despite the contingent nature of the deal, Canopy has treated Acreage as a member of the family, giving it immediate unfettered access to Canopy's extensive intellectual property.

Marcato Capital Management LP, owner of approximately 1% of Acreage's subordinate voting shares, immediately reacted negatively to the proposed transaction, noting that it was "unbelievably lopsided in Canopy's favour". Proxy advisors issued split opinions, with Glass Lewis supporting the transaction from the perspective of both Canopy and Acreage, and ISS recommending Acreage shareholders vote "against", noting that, while it appeared that Acreage would benefit from Canopy's industry expertise and intellectual property, the structure of the deal presented unique challenges for Acreage. Despite such opposition, shareholders of both companies approved the transaction in June.

From Entrepreneurs to Operators to CEOs of Multinational Companies

Despite the industry's infancy, we've seen a high level of executive turnover in recent months, as boards have pushed aside entrepreneurial founders in favour of managers with operational skill sets who can strengthen balance sheets. Bruce Linton, co-CEO and founder of Canopy, was the industry's most high-profile victim.

Mr. Linton founded Canopy in 2013, and subsequently built it into the leading cannabis company in Canada, with a value of approximately \$18 billion. In 2017, Canopy found a sizeable investor in Constellation Brands, Inc. (NYSE:STZ), an international producer and marketer of various alcoholic beverages. Constellation initially invested \$245 million for a 9.9% stake in Canopy and less than a year later, invested an additional \$4 billion, increasing its ownership to 38%, with further warrants that would push its equity ownership beyond 50%. As part of the deal, Constellation was given four out of seven seats on Canopy's board.

In July 2019, despite industry-leading growth over the past five years but after the company reported a higher-than-expected \$74 million loss in the

three-month period ended March 31, Mr. Linton and Canopy parted ways in what Mr. Linton dubbed a "termination". Mere days before Mr. Linton's firing, Constellation's CEO stated he wanted "a more focused long-term strategy to win markets while paving a clear path to profitability" at Canopy.

Aphria Inc. (TSX:APHA) also changed the nameplates on the doors of their executive offices in 2019, with both CEO, Vic Neufeld, and co-founder, Cole Cacciavillani, stepping down. At the time, Mr. Neufeld cited personal reasons for his departure, noting that "with legalization and globalization, including a huge market opportunity with positive developments in the U.S., Aphria's next generation of leadership may take the reins".

There may, however, be more to the story. Aphria had been subject to a short attack by investors, Hindenburg Research and Quintessential Capital Management, which alleged that Aphria had paid inflated prices for the purchase of assets from insiders, causing share prices to tumble by 50%. This massive collapse in share price led to Aphria's appointment of Irwin Simon as interim CEO and chairman of the board, replacing Mr. Neufeld. In the

wake of Mr. Neufeld's departure as CEO, Aphria's shares closed up 5.4%, although they have yet to recover to the near \$22 peak witnessed in the fall of 2018.

We note that executive turnover in the early stages of growth is not unique to the cannabis industry. We've seen similar levels of turnover in other emerging sectors that have had their companies transition from private to public firms. Both the tech sector in the late 1990s and early 2000s and the blockchain industry today have experienced high employee attrition rates, especially at the senior levels. The common denominator in all these industries is the struggle to find the right balance in leadership needed to grow market share while meeting new investor expectations around everything from profitability to governance.

Corporate Governance and Regulatory Challenges

While M&A activity and management changes in the cannabis industry dominated the headlines over the past year, they have been tempered by an undercurrent of questionable, if not illegal, practices and decisions by a few operators that risk tainting the industry and the directors in it. The media spotlight on a few bad apples should serve as a wakeup call for boards to not only focus on their oversight responsibilities but also to double down on corporate governance best practices.

Public confidence in the cannabis industry has been maintained by compelling capital raises and market optimism. However, as the initial gloss begins to fade, with increased competition, slowing growth rates, and continuing legalization delays in the U.S., focus is beginning to shift to how these companies are run, particularly with wider institutional investment and the higher expectations that come with it.

Unfortunately, cannabis companies have a long way to go as evidenced by The Globe and Mail's "Board Games" report, an annual ranking of Canada's TSX Composite Index boards based on their governance and executive compensation practices. While this measure does not capture the entire cannabis industry – given the limit on surveyed companies to only the TSX Composite Index – this ranking provides a solid preliminary indicator of the corporate governance practices of the sector. Notably, of the 237 companies analyzed last year, Canopy and Aurora Cannabis Inc. (TSX:ACB) finished last, while Aphria was 12th from the bottom. All three companies received poor aggregate scores on board composition, shareholdings and compensation, shareholder rights, and disclosure. Specifically, The Globe and Mail noted an absence of diversity policies, problematic option award structures, and the lack of CEO succession planning.

Proxy advisory firms ISS and Glass Lewis have also flagged a similar set of issues: In ISS's 2018 report on Canopy's AGSM, the proxy advisor criticized the company's lack of adequate commitment to enhancing gender diversity. Similarly, for Aurora's 2018 AGSM, Glass Lewis highlighted many problematic pay practices, including purely discretionary long-term incentive awards, the absence of a clawback provision, and a drastic increase in fixed pay quantum slated for the following year.

Perhaps the most extreme example of rampant corporate governance issues remains the debacle that unravelled at Namaste Technologies Inc. (TSXV:N) over the last year, as catalyzed by its now terminated CEO, Sean Dollinger. The first cracks began to appear in September 2018 after a news report claimed that Namaste was in violation of Quebec law pertaining to the sale of unauthorized cannabis.

In October, short-seller Citron Research released a report alleging fraud at a massive scale throughout the organization, punctuated by a particularly damning statement regarding Mr. Dollinger: "Rarely in its history has Citron seen a fraud so blatant: for context, we honestly view Sean Dollinger as a walking securities violation. If Namaste was a U.S.-traded company it would be halted and Dollinger would probably face criminal charges."

Calling for a trading halt, Citron cited two specific instances of alleged fraud. First, Citron cited a YouTube video in which Mr. Dollinger stated that Namaste had engaged with NASDAQ for listing. Citron perceived this as premeditated market manipulation, and the video was subsequently removed. Secondly, Citron alleged that Mr. Dollinger engaged in related-party sale of Namaste's U.S. assets, after stating that this transaction was engineered to an arm's length party.

Subsequently, Namaste terminated Mr. Dollinger's employment and commenced legal action for damages, while initiating a strategic review. Mr. Dollinger retaliated by initiating a lawsuit against Namaste, but a settlement quickly followed in February 2019 and the company made a series of other proactive changes to advance its strategy and restore shareholder value.

Boards should also be aware that regulatory risk has gained increased attention from shareholders. Despite efforts to ensure proper checks and measures, there is increasing speculation and evidence that regulatory problems are rampant in the industry. While relatively minor infringements may escape public view, the debacle at CannTrust Holdings Inc. (TSX:TRST) is a stark example of non-compliance that has left shareholders wondering how the board could not have known. In July, CannTrust halted sales of all cannabis products following a Health Canada investigation into illegal growing activities that saw the company growing thousands of kilograms of pot in unlicensed rooms. These findings led to an immediate 40% collapse of CannTrust's share price further compounded by the revelation that both the CEO and chair had been aware of the issue.

While additional regulatory action – which could make CannTrust the third company in the past year to have its licence suspended – is under consideration, the board has already removed both the CEO (notably for cause, which is almost unheard of in the Canadian marketplace) and chair, and initiated a strategic review. While the outcome of the CannTrust saga is not yet known, what is clear is that the cannabis industry is under increased scrutiny to unearth additional bad behaviour.

What's Next for Marijuana?

In short, more M&A and lagging governance practices will result in more transactions and more proxy fights.

First, we expect to see a continuation of the M&A activity that has dominated industry headlines over the past year.

Given the potential for large entities to scoop up controlling positions,

and maybe even fully acquire smaller players, small companies looking to protect themselves and seize a piece of the market will have to tread carefully. In order to avoid being snapped up by larger competitors, or even speculators from outside the market, new entrants and slow growers will have to remain nimble in the face of intense competition. We could see smaller companies

partnering up as a way to scale up and protect themselves against the massive war chests of larger potential acquirors.

In the U.S., we also expect to see further consolidation as laws and regulations become less restrictive. As the first generation of entrepreneurs and growth-driving leaders exit the Canadian market, emerging U.S. cannabis businesses

may benefit from their experience and skill set forged over the last five years of empire-building in the north. Further, the Acreage–Canopy deal may provide a template for similar cross-border M&A.

In addition, as the Canadian market matures and growth rates slow, regulatory and corporate governance concerns are very likely to come to the forefront. Currently, investors are dazzled by the

glorious and unprecedented opportunities, but reality will inevitably kick in – it is only a matter of time before poor actors within the marijuana space are forced to address shareholder concerns.

To date, cannabis companies have largely been insulated from governance activism due to their strong TSR performance. However, the cracks in the wall exist for those willing to look, and it is only a

matter of time before a breach is made. If cannabis companies want to attract sustainable institutional interest rather than retail/alternative funds, they will need to get their governance house in order.

PAYING FOR THE LONG GAME: A TALE OF SHAREHOLDERS' PURSUIT OF BETTER ALIGNMENT — TSR OR EVA?

While there is almost no debate in the shareholder community over the merit of linking pay to long-term performance, the question many companies are facing, however, is how exactly to measure performance and what metrics best reflect a company's success?

Historically, the trend has been for companies to have a greater proportion of performance share units (PSUs) in the design of the long-term incentive (LTI) framework and to move away from stock options and restricted share units (RSUs) – although most shareholders seem to agree that RSUs are the lesser evil between the two. ISS's voting guidelines also favour RSUs over stock options because options, as a leveraged instrument, can be extremely volatile on a year-over-year basis. While stock options offer the greatest upside among all equity instruments when things are going well, they have little or no retention value when share prices are underwater. RSUs are an effective remedy for both concerns, except that they offer limited linkage to management's performance.

While we at Kingsdale have seen an increasing number of TSX issuers shift their mix of LTIs towards performance-based awards in recent years, fiscal year 2018 marked the first year the median mix of PSUs reached 50% among TSX 60 issuers.

Interestingly, an LTI framework consisting of 50% or more in PSUs is deemed as a positive factor in ISS's qualitative pay-for-performance analysis. As a result, we are seeing companies change – or are committed to changing – the LTI mix as a way of showing responsiveness in light of low say-on-pay support in 2018, or of showing a commitment to improving their compensative practices in order to gain shareholder support.

History of Economic Value Added (EVA)

The concept of EVA is not new. It was introduced in the 1980s by the management consulting firm Stern Stewart & Co. Since then, we have seen companies incorporate some form of EVA measures into their incentive programs, particularly U.S. issuers in the 1990s. However, EVA has never gained enough traction and, until recently, remained an outlier.

This all started to change in February 2018, when ISS acquired EVA Dimensions, a firm specializing in EVA research founded by one of the co-founders of Stern Stewart & Co. In March 2019, ISS published a white paper titled "Using EVA in Pay-for-Performance Analysis", in which they recommended the use of EVA as an alternative measurement of a company's economic performance in its quantitative model. As of publication, ISS has not yet announced the official timing of EVA adoption but we expect implementation in the 2020 proxy season. Issuers would be prudent to start considering its implications.

When you win [with stock options], you win the lottery. And when you don't win, you still want it. The fact is that the variation in the value of an option is just too great. I can imagine an employee going home at night and considering two wildly different possibilities with his compensation program. Either he can buy six summer homes or no summer homes. Either he can send his kids to college 50 times, or no times. The variation is huge; much greater than most employees have an appetite for. And so as soon as they see that options could go both ways, we proposed an economic equivalent. So what we do now is give shares, not options

—Bill Gates (2003)

Total Shareholder Return (TSR) Continues to Dominate the Conversation

For the longest time, TSR has been the most prevalent metric that companies use in designing PSUs, thanks to its clear advantages over conventional financial metrics, including that it is transparent and standardized, comparable across the board, easily benchmarked in the industry, and easy to understand and communicate.

Both ISS and Glass Lewis use TSR as the primary measure in their respective pay-for-performance models. However, there is a common misperception that ISS has a preference for TSR and so linking pay to TSR would help a company get a supportive recommendation on its say-on-pay resolution (or its compensation committee members, if say-on-pay is not yet adopted). To our knowledge and based on discussions with ISS, this is not

the case. In fact, the advisor's preference is for companies to adopt multiple performance metrics in their LTI designs, rather than relying on a single metric – and ideally, these metrics do not overlap with the ones already incorporated in the short-term incentive programs.

The Case Against TSR

The convenience of TSR comes at a cost. The two major complaints from executives and shareholders are its point-to-point sensitivity and a lack of line-of-sight for the leadership team.

Point-to-point sensitivity refers to TSR sensitivity to the starting- and end-point of the measurement period that puts a lot of weight on the selection of these two dates. In some cases, the same three-year TSR can tell a very different story if the measurement period is shifted by a few weeks, or even days. ISS has attempted to address this issue by using average price for starting- and ending-month to smooth TSR.

This raises the obvious question, however, of just how effective TSR is as a long-term performance indicator.

A lack of line-of-sight refers to the fact that TSR, as a market measure driven by investors' expectations, reflects many external factors and investor behaviours that are arguably beyond the control of the executives, thereby hindering its ability to provide a clear vision for the CEO and the leadership team. More importantly, TSR does not provide any guidance or insight to executives about how to increase TSR, leaving the whole discussion around pay-for-performance an ambiguous exercise with no clear actionable outcomes.

EVA as an Alternative

Following its 2019 Annual Policy Survey, ISS is considering adopting EVA – a company's operating profit less a weighted-average cost of capital charge on all capital used in business operations – as a secondary measure in its quantitative pay-for-performance model as early as the 2020 proxy season. This year, as part of its phased-in process, ISS included EVA measures in its proxy research reports for information purposes.

Under its current quantitative screen, ISS applies the Financial Performance Assessment (FPA) as the secondary measure after the primary three screens have been calculated – namely, multiple of median, relative degree of alignment, and pay-TSR alignment. The FPA utilizes three or four financial metrics – slightly different depending on the company's industry – based on generally accepted accounting principles (GAAP). The potential metrics include return on invested capital (ROIC),

return on assets (ROA), return on equity (ROE), EBITDA growth, and cash flow (from operations) growth. One of the main criticisms of the FPA, which has been acknowledged by ISS, is that all the GAAP-based measures are inherently influenced by accounting standards and can therefore be manipulated by management. This, in ISS's view, distorts true economic performance.

EVA, on the other hand, represents an estimate of a company's true economic profit as measured by the net operating profit after taxes less the cost of capital. It effectively removes any distortions caused by accounting treatment utilizing over a dozen adjustments to earnings and capital base.

When adopted, ISS is planning to incorporate EVA metrics into the secondary FPA test moving forward.

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EXAMPLES OF EVA INCORPORATED IN INCENTIVE COMPENSATION PROGRAMS

| COMPANY | METRIC | CALCULATIONS | INCENTIVE DESIGN | | |
|--------------------------------------|---------------------------------------|---|---|--|--|
| | | | MAXIMUM | TARGET | THRESHOLD |
| Total Energy Services Inc. (TSX:TOT) | Economic Profit | Economic Profit is calculated by deducting the weighted average cost of capital (WACC) from the net operating profit after-tax (NOPAT) expressed as a percentage of the average amount of the invested capital for the year (NOPAT Return) | NOPAT Return exceeds WACC by 120% – 100% bonus | NOPAT return meets or exceeds WACC – 50% bonus | NOPAT return does not meet or exceed WACC – 0% bonus |
| Avery Dennison Corp. (NYSE:AVY) | Cumulative Economic Value Added (EVA) | EVA = after-tax operating profit - (WACC × average invested capital) | Cumulative EVA of \$612 million - 200% payout | Cumulative EVA of \$537 million – 100% payout | 50% payout – threshold performance not disclosed |
| Ball Corp. (NYSE:BLL) | Economic Value Added (EVA) | EVA = net after-tax operating profit (Ball's after-tax hurdle rate × average invested capital) | Ball established a minimum of 9% after-tax as the hurdle rate, which is above the estimated WACC of 6%. Payout ranges from 0% to 200% | | |
| Deere & Co. (NYSE:DE) | Shareholder Value Added (SVA) | SVA = operating profit - implied charge for capital (12% of the equipment segment's average identifiable operating assets on an annual basis. Financial services are assessed an annual pre-tax cost of average equity, approximately 15%). | \$7,800 million SVA – 200 target payout | \$3,900 million – 100% target payout | \$5 million – threshold payout (details not disclosed) |

ISS's Influence and Implications

As ISS works towards rolling out EVA as part of its formal pay-for-performance test, we expect more issuers to move to adopt EVA as either one of their primary measures or as some form of modifying factor that affects the overall payout of an incentive program.

For those who don't adopt, we expect there to be significant discussion at the compensation committee level and with shareholders. Some companies may find it beneficial to have both EVA and TSR in their compensation program to gain perspectives from both a leading and a lagging indicator, as the two naturally complement each other. Either way, the adoption of EVA will mark a fundamental shift in how companies and shareholders think about performance, especially in the context of sustainable value creation over the longer term.

At the very minimum, companies with a say-on-pay vote will have a vested interest in understanding and tracking their EVA performance, so they can better prepare for their annual meeting and engage more effectively with shareholders.

What to Expect in 2020

We are seeing shareholders increasingly putting pressure on boards and management around matters related to performance-based incentives, rationale of performance metrics, how they are linked to the underlying business strategy, and how they drive sustainable value creation over the long term. In light of such pressure, some companies have elected to either adopt a PSU program or shift the LTI mix towards more PSUs as a way of demonstrating their responsiveness to shareholder requests, which has in many cases proven quite effective in gaining the proxy advisors' support. We are expecting this trend to continue in 2020 and in the years to come.

Subject to the results of its policy survey, ISS may consider adopting EVA, and the four EVA-based metrics (EVA Margin, EVA Spread, EVA Momentum vs. Sales, and EVA Momentum vs. Capital) in their 2020 pay-for-performance model as the secondary quantitative performance test. As we noted earlier, this might lead

Pro Forma Plan Design Concepts

As an illustration of how EVA can be incorporated in incentive programs, we have outlined below several alternative PSU plans:

1. EVA as an absolute measure: annualized EVA growth rate over a three-year period.

| PSU PLAN | | | | |
|--------------------------------|-----------|-----------|--------|------|
| PERFORMANCE METRIC | WEIGHTING | THRESHOLD | TARGET | MAX |
| 3-Year Annualized EVA Growth | 50% | 2.0% | 5.0% | 7.5% |
| 3-Year Absolute TSR Percentile | 50% | 25% | 50% | 100% |

2. EVA as a relative measure: EVA growth relative to a performance reference group over a three-year period. (E.g. against quartile performance levels of the peer group.)

| PSU PLAN | | | | |
|---------------------------------------|-----------|-----------|--------|-----|
| PERFORMANCE METRIC | WEIGHTING | THRESHOLD | TARGET | MAX |
| 3-Year Relative EVA Growth Percentile | 50% | 25% | 50% | 75% |
| 3-Year Relative TSR Percentile | 50% | 25% | 50% | 75% |

3. EVA as a modifier: The overall payout level is subject to EVA factor. (E.g. score is first calculated based on a relative TSR test, and then an EVA modifier based on three-year cumulative results is applied.)

| PSU PLAN | | | |
|--------------------------------|-----------|--------|------|
| PERFORMANCE METRIC | THRESHOLD | TARGET | MAX |
| 3-Year Relative TSR Percentile | 25% | 50% | 75% |
| Payout % | 50% | 100% | 200% |

X

| | |
|------------------------------|-----------|
| 3-Year Cumulative EVA Target | 0% - 100% |
|------------------------------|-----------|

Alternatively, EVA can be incorporated in short-term incentive programs in a similar fashion, with the only adjustment being the measurement period.

companies to consider incorporating some form of EVA measurement in their incentive program design. However, for most companies in 2020, the more practical implication is to start socializing the concept of EVA and develop a better understanding of how this will impact their quantitative pay-for-performance score next year.

It is unlikely that we are going to see a large number of issuers adopt EVA in the foreseeable future, as the case against EVA has always been its high degree of complexity and the challenges it brings to both internal and external communications. ISS's proposed methodology does not change this. We do, however, believe the adoption of EVA measures by ISS will help advance a healthy dialogue between management and shareholders on their effectiveness in creating true economic value.

One area we think warrants more attention and discussion is how to ensure

executives continue to hold shares acquired through exercise of equity incentives for a longer term following exercise in order to mitigate the risk of executives "gaming" for short-term gains. This is typically addressed in the form of post-retirement holdings, which is still deemed a leading practice in Canada. When comparing the headline-grabbing pay packages of Elon Musk at Tesla Inc. (NASDAQ:TSLA) and John Chen at BlackBerry Ltd. (TSX:BB), one notable difference is the five-year post-exercise holding period included in Mr. Musk's arrangement. While it is much easier to appreciate the value of such holding provisions in the context of these more extreme examples, the underlying principle is the same for most issuers whose CEO's compensation package largely consists of equity-based incentive compensation awards. Linking executive pay to shareholder value is obviously the starting point, but holding executives accountable over the longer term, in our view, is the natural next step.

OR

Our Advice

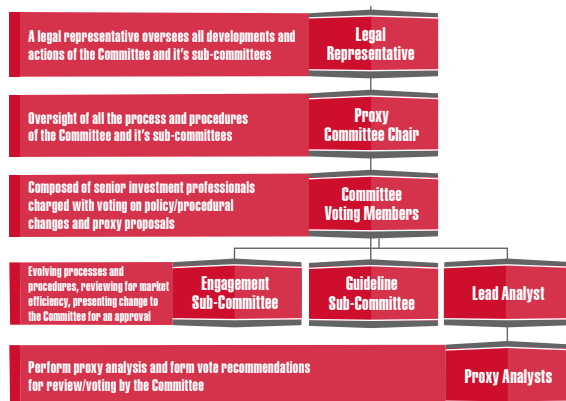
When designing shareholder resolutions and considering governance topics such as board composition and tenure, it's surprising how many issuers leave a key box unchecked when deciding on what they put forward. Working with their counsel and bankers, boards work hard to ensure a proposal aligns with the expectations of the regulators and conforms to market standards, and even gets a thumbs-up from Institutional Shareholder Services, Inc. (ISS) and Glass, Lewis & Co. (Glass

With an increase in both the number and size of internal governance teams at institutional investors, more prescriptive policies being developed – such as those on environmental, social, and governance (ESG) issues and diversity – and a decreasing willingness to farm out vote decisions to the proxy advisors, it is incumbent on issuers to ensure they not only understand, but also take into

In practical terms, nothing could be worse than designing a shareholder proposal on gender diversity, for example, that would gain the support of ISS and Glass Lewis, only to realize that a significant shareholder like BlackRock Inc. has a different policy calling for at least two female directors and the flexibility to diverge from the proxy advisors, which could result in a failed proposal.

Furthermore, many institutional investors lead ISS and Glass Lewis on certain policies, raising the bar for issuers a year or two before the same or similar policies are reflected in the proxy advisors' recommendations. Why? Some large funds have identified a competitive advantage to developing and evolving their own custom policies ahead of others – even those of the proxy advisors.

An external service provider, Glass Lewis, serves as Russell Investments' proxy administrator. They provide research and proxy voting execution services, subject to ongoing supervision by our internal proxy coordinator and oversight by the Committee. Glass Lewis conducts research regarding each proposal presented for a vote, then evaluates each matter using our guidelines and takes action consistent with these guidelines. When ballots present unique issues or topics not specifically set out in the guidelines, the proposal(s) are referred to the Committee for a vote.



The diagram illustrates the ESG Research Process as a sequence of five steps, each represented by a red hexagon with a grey border. The steps are arranged horizontally from left to right:

- Glass Lewis Research**: The starting point of the process.
- Voting Analyst**: A central role indicated by a double-headed vertical arrow connecting to the **Input Equity Analyst & PMs** above and the **Input Engagement Specialist** below.
- Corporate Governance Analysis**: The first analytical step.
- Proxy Committee Review**: The second analytical step.
- Vote Instruction**: The final step in the process.

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Passive investors have also differentiated between active ownership and passive investing, meaning that exercising votes, especially for companies that funds might be required to own, can serve to mitigate risk and lead to increased long-term performance.

For example, British Columbia Investment Management Corporation (BCI) believes that boards of directors are responsible for ensuring a company has systems in place to effectively assess and manage risk, including environmental and social risks. Specifically, there is increasing regulatory and investor pressure on companies to provide climate-related disclosure. BCI will generally vote against the chair or all returning members of the relevant board committee who, in their

view, have not effectively performed this critical function and if corporate performance has been unsatisfactory.

Moreover, some investors may have policies that are more rigid or have significantly different thresholds than ISS and Glass Lewis. For example, State Street Global Advisors expanded its board gender diversity voting guidelines to further encourage companies to diversify their boards. Starting in the U.S., U.K., and Australian markets in 2020, followed by Japan, Canada, and continental Europe in 2021, it will vote against the entire nominating committee if a company does not have at least one woman on its board, and has not engaged in successful dialogue on State Street Global Advisors' board gender diversity program for three consecutive

years. Closer to home, in Canada, BMO Global Asset Management has taken a more nuanced approach when it comes to overboarding, in that it considers non-executive chairmanships equivalent to two non-employee directorships.

These harder-line policies may even be product features for underlying client appetites, and voting in line with them and disclosing those votes can demonstrate the stewardship required by a fund's stakeholders, especially on environmental and social issues. By being more lenient on some matters and stricter on others, investors can signal to the marketplace their beliefs on governance issues and set their engagement agenda to promote changes.

Who Else Carries Influence?

Beyond the proxy advisors, there are other interested onlookers who may not dictate votes but can still influence the conversation and amount of attention or distraction around a proposal, such as those around proxy access and ESG-related matters. In the case of proxy access proposals in 2017, the Canadian Coalition for Good Governance (CCGG) played a critical role in engaging in dialogues with two banks (Toronto-Dominion Bank (TSX:TD) and Royal Bank Of Canada (TSX:RY)) that received shareholder proposals that eventually led to the adoption of proxy access policies by both institutions.

Mouvement d'éducation et de défense des actionnaires (MÉDAC) has been the most active voice on a broad range of issues concerning shareholders, such as those related to compensation, board governance, and the environment. In 2019, 60% of all shareholder proposals

were submitted by MÉDAC, up from 58% the preceding year. It is worth noting that 64% of these proposals were targeting leading financial institutions, and about half (45%) of the proposals were related to compensation matters.

In addition, for the first time, MÉDAC submitted proposals asking issuers to incorporate ESG criteria into their incentive compensation programs. This year, MÉDAC has targeted 15 companies, including eight financial institutions, with these proposals.

The 2015 Paris Climate Agreement, a United Nations-backed initiative signed by 194 countries committed to significantly reducing greenhouse emissions, has also influenced the way shareholders vote, and has set a new standard for what investors are looking for. Shortly after ratification, 288 institutional investors, with \$26 trillion in

assets, signed a statement in support of the agreement and the Task Force on Climate-Related Financial Disclosure.

Since the Paris Agreement, we have seen an increased level of disclosure among major issuers in Canada (*a topic we discuss in greater detail on page 23*) along with a sharp rise in shareholder proposals asking companies to "up their game" on environmental issues (from ten in 2018 to 18 in 2019).

Adding to this movement, late last year, 414 institutional investors from around the world signed and presented a "Global Investor Statement" to world leaders calling for more action to meet Paris targets. Many of these investors have not only led with action but are encouraging companies in their portfolios to improve on key environmental issues.

Figure W

Proponents of Shareholder Proposals

■ MÉDAC
■ Other Proponents

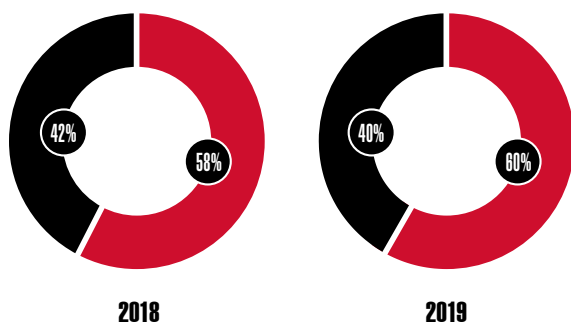
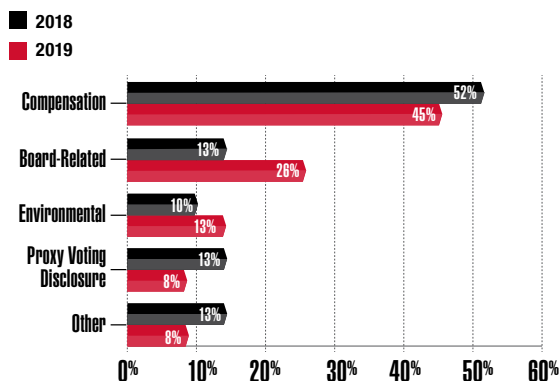
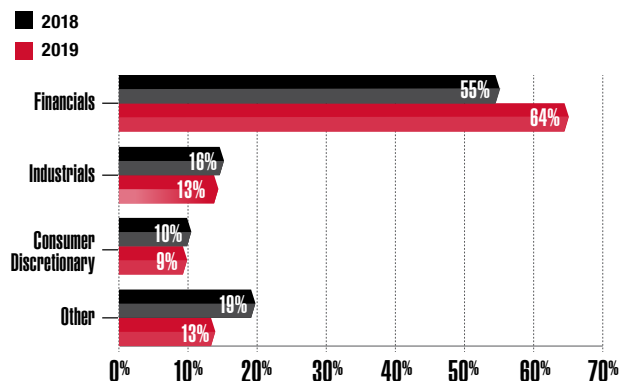


Figure X

Types of MÉDAC Proposals



MÉDAC Proposals by Sector



Threading the Needle: How Issuers Can Tailor Management Proposals

It is clear that having a deeper read on the decision-making processes of your shareholders is key, especially in situations where a proposal may be considered controversial and where a portion of your shareholder base is against it. What questions

should issuers looking to thread the needle ask, and what makes for an optimal bespoke proposal for your shareholders? Here are the top ten points to consider:

1. Do shareholders vote based on custom policies?
2. Are these policies publicly disclosed? To the extent you lack certainty on the application of the policies in your circumstances, have you engaged the shareholder?
3. When the policies are vague, under what circumstances and to what extent can discretion be applied?
4. Is your information or relationship up to date given policy changes and staff turnover? When is the last time you talked to the vote decision-makers? What did they say?
5. Will the portfolio managers have a say in the voting decision?
6. Have you checked past voting records?
7. To what extent does a shareholder deviate from ISS and Glass Lewis? Does it align with one proxy advisor more than another?
8. Have you completed a risk assessment of how shareholders will react to proxy advisors' recommendations and the vote impact? Going back to your intended proposal, what changes should be considered to ensure success?
9. Are there any shareholders that might be willing to reconsider application of their policies to your unique circumstances and warrant early engagement?
10. If a vote could be close, to what extent will retail shareholders play a factor? If they will, how frequently have they voted with management in the past? Are you doing all you can to ensure the proposal is simple, clear, and compelling to win their vote?

As the standards for governance continue to rise, shareholder intelligence on an individualized basis will define success or embarrassment.

RISE OF THE MICRO-ACTIVIST: HOW CAN BOARDS OF MICRO- AND NANO-CAP COMPANIES PREPARE AND DEFEND WITH LESS?

The Canadian market, compared to our American neighbours, is a lot smaller, which means that a larger percentage of companies targeted by activists will invariably be on the small side.

In recent years, we have seen a trend of smaller companies being targeted by activists, with micro- and nano-cap companies accounting for 66% of the public targets in 2018 and 64% in 2019.

Despite this disproportion, the bulk of “how-to” guides and standard defence playbooks are constructed for companies exponentially greater in size.

As a result, the default position at too many micro- and nano-cap companies is frequently to either ignore a potential activist threat in the hopes it will go away or to rely on their regular counsel and financial advisors (who may have little proxy contest experience) for strategy development. Subsequently, these companies often implement a fire-drill strategy, with their leadership stuck in a distracting cycle of reacting to circumstances versus proactively managing the playing field to their advantage.

Perhaps most damaging in these situations, we have observed that a

historical lack of resources to support shareholder engagement, coupled with a close set of friends and family who have roles with the company (management, directors, and vocal, but not necessarily large, shareholders), can lead incumbent boards to dramatically or even fatally overestimate their level of support.

How We Define Nano- and Micro-Cap Companies

Nano-cap:
< \$50 million

Micro-cap:
\$50 million – \$300 million

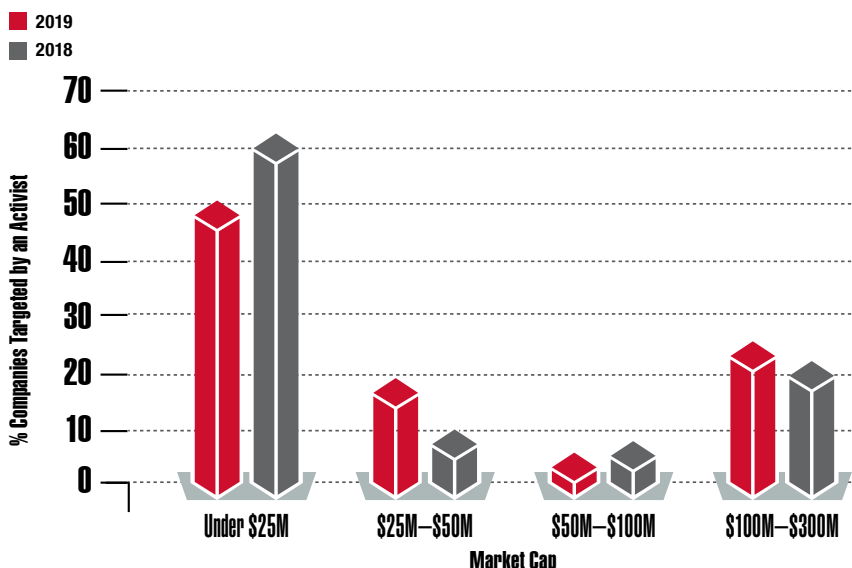
By the Numbers: Micro- and Nano-Cap Companies Under Fire

While the day-to-day affairs of a small company are usually more than enough to keep management and the board occupied, they ignore the peril of activism at their own risk. Based on our analysis of micro- and nano-cap companies, roughly

half the proxy contests launched over the last two years at companies with market caps below \$300 million have been at companies with market values under \$25 million (50% of proxy contests in 2019 and 62% in 2018).

Figure Y

Distribution of Activism at Companies with Market Caps of Less than \$300 Million



So far in 2019, 11 proxy contests were launched against nano-cap companies, with activists earning a win rate of 80% of the completed contests and management winning just one fight.

Guyana Goldfields Inc. (TSX:GUY) and Ascent Industries Corp. (CSE:ASNT) and one management win at Stuart Olson Inc. (TSX:SOX). Two fights are still ongoing.

Notably, we've observed that over the past two years, activists who target smaller companies focus mainly on demands related to governance, which is not surprising given the close-knit nature of many of these boards.

Meanwhile, there were five proxy contests launched against micro-cap companies, with two activist wins at

Since 2018, management at micro- and nano-cap companies have a win rate of 53%.

| ACTIVIST DEMANDS AT MICRO- AND NANO-CAP COMPANIES | | | | | | | | | |
|---|------------|------|------|------|------------------|------|-------|------|--|
| MARKET CAP | Governance | | M&A | | Strategic Review | | Other | | |
| | 2019 | 2018 | 2019 | 2018 | 2019 | 2018 | 2019 | 2018 | |
| Under \$25M | 75% | 72% | 13% | 17% | 13% | — | — | 11% | |
| \$25M – \$49M | 33% | 100% | 67% | — | — | — | — | — | |
| \$50M – \$99M | 100% | 100% | — | — | — | — | — | — | |
| \$100M – \$300M | 75% | 67% | 25% | 17% | — | 17% | — | — | |

The Challenge of Defending as Micro- and Nano-Cap Directors

Activist attacks are usually designed to be distracting to the board and management as well as to negatively impact a company's ability to execute on its business plan, while exploiting key vulnerabilities that will move the hearts and minds of shareholders.

In smaller companies where management wears multiple hats and is responsible for multiple areas, the extent

of that distraction can be even more widespread. For example, while a larger company may have an internal general counsel to lead on legal considerations, an in-house investor relations team to handle shareholder interactions, and an established public relations department to deal with media, in smaller companies, a few executives and directors may find themselves suddenly responsible for managing these tasks, forced to rely on

unqualified staff, or having to bring on external advisors to handle these issues.

Smaller companies also tend to lag when it comes to governance. First, structural defences at these companies that are common in the marketplace – such as an advance notice by-law – may not have been considered, and governing documents may well be out-of-date. A recent example of a nano-cap

company lagging in governance was Synex International Inc. (TSX:SXI) which received surprise nominations at its annual general meeting (AGM) because of its critical error in failing to adopt an advanced notice by-law despite being involved in a proxy fight the previous year.

Secondly, the boards of micro- and nano-cap companies tend to have evolved over time rather than having been built around a thoughtful skills matrix with an intentional recruitment (and refreshment) process. This means friends, family, and other associates tend to be those tapped to populate boards in their earliest stages

When it comes time for an activist to pull the trigger, micro- and nano-cap companies are at an increased risk of receiving a requisition for a shareholders meeting.

and they have a tendency to remain for long periods. Moreover, smaller companies tend to have interlocking relationships when it comes to executive and director roles, shared work spaces, shared legal counsel, and sometimes even a shared CFO. This calls into question their objectivity and independence, especially when issues related to management performance (likely that of a friend) are identified. When companies like this are confronted by an activist, by most objective standards, shareholders will conclude that at least some change is warranted, putting the incumbent board at risk.

When it comes time for an activist to pull the trigger, micro- and nano-cap companies are at an increased risk of receiving a requisition for a shareholders meeting. As the threshold to requisition a meeting in Canada is 5% of issued and outstanding shares, it is comparatively easier for an activist to accumulate that amount of stock for less money than trying to do so at a company with a billion-dollar market cap. In fact, we have seen instances where a poor turnout or result at an AGM motivated an activist to requisition a meeting shortly thereafter. Proxy season can quickly give way to requisition season where tiny companies are concerned.

Why Are Micro- and Nano-Cap Companies Considered Easy Targets?

When we talk to activists looking to target a micro- or nano-cap company, there is generally an air of confidence and a view that the target is a sitting duck, ripe for change. Aside from the well known list of reasons all companies can become activist targets – undervalued, underperforming, governance failings, etc. – there are certain factors that couple with these to put micro- and nano-cap companies at even greater risk:

- **Shrinking pool of poorly defended larger targets.** As larger market cap companies become increasingly attuned to the threat of activism and the number of defence practitioners multiplies to service them, activist funds looking to deploy capital with minimal risk are willing to look further downstream to identify targets.
- **Emergence of smaller activists with smaller pockets.** The reality is that there are probably fewer than a dozen large, high-profile activist funds with sufficient assets under management to allow them to take a large enough position in a major company to make a difference. For everyone else, it is more practical and less expensive to accumulate a meaningful number of shares in a company with a smaller market cap. It also means that individual and first-time activists – former founders and insiders – who have limited resources are able to take meaningful action.

In 2019, we saw 16 first-time activists, 13 of which were interested in micro- and nano-cap companies. Of these 13

contests, eight fights have concluded, with only two being won by management. Not exactly a reassuring statistic.

- **Unexplored opportunities based on surface value.** With fewer analysts and financial advisors, there are more opportunities to identify levers to increase value. While a small company may not receive as much media attention if they have a misstep, that can also mean that opportunities for value creation may not be widely noticed. Operationally, an activist may look at a company and conclude it is much easier to double the value of a \$100 million company than that of a \$1 billion company. Smaller companies generally have a larger world of potential acquirors, which could result in a quick win for an activist investor. In addition, smaller companies often have great assets but are struggling in some way to get them to a larger market. This gives activists an opportunity to get in before the growth spurt.
- **Limited number of large investors to convince and/or compete with.** Smaller companies generally have smaller investors, resulting in better potential flexibility. Large institutional investors, on the other hand, are often restricted by fund requirements related to minimum share price and maximum level of ownership, which can limit the influence of proxy advisors and the added dynamic required to win them over.
- **Pent-up demand for change but no supporting champion.** As micro- and nano-cap investors tend to be smaller in

size, a number might be unable to force change, as most lack the resources and wherewithal to run a formal proxy fight. Once a champion for change emerges, these shareholders can quickly coalesce around the champion to apply exponential pressure on management. Even where no true activist exists, technology has made it infinitely easier for disgruntled shareholders to organize and act as one by withholding votes or killing a transaction. While this type of organizing is becoming increasingly common on online bulletin boards, this year we ran into shareholder opposition that was being organized via an invite-only application that shielded the organization's activities from outside eyes.

- **No defending army.** Activists know a micro- or nano-cap company is unlikely to have an affordable A-list defence team on standby, which creates the possibility for early – perhaps even irreversible – mistakes by the company, thereby supporting the perception of an easier win.
- **Strategy not well-communicated to the market, combined with a lack of shareholder engagement.** This creates a vacuum that an activist can easily fill to create the perception that the company is, and will remain, adrift until external action is taken.
- **No counter-thesis.** Smaller management teams and boards may be focused on executing the current strategy and do not have the bandwidth to explore alternative strategies for value creation, especially if

they have not been pressured to do so or lack the appropriate expertise, such as in capital allocation or capital markets, at the board level.

• **Increased frequency of questionable practices.** By virtue of the smaller size of the board and management, it is more common to identify issues

related to compensation, related party transactions, and dual CEO/chair roles, especially at founder-led companies.

How Are Micro- and Nano-Cap Activists Different?

Aside from the fact that most activists do not have the resources, experience, or teams that the Ackmans and Ichns of the world do, there are a few characteristics we see repeatedly in activists who target micro- and nano-cap companies that can make them more aggressive and less predictable.

First, limited experience and perhaps not a full complement of advisors means the normal activist playbook can go out the window when the rules of engagement are ignored and questionable tactics are employed.

Second, and related to the above, these activists are more likely to be aggressive publicly and tend to become aggressive sooner. Whereas larger institutional shareholders in larger cap companies and the proxy advisors like to see that a meaningful effort was made to reach

a compromise through meaningful engagement between the two sides, the same dynamic does not exist at smaller companies. As a result, activists are more pointed in their criticism of management and likely to use press releases as a key part of their strategy to apply pressure, especially in the early stages of a proxy fight. This is not to say that it will generate media coverage, but the back and forth of press releases becomes a key channel to advance their narrative and reach shareholders.

Third, and another reason why activists at this level do not put the same emphasis on engagement before launching, is that they tend to be less constructive than larger activists. With smaller boards and management teams, the activists tend to be of the view that the board and management lack the widespread competency needed to

create the desired change. Accordingly, they focus on tearing down a company and stoking anger to create an overwhelming desire for change in order to get the incumbents voted out rather than creating a detailed white paper and path forward to get themselves voted in. Compounding this is the lack of proxy advisor influence that necessitates not only a case for change but also some sort of an alternative thesis and plan for the company if a majority is sought.

Micro- and nano-cap companies, however, should be aware that activists can masquerade as strategic investors – knowing that smaller companies are often starving for capital but often thinly traded. Micro- and nano-caps are often so keen to sign up these investors, they do so without support agreements in place, leaving themselves vulnerable to activist interventions.

What Micro- and Nano-Cap Companies Can Do

Aside from the standard activist defence checklist that starts with advice to “think like an activist” and includes being prepared, knowing your vulnerabilities, and putting an early warning system and team of advisors in place, here are some additional considerations for smaller companies:

• **Double down on paying attention to your shareholder list and your shareholders.** Traditionally, at Kingsdale, we’ve found that management at micro- and nano-cap companies lack an understanding of their shareholder bases. Most fail to request non-objecting beneficial owner (NOBO) and other lists available to them, and instead they rely on financing records, with little subsequent active engagement with the shareholders or brokerages to understand who owns their stock today.

Beyond the list itself, extra attention should be paid to engaging large shareholders and responding to general shareholder inquiries. While a company may not have the bandwidth for full-scale, broad-based shareholder engagement, it is important to start somewhere. Engaging the top five

shareholders who are not known to management is a good start.

Moreover, smaller companies generally rely heavily on a few conversations with large shareholders to gather feedback rather than conducting active solicitation or outreach campaigns to get an understanding of concerns not voiced by large shareholders who are close to the company.

It is crucial for a company to be quickly responsive to those shareholders who do reach out. Nothing can escalate a situation more than having emails from shareholders sitting in an inbox for days with no response from the company. We understand that smaller companies may communicate developments to the market less frequently than larger companies, creating concerns about disclosing material non-public information in response to shareholders. However, activists will contact the investor relations team as a first step to assess a company’s responsiveness to shareholders and general competency on key issues. Ignoring an activist is not effective in making them disappear.

• **Understand the impact of guerilla-style activism.** As discussed earlier, a loosely associated group of unhappy shareholders can have a material impact on vote results. Even if a vote is not defeated, a significant “withhold” campaign can cause embarrassment for directors, especially if majority voting applies. While we would generally not advise engaging shareholders who are organizing on the message boards or putting ads in papers, as it would feed the attention they require to mount their campaign, companies should monitor retail sentiment and have plans in place to increase the turnout of supportive shareholders who may not have otherwise voted, to offset any negative impact.

• **Don’t ignore the importance of a routine AGM.** Beyond the vote results themselves, a high turnout is a sign of a healthy company. 95% support for directors from 5% of shareholders tells a much different story than 90% support from 80% of shareholders. One of the first things an activist will look at in assessing the viability of launching a proxy fight is previous years’ turnouts. If turnout is low, that means an

activist's position will have a disproportionate impact on the outcome of the vote. For example, a 6% shareholder at a company where turnout has averaged 30% will control 20% of the voting shares.

Running a strategic AGM outreach and solicitation program will not only increase voter turnout but also provide management and the board with an opportunity to address many of the vulnerabilities outlined above, such as better communicating the story, engaging shareholders directly, and getting them to exercise their voting muscles (since many will have never done it before) well before you actually need their vote.

- **There is no downside to spending time on best-in-class governance.** While the proxy advisors may not have an impact on your shareholder base, good governance cannot be ignored. Companies should consider what their

peers are doing, what companies of the size they aspire to be are doing, and what other companies also owned by key shareholders are doing. If a company has the hallmarks of a friends-and-family board, that will be low-hanging fruit for an activist to target and the company should be proactive in making changes to add independence. Similarly, absence of a say-on-pay vote can be a sign of insularity; without a say-on-pay vote, issuers should not assume that shareholders are supportive of management's compensation, especially when performance has been an issue.

- **Be prepared to upgrade your board and question the validity of an activist's nominees.** It is harder to attract brand name directors to serve on micro- and nano-cap companies. Activists may recruit first-time directors, friends, or business associates whose independence from the activist can be called into question in the same way

that they will try to target incumbent directors. Activists are likely to target a few specific directors who companies should be able to identify on their own in advance: Who has the longest tenure? Who is the least independent? Who has generated the worst shareholder returns? Companies should be prepared to co-opt the change narrative by having an evergreen list of prospective directors available to consider – if not proactively refreshing the board in advance.

While preparing for activism can be daunting and resource-consuming, it is better than the alternative of not being prepared. Preparation does not need to take place all at once and can be done in bite-sized chunks. The worst that can happen is you are more prepared. The best that can happen is that you ward off an activist threat before it ever emerges by removing yourself as a target.

BOARD OF RIVALS: WHAT BOARDS CAN DO TO HARNESS THE ENERGY, EFFORT, AND PASSION ACTIVISTS BRING TO THE TABLE

Interactions with activist shareholders are almost universally divisive experiences. Even if the incumbent board prevails, with a majority of its nominees re-elected or a settlement reached, deep rifts among shareholders – and even between directors and management – are likely to have been exposed. But it doesn't have to be this way.

Most proxy contests become a shouting match between two sides professing their love for, and commitment to, the company while at the same time being wholly uninterested in listening to an alternative point of view or exploring courses of action that diverge from what they have already deemed to be optimal. As bad blood boils, focus is placed on what went wrong and who should be held accountable, not on what solutions and points of commonality can be found. In proxy fights, as in politics, it is always easier to say what you are against than what you are for. And it's even harder still to illuminate a credible path to get there.

We have observed that the process of recruiting and adding activist nominees – who are independent of the activist fund itself – to a company board, then having them in the boardroom, can be a

productive (but yes, sometimes painful) one, from both a knowledge and a cultural perspective. Consider the general state of boards in Canada right now: The relatively small pool of those qualified to be directors at Canadian companies is further depleted by residency requirements, personal liability risk, and financial means (i.e. due to ownership requirements, being a director isn't always cash lucrative), not to mention the fact that boards have a tendency to rely on existing relationships to identify new directors rather than conduct a formal search. The consequence of this is that even if a board checks all the boxes from a formal independence perspective, boards built by relying on the Rolodexes of its current directors run the risk of tending towards insularity.

While a skills matrix may demonstrate a broad array of formal skills and expertise are present, homogeneity of personalities and backgrounds may reduce risk-taking and lead to group thought and confirmation bias.

While much has been said with regards to diversity of obvious traits, usually physical like gender or race, little has been explored about purposely

identifying and recruiting perspectives that diverge from those of the incumbent board or that bring a different personality into the mix. For example, while many like to regard themselves as Type A personalities – individuals who are outgoing, ambitious, impatient – directors should look around the table and observe how many directors are more exhibitiv of Type B personality traits such as enjoying working at a more predictable and steady pace, focusing less on winning and losing, offering encouragement, and valuing patience and teamwork. How could a board of Type B directors benefit from the intentional recruitment of the proverbial “bull in a china shop”? How could a board dominated by Type A directors find value in adding members who are more welcoming of process and exploring ideas and concepts?

Compare this to how activists think about director recruitment. Activists have become increasingly artful in designing their slates and, with activism becoming a more accepted practice, attracting more of their preferred candidates. While they will ensure they check all the boxes when it comes to skills, experience, and even gender and ethnic diversity, they will also look for individuals who can shake

up a boardroom. To be clear, activists generally do not seek out nominees who will be disruptive for the sake of disruption, but rather directors who hold an alternative set of beliefs and are confident enough to challenge the status quo, ask the tough questions, and put forward new ideas.

We have seen many instances in which an activist nominee knows a company better than the incumbent directors, having spent months, if not years, dissecting the company, interviewing former employees, and visiting its operations.

When they step into the boardroom, they can demand reams of information, reopen previously closed files, and force other directors to up their game. While all directors have a fiduciary duty to act in the interest of all shareholders, not just the ones who nominated them, activist nominees have also staked their reputations on creating change and being more action-oriented.

Rather than asking what boards can do to prevent an activist nominee from joining their ranks, especially in situations where it is clear shareholders want change, they

should ask what boards who are targeted by activists can do to harness the energy, effort, and passion these activists bring to the table?

Much time is spent talking about the power of collaboration and the necessity of collegial relationships at the board level, but can conflict, or at least some constructive tension between directors, benefit shareholders and breed success? How can thinking differently about activist nominees and their ideas be more fully leveraged by companies?

How Do Directors Really Feel About a Diversity of Views?

This is an introspective question that directors should reflect on privately to parse out what they believe they should say publicly and how they really feel internally – especially if they have been the subject of personal attacks by an activist: *“I know diversity of views is supposed to be a good thing, but do I really want this boat rocked and have to deal with them myself?”*

The importance of a “diversity of views” has become an obligatory soundbite in the governance world that is usually followed by a mantra about the value of different backgrounds, experiences, and skill sets in the boardroom, yet the reality can be very different. Directors may be open to hearing a diversity of views when delivered by fellow directors of a different gender, ethnicity, experience, or background, but when an activist point of view is introduced into the discussion, that openness can quickly fall to the wayside. Too often boards can fall into a mindset of “When I want your opinion, I will give it to you”.

When under fire and the subject of scrutiny, directors who otherwise talk about their fiduciary duties

and commitment to the company can become wholly uninterested in entertaining points of view that do not align with or confirm their chosen course of action, let alone welcoming a new board member who holds those points of view. Alternative points of view in the context of an activist interaction are often described as, among other things, “not understanding of the real problem”, “demonstrating their inexperience”, and “contrarian” in an effort to quickly dismiss them without having to deal with their substance. Yet, time and time again, these points of view gain traction with substantial portions of an issuer’s shareholder base.

Disagree with this perspective? Consider how the concept of adding an activist nominee to the board is frequently described and discussed. Adding an activist’s nominees to the board, especially if awarded in a vote, is often described as the “downside scenario”, particularly if that nominee is to be included on crucial committees. The “lesser of two evils” is conceding a seat or more via settlement. The board’s willingness to entertain adding one or more activist nominees generally arises

and increases dramatically when they conclude that adding the nominees via a settlement will likely result in fewer activist representatives on the board than would otherwise be awarded via a shareholder vote.

Companies will also argue that having an activist nominee in the boardroom will be “disruptive”, but this argument, too, gains little traction with shareholders. When companies talk about the threat of upsetting the board dynamic, the importance of working together in a collegial fashion and consensus, shareholders can perceive this as an argument coming from a board that has grown too comfortable, interpreting such statements as an inclination to steer away from asking difficult questions, arguing controversial courses of action, or challenging the status quo. From a shareholder perspective, how can they be assured a company is striving for its best if they do not perceive a constructive tension at the board level? Put another way, many shareholders subscribe to the view that diamonds are only made when pressure is present.

Activists on Board

Despite incumbent directors’ resistance to adding activist nominees to boards and the many arguments that warn about the disruption they will cause, activist nominees are still appointed and elected to boards on a regular basis. Why? Because they are sometimes viewed by their shareholder peers as at least partially correct about the company’s underperformance and undervaluation, often due to the fact that they have put

forward a credible thesis in the form of a white paper, as well as having become increasingly adept at identifying and forwarding qualified director nominees and even management candidates.

While incumbent directors may complain they have “never heard of” the activist nominees as a way to infer an obvious lack of qualifications since they have never heard of them, shareholders may

hold the view that any change is better than the status quo. What is the downside of having one or two new shareholder voices on the board?

In an increasingly common tactic, activists will seek to use a company’s unwillingness to consider alternative points of view at the board level as a demonstration of the board’s entrenchment. Activists will reach out privately and “attempt” to reach

a settlement with the company, knowing this gambit will increase their credibility with reasonable shareholders when made public and the rejection of the settlement offer, in fact, reinforces the notion the board is entrenched.

It is important to point out there is a distinction to be made between activist nominees who are added via settlement and those added via a proxy contest, with the former usually having undergone a review and meeting process with the board to assess their qualifications and address any concerns regarding issues such as conflicts of interest. If a board deems the nominee to be lacking in certain necessary skills, the opportunity exists to negotiate with the activist to find a more qualified director.

Rarely, if ever, is a board seat the final objective of an activist. A board seat

is simply a mechanism to achieve the endgame the activist desires. Professional activists will tell you that they only need two directors on a board to bring about the change they want: one to make a motion and another to second it. They are confident that their nominees will be so effective and make life so miserable for underperforming directors that they will be able to slowly force the turnover of the board – in either its directors or its point of view. What long-tenured director a few years from retirement would want to continue serving on a board where every meeting had suddenly become a painful cross-examination? It is also important to note that while not explicitly targeted in activist campaigns, CEOs are frequently a target, with the activists already having a shortlist of candidates they want to put forward.

Activist-Induced Change

In several recent examples, we've seen activist nominees effect immediate change upon being elected to their respective boards.

For example, since a December 2018 special meeting of shareholders at Detour Gold Corp. (TSX:DGC) in which activist Paulson & Co., Inc. won majority control of the board, the company has replaced its CEO, CFO, and parted ways with its COO. We've also seen significant changes at Guyana Goldfields since that company's proxy battle ended with a settlement agreement in April 2019 that

gave the activists two out of seven board seats. Since April, Guyana Goldfields has replaced its CEO and CFO, and in August, a news story surfaced about the company exploring options including a potential sale of the business. Finally, at Aimia Inc. (TSX:AIM) we've seen wholesale management and structural changes since March 2018, after the company added two activist nominees.

While the market will ultimately decide if changes like these were effective at building value, it's evident that activist nominees can trigger change.

The Activism Opportunity for Boards

It is said that every cloud as a silver lining. If we adopt that mindset when it comes to activist nominees, the question becomes what opportunities exist if we think of an activist not as a self-interested, self-serving investor but as a shareholder who has spent a lot of time thinking about the company, engaging the market, and is passionate about the company's potential future? Looking around the boardroom table, how many incumbent directors do you see bringing that same passion and obsession with value creation to the company? Here are some key questions for boards to consider:

- **Would it be useful to broaden your thinking when it comes to diversity recruiting?** Almost universally, director recruitment concentrates on finding someone who has a specific apparent

feature like "open-pit mining experience" or who is more "racially diverse". While valuable, would the board benefit from considering other less tangible factors such as an individual's personality, motivations to serve, and willingness to challenge the status quo? While it is important to have functional expertise and experience on the board, could there be value in adding someone who is truly passionate about creating value, perhaps with a private equity background? What about someone who has shown the ability to thrive in a crisis or develop disruptive strategies?

- **Can you use an activist's recruitment process to bolster your own recruitment and refreshment?** Having the best and most capable people trumps how you came to find

Chances Are an Activist Interaction Will Result in Activist Nominees on Your Board, but How Many?

Both issuers and activists must carefully weigh the benefits of taking a fight to a vote against the risks.

As the charts below show, while the total number of board seats gained by vote is larger than the seats gained in a settlement, we have found that over the past five years, activists in Canada who settle are more successful, on a percentage basis, in obtaining board seats than activists who let shareholders decide their fate. This is not surprising, given the fact that self-preservation plays a role, meaning incumbent boards are more likely to entertain a settlement (and a standstill agreement that comes with it) if they believe the outcome of a vote will be worse for them. Otherwise, if they have confidence the activist will lose in a vote, why bother settling?

Figure Z

Board Seats Gained: Via Votes at Meeting Relative to Demand

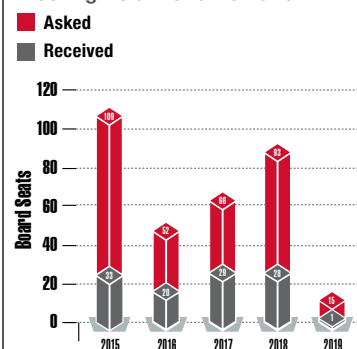
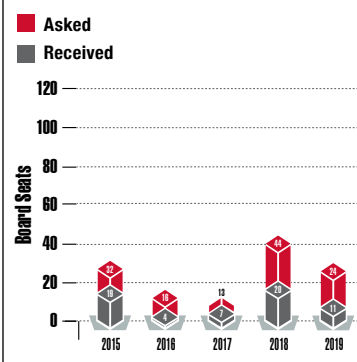


Figure AA

Board Seats Gained: Via Settlement Relative to Demand



them. Activists tend to present to companies a different set of potential nominees than the company would have identified through its own board recruitment (to the extent that there is, in fact, a refreshment process in place). While all may not be qualified, the fact is that the stigma around being an activist nominee has worn off in recent years and very credible individuals are choosing to serve as activist nominees. When you couple this with the fact that activists often target long-tenured directors, boards that have recognized the need for change but for certain delicate reasons have been hesitant to remove a stubborn board member could now have an excuse for action. We have been surprised by the number of times we have heard members of a nominating committee remark that a certain director should have moved on or should be moving in a few years, but have no plan to make a switch. If an activist brings forward a credible candidate, shareholders will not look kindly on those they see as robbing them of valuable expertise and a fresh bias for action.

- **How can you harness activist-nominated new blood on the board to move in a positive direction?** While ignoring the past, especially when it includes personal slights, can be easier said than done, we have generally found that activist nominees, once added to a board, have a constructive influence on the board by, at the very least, forcing

the underperforming directors to up their game. We have seen success, especially in situations where efforts are made to welcome and integrate activist nominees to the board rather than try to isolate them.

Incumbents should not assume that an activist nominee will share all the same biases as the activist, nor that they will only be beholden to that one shareholder. Withholding information and reserving committee roles only for tenured directors only tends to reinforce the reasons why the activist nominees made their way onto the board in the first place. We have heard from some nominees that their eyes are opened once in the boardroom and things aren't as they appeared. An independent nominee can be an independent thinker.

Where efforts are made to educate, integrate, and challenge the strength of the activist nominee's bond with the activist, boards are often surprised to find just how independent nominees can be. Where an activist nominee's placement is the result of a settlement, this takes on increased importance as a clock will be ticking and the company will be under pressure to show results. For example, it is not unusual in a proxy fight for an activist to advocate a particular course of action that the board has already considered and ruled out, but for confidentiality reasons is unable to disclose that. Once on the board,

activist nominees are able to identify and understand the problem.

- **How do you aim a tornado?** The risk in building a board of rivals is that you create a group of people who become focused on talking and arguing without reaching a decision – let alone a consensus. This is where the role of a strong chair comes in, at both the full board and the committee levels. Directors tend to become more appreciative of broader and even opposing perspectives as they become more comfortable leading within that environment. We have noted that directors on a board that is considering adding an activist nominee, who have already interacted with another activist nominee on another board, tend to be less threatened by the prospect. We would also note that uniting the board around a common goal and set of standards is also helpful and made possible through a substantive director evaluation process. This allows all directors to move past personal biases and cliques to a more robust evaluation of performance.

We are big believers in the idea that it is far better to aggressively test ideas privately than to have them fail publicly. Given the number of unhappy shareholders we encounter, we think more boards would be well served by welcoming directors who are willing to ask tough questions and are unafraid to argue with their colleagues.

WHAT BOARDS OF DIRECTORS CAN LEARN FROM THE TORONTO RAPTORS

The world of business is often like sports, especially when it comes to boards of directors who have to square off against a shareholder activist. It's convenient, then,

that the NBA champion Toronto Raptors' home arena is located at the foot of Bay Street, the heart of the nation's financial district. As Canada continues to bask

in the Raptors' championship season, it is useful to see what directors can learn about building not only a winning team, but also a resilient one.

Always Evaluate

Like the Raptors at the start of the season, companies have a strategy they plan on executing. But, unlike the Raptors, many companies are unprepared to critically evaluate that strategy as it rolls out, to make needed adjustments, and to respond to adversity.

This season, the Raptors had injury issues: Kawhi Leonard missed 22 games as part of his load-management protocol, and Serge Ibaka was sent to the reserve unit. For boards, when targets are missed, results fall short of guidance,

and adversity – such as a short-seller or activist shareholder – strikes, what changes are they prepared to make in response? Or, more importantly, what has been done to prepare and build resiliency into the enterprise in advance?

Raptors coach Nick Nurse dealt with each of these delicate situations effectively and won the respect of players and fans in the process, demonstrating that accountability matters. Directors need to be able to put their companies into a constant state of internal review,

to challenge the underlying assumptions of their strategy, and to make changes when needed to maintain shareholders' and the market's confidence.

Boards need to ensure a balance of expertise so that they are able to not only question plans effectively but also adequately evaluate management in order to ensure they get their number one job right: hiring the right CEO (and firing the old one if needed).

Right People for the Right Time

Raptors president, Masai Ujiri's decision to fire the coach of the year and trade fan favourite, DeMar DeRozan, for the often injured, rental player, Mr. Leonard, left many people scratching their heads. But Mr. Ujiri was enacting a lesson that many boards fail to appreciate: Regardless of your affinity for an individual and their past contributions, the team that got you to where you are might not be the team to get you where you want to go.

Take the gold industry for example: Directors with exploration and development experience may need to

be replaced with mine builders and operators at the appropriate time. Crucial to this refreshment is succession planning, especially for the CEO role, which was a key issue in Paulson & Co.'s recent proxy fight against Detour Gold. Unlike the Raptors, who identified Nick Nurse as Dwane Casey's successor after five years as an assistant coach, Detour Gold was vulnerable because a lack of succession planning had left it with a revolving door at the CEO position. In the cannabis industry, we have seen and will continue to see, the need for founder-CEOs to be replaced with CEOs

who can absorb the massive scaling up and growth in the industry. Such was the case with Aphria Inc (TSX: APHA), where both co-founders recently moved on from the company.

Just as fans see a general manager's willingness to make bold moves as an indication of the team's commitment to win, shareholders view succession planning and an ongoing commitment to board refreshment as an indication the company is committed to long-term success.

Develop Your Bench Players

The Raptors built a team with a strong bench, understanding that individual players – even stars – aren't always available or appropriate to get the job done. By ensuring adequate depth and competence beyond front-line players, they were able to outlast and outcompete teams that relied heavily, or entirely, on superstars.

Similarly, in the corporate world, there are clear benefits to understanding where you can effectively slot in new talent during periods of adversity or change. Furthermore, it is critical to be tapped into industry professionals beyond the company's immediate cohort and to continually attempt to shore up

obvious weaknesses and any skill gaps that may develop following a change in market or operational conditions. Like fans, you can bet your shareholders will be making similar comparisons.

Deliver for Your Fans

For boards, "fans" are your shareholders. Prior to this past season, Mr. Ujiri remarked that being good wasn't good enough; the Raptors needed to be great, and directors would be wise to adopt a similar mindset.

Like fans of the Raptors, which had become a reliable 50-win team without a championship, shareholders of companies that deliver consistent results can be prone to demanding even more if

opportunity is seen to exist, as illustrated in M&G Investments' recent proxy fight against Methanex Corp. (TSX:MX) and JANA Partners LLC's campaign against Agrium Inc. when it was the second-best performer among its peers.

In Canada, where our unique regulatory regime paves an easy road for shareholder activists, a company's performance does not allow it to escape an activist attack if more is

expected. Boards need to be willing to explore strategic opportunities, evaluate their company through the eyes of an activist, and be prepared to explain why a particular course of action does not make sense. As Mr. Ujiri has remarked, sometimes the best moves are the ones you don't make. When an opportunity to create value is seen but boards are unable or unwilling to act on it, shareholders will be quick to replace them with directors who are.

Do You Reward Your Stars for Past Results or Meeting Future Expectations?

By all measures, Kawhi Leonard was an impactful superstar and all indications were that the Raptors were willing to break the bank to keep him in the fold.

But how much they are willing to pay their superstars highlights a core question for them to consider, and one that is familiar to boards: How much is a winner worth?

Too many boards are judged by shareholders to have overpaid for CEOs who previously demonstrated success, without adequately tying compensation

to future performance metrics, such as total shareholder return. While boards will argue that large make-whole payments are needed to attract unique talent or that voluntarily retiring executives are deserving of a special payout or severance, shareholders are likely to see things differently. Many simply do not buy into the "CEO-superstar" narrative that boards have used to justify eye-popping pay packages.

As Mr. Ujiri demonstrated in re-signing Serge Ibaka and Kyle Lowry two years ago, success hinges on not overpaying

for talent but still appropriately incentivizing them to succeed. Die-hard fans and shareholders are generally in it for the long haul, with both expecting year-over-year performance for their loyalty and the sound investments in talent that requires.

To apply these lessons to your company, you don't need to be an expert in basketball or even a fan. Just a fan of good governance.

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