

REPORT ON BUSINESS

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[A love story]

**GREG BOLAND AND
MICHAEL MCCAIN SHOULD
HATE EACH OTHER.
THEY DON'T**



WAR *and* PEACE *and* COLD CUTS

How did one
impertinent shareholder
outflank a Canadian
Establishment company
like **Maple Leaf Foods**?
Jacquie McNish goes
behind the scenes to
discover the new school
of investor activism

—
photograph by Kourosh Keshiri



Maple Leaf
Foods CEO
Michael McCain
(left) and
disgruntled-
investor-turned-
board member
Greg Boland

In a Toronto meeting room bearing the name

“TOP DOGS,”

two alpha business chiefs are singing each other's praises.

“He is smart as hell!” “Scary bright!” “Accomplished!”

That’s Michael McCain talking. He has been chief executive officer of Canada’s largest food processing company, Maple Leaf Foods, for 13 years. Tall and broad-shouldered with a wavy crown of steel-wool hair, the 53-year-old is an effusive communicator who frequently leans into the table as he drives home a point.

Basking in the CEO’s praise a chair away is Greg Boland, hedge fund owner and Maple Leaf shareholder. Lean and sinewy, Boland, 47, lets McCain do most of the talking while he balances his chair on its hind legs. On the few occasions that Boland interjects, he is economical with words and delivers them in a quiet monotone. “Michael, to his credit, listens.”

Breaking into a wide smile, McCain enthuses, “We are more the same than we are different.” Counting fingers, he rhymes off similarities: “analytical,” “objective,” “results-oriented,” “Type A,” “adventurous.” He stops mid-stream when asked if he shares Boland’s passion for rock climbing.

“No way,” McCain yelps in mock fear. Recalling a photograph of Boland hanging from a stiletto-peaked Italian mountain, he wags a finger at his partner, “You silly bastard, don’t do that.”

It’s a good bet McCain uttered the same warning a year and a half ago. But it wouldn’t have been with a smile. These two have waged an unusual but telling corporate war that ended with a truce that left the outnumbered McCain in charge.

In August, 2010, Boland’s fund, West Face Capital, put Maple Leaf in its crosshairs, acquiring a 10% stake in a company that had disappointed investors for years.

McCain’s executives and directors knew they were under attack: Boland was an activist with a record of shaking up companies. Sure enough, in the following weeks, Maple Leaf became the object of withering private and public critiques, culminating in West Face launching a proxy contest days before Christmas, 2010.

The peaceful outcome in what is normally a battle to the death speaks to the effectiveness of the latest chapter of the activist playbook. The days of “greenmail” and “raiders” are gone. A new generation of shareholder rebels are applying enormous financial clout, shareholder support and a good supply of patience to awaken the management of slumbering corporate giants. It’s an American phenomenon; Boland is an outlier. But American activists are pointing their lances toward Canada too. New York hedge fund owner Bill Ackman recently brought his roughhouse tactics north to shake up management at industry slowpoke Canadian Pacific Railway Ltd. “This is about restoring the balance of power back to the owners. The activist acts as the tip of the spear and is willing to take the body blows,” says Ackman.

T

here was a time when Greg Boland was paid to defer to the elite.

It was the late 1980s, and Boland was the first-year science student at the University of Toronto. He was paying his way through school as a waiter at Palmerston, a top-tier restaurant that was making a star of the Jamie Kennedy. One night Boland was asked to serve

at a private party of businessmen who had gathered to raise funds for a portfolio management program at the University of British Columbia’s Sauder School of Business. Boland was captivated by the war stories recounted by investment legends like Milton Wong.

When the guests told Boland that the Sauder program trained students by giving them university endowment money to invest, “I thought, ‘Holy shit, this is really cool,’” Boland recalls. “I liked the tangibility and the practicality of it, opposed to the theoretical stuff you normally get in school. Within months, Boland enrolled at Sauder.

Growing up as one of two children of a divorced mother in Ottawa, Boland spent most of his spare time racing downhill: “It hooked me mentally and physically.” But he was good with math too—and, later, software code. The combination—“a thrill-seeking puzzle solver,” in Boland’s own words—pointed the way ahead.

The cold calculations that come with both math and advanced skiing made Boland a perfect fit for the portfolio management program at Sauder. His computer skills put him at the forefront of an emerging style of investment strategy: quantitative analysis. What most impressed teachers was Boland’s Zen-like confidence in going against the grain. “It was quite apparent early on that he was an independent thinker,” says Rob Heinkel, a Sauder finance professor. “He was

hard-working, always very calm, not cocky or smug. What distinguishes Greg is his gut feel. When he locks on to an idea, he goes with it. He has conviction."

Boland quickly embraced new trading technology, writing his own investment computer models by the time he graduated. His skills landed him a place on the most profitable trading desk on Bay Street: RBC Dominion Securities Inc. hired him in 1991 and placed him alongside Roland Keiper, the sharpest eye on the Street for undervalued or overpriced securities. Specializing in junk bonds and arbitrage trades, the small team racked up massive profits for RBC and pocketed millions of dollars for themselves by shorting stocks or spotting undervalued securities. Big wins included bets against Royal Trustco Ltd. and Newcourt Credit Group Inc. before the financial giants toppled.

Boland specialized in distressed debt, a grim and emotionally charged corner of the capital markets where corporate bonds and debentures are sold at deep discounts. While other investors thumped tables to get concessions on troubled bonds, Boland remained coolly focused on solutions. "He is completely able to divorce his emotions from investments. I've never seen anyone like him, who can keep his ego out of the investment process," says Jim Doak, a portfolio manager who worked alongside Boland in the late 1990s.

Boland's success attracted imitators, meaning the "pretty easy money" he had been making became more elusive. Casting about for new ways to profit from troubled companies, Boland wanted to use RBC's investment clout to push for management and strategic fixes at struggling companies. But there was a problem with that sort of aggressiveness: RBC's shared bloodlines with the Canadian establishment. Boards were populated by RBC clients; if Boland got tough, he'd soon tread on the wrong toes. "I was very constrained at RBC," he says—a characteristic understatement.

In 1998, Boland left the cavernous trading floor at RBC Securities to set up a one-man desk at Enterprise Capital, an investment boutique founded by Jim Doak and Jim MacDonald, former Scotia Capital investment stars. At Enterprise, Boland effectively ran his own fund for his core client, Greenwich, Connecticut-based Paloma Partners LLC.

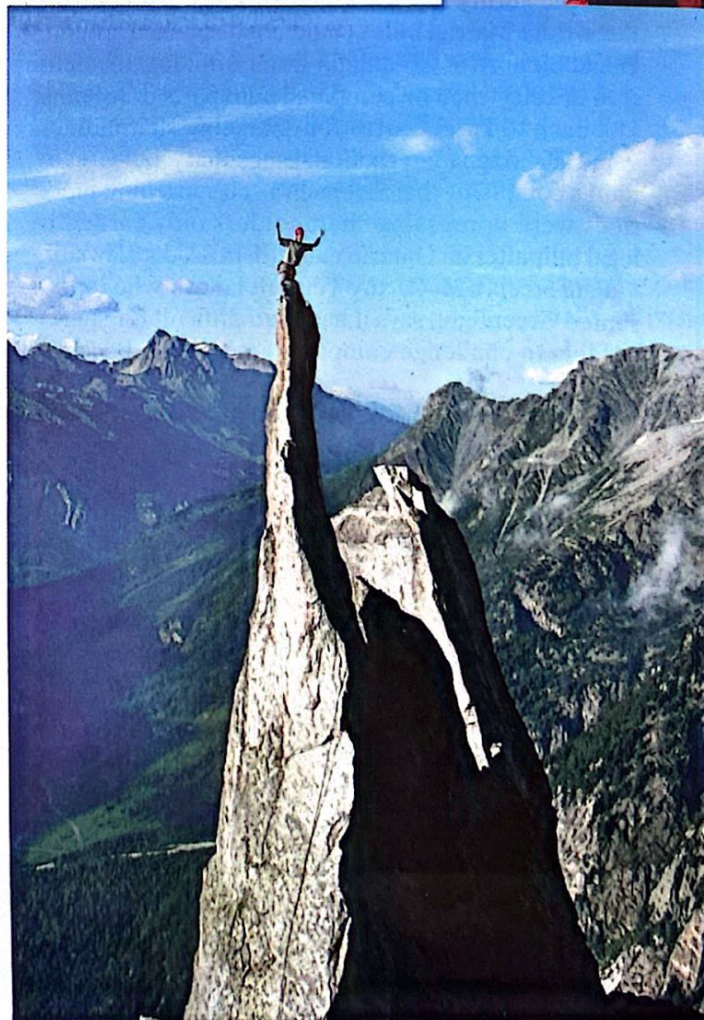
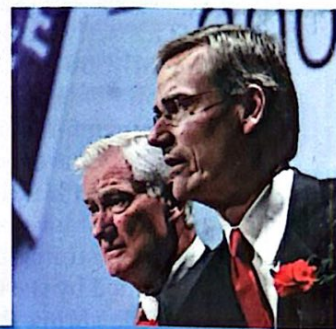
Leaving RBC meant Boland had more freedom to push for change at ailing companies. It also gave him more flexibility and money to feed his thrill-seeking side. "Greg did not have the same Germanic call of duty as the rest of the Street," says Doak, who marvelled at Boland's "James Bond lifestyle" of arriving late at the office and disappearing for long stretches in search of adventure.

Boland's idea of relaxing is defying death. He clambers up knife-sharp rock peaks with bare hands, heli-skis down avalanche-prone mountains, loops through the skies in aerobatic airplane manoeuvres and wind-surfs swells in Hawaii. Boland says the duress of extreme sports fortifies his trademark confidence. He calls this the "calm loop"; the more you believe you can do it, the greater the chances you can. Or, to put it the other way, "If you are perched on a steep mountain in Alaska and think about falling, you will."

Boland can get away with his James Bond act because most of his investments are long-term plays that seldom require minute-by-minute attention. Still, he ensures he is a phone call away with satellite-linked communication devices he packs for every trip. Several years ago, Boland was nearing the Sun Gate of Machu Picchu after a daylong trek up the Andes, when his phone began ringing. While his companions toured the magnificent Incan ruins, he discussed investments over the shoe-box-sized device.

Shortly after setting up his own desk, Boland cemented his reputation as a daring investor by making a bet that many initially dismissed as lunacy. TVX Gold Inc. was heading for the abyss in the late 1990s after its mining project in Greece was shuttered. Boland snapped up a large stake in TVX bonds that were trading at a 60% discount. What he saw that others missed was TVX's portfolio of gold-mining options, which protected TVX if the price of gold fell

Greg Boland, bagging a peak in the Alps in the bottom photo, relies on extreme sports to retain high-stakes calm; Michael McCain, seen below with his late father, Wallace, gained his clout more traditionally



and would yield huge profits if prices recovered. After gold prices levitated in 2001, Kinross Gold Corp. bought the bankrupt company. Boland quadrupled his money.

By the mid-2000s, Boland was ready to put down deeper stakes. He married and committed to a new, more absorbing business. In 2006, he founded a hedge fund that would agitate for change at underperforming companies. West Face Capital is named for the hostile side of a mountain—an apt metaphor for anyone tilting against Canada's business edifice.

Located off the Bay Street grid in a bland Bloor Street office tower, West Face's utilitarian space could be confused for a call centre. The small reception area doubles as a kitchen. A solitary bookshelf stores a worn copy of the Yellow Pages. Behind a glass partition, casually dressed men wearing headsets study computer screens. Of West Face's 30 employees, some trade securities, some monitor investments and others hunt for new opportunities.

Boland declines to identify his backers, other than to say it is a small group of international sovereign wealth funds and Canadian pension funds and endowments. He started the fund in 2006 with \$500 million; today, new investors and strong annual returns have increased West Face's assets under administration to \$2.5 billion. That gives Boland the means to buy big stakes in corporate weaklings. In little more than five years, he has successfully agitated for change at more than a dozen Canadian companies, including Stelco, ACE Aviation and UTS Energy, pocketing gains by pushing for new strategies, asset sales or lucrative takeovers.

This activism would not have been possible until recently, Boland says, because directors were too clubby. "Things are changing slowly in Canada. Now board members have a greater understanding of what their duties are to stakeholders."

But Canada still has its distinct issues, as American activist investors have discovered. Bill Ackman's quest for strategic change at Canadian Tire in 2006 was foiled by the Canadian capital-market oddity of multiple voting shares, which ensured that controlling owner Martha Billes could not be pushed around. David Einhorn at Greenlight Capital got lots of attention in 2005 when he compared auto parts czar Frank Stronach to Fidel Castro for damaging shareholder value at a Magna International subsidiary. But Greenlight's complaint that Stronach's self-enriching practices were oppressing shareholders only earned it legal bills after an Ontario court dismissed its lawsuit.

Paul Steep, a McCarthy Tétrault lawyer who represented Greenlight, says it has been difficult for shareholders to challenge companies in Canada because

judges have been "far more deferential to corporate officers and directors" than their U.S. counterparts. With the arrival of more business-savvy judges and legally sophisticated shareholders, "our judges are becoming more attuned to the deficits of governance in Canadian business and less inclined to defer to directors," Steep says. Thus directors need to pay more attention when activists call.

Michael McCain was wrapping up a vacation at his Georgian Bay cottage in August, 2010, when he learned that West Face had just purchased 10% of Maple Leaf Foods. The news could not have come at a worse time. The company had just finished what McCain calls a "fight for survival," after a 2008 listeria outbreak at its Toronto meat-processing plant killed 23 people. Then came the global financial crisis and the resurgence of the loonie, which meant Maple Leaf's collection of aging plants could no longer count on a cheap currency to compete against larger and more efficient U.S. rivals. And there was more. The company was going through an ugly divorce with its biggest shareholder, Ontario Teachers' Pension Plan, and, toughest of all, Michael's father and mentor, company chairman Wallace McCain, was fighting a losing battle with pancreatic cancer.

"The coalescing of challenges," as Michael McCain calls it, meant the family was losing its grip on a company that he now concedes "had not delivered" to shareholders for years. Maple Leaf's stock price had been sinking since 2005, badly lagging

such U.S. peers as ConAgra Foods Inc. and Sara Lee Corp.

McCain, who had pocketed nearly \$20 million in compensation in the three years leading up to 2010, was largely insulated from a shareholder backlash because of his family's unique shareholder partnership with Teachers'. Further securing his grip was a board that included some of his father Wallace's closest friends, many of them with shared roots in New Brunswick, home to the McCain french-fry empire. The board's lead director was Purdy Crawford, now 80, whose status as dean of the Street was illustrated when he became a one-man task force on the asset-backed commercial paper meltdown in 2007. His friendship with Wallace dated back to college days. Joining him on the board are such pillars of the establishment as Geoff Beattie, CEO of the Thomson family's Woodbridge Co. Ltd. (which owns *The Globe and Mail*), and James Hankinson, former president of Canadian Pacific Ltd. Closely knit, influential and deeply connected, the board was untouchable.

Or so it appeared until the day in 2010 that the company unveiled a sweeping \$1.3-billion strategy focused on modernizing its sprawling network of meat-processing facilities. The hefty price tag was equivalent to 84% of Maple Leaf's total stock market value. After standing mute since 2005 while the company's stock price swooned 40%, investors balked. Maple Leaf had already spent hundreds of millions buying companies and modernizing facilities, yet its margins were still prosciutto-thin. "Shareholders had lost faith in the company," Boland declares.

But there was little frustrated investors could change so long as Teachers' continued to back the McCain family. The pension plan had handed effective control of Maple Leaf to the McCains under an agreement that tied its 35% stake to the McCain family, which owned a 30% interest. The agreement gave the McCains the right to nominate more directors, assuring the family control of the board.

By 2010, however, the bond with Teachers' was unravelling. A new pair of managers at the fund, Bill Royan and Wayne Kozun, had been given responsibility for the Maple Leaf investment. According to insiders, the two were adamant that the planned restructuring had to be more thoroughly analyzed before it was approved. When the recommendations fell on deaf ears, Teachers' announced it was pulling out of the agreement with the McCains. The move put the pension plan in a ticklish position. If it went public with its complaints or launched a proxy battle, it would be challenging conduct that it had tacitly approved for nearly 15 years.

Asolution to the sticky situation arrived in the summer of 2010 when Greg Boland paid a visit to Teachers' offices. The investor had had his eyes trained on Maple Leaf's limp stock for nearly a decade. What he saw in the widening delta between the pension plan and the company was an opportunity to pull the latter out of its slump. If Teachers' sold its stake, the McCain family would lose control and have little choice but to be more responsive.

By August, Teachers' was so desperate to extricate itself that it sold a third of its stake—10% of Maple Leaf Foods' shares—to West Face. In a stinging rebuke of the company, the fund sold at a 9% discount to the market price. For \$113 million or \$8.25 a share, Boland placed a maverick bet on a stock that the big money was fleeing.

McCain and his board did not see that the ground was shifting. Their first reaction, according to people close to the board, was to dismiss their new investor as a short-term opportunist who wanted to take advantage of turmoil to squeeze out a quick profit. Maple Leaf had a multiyear turnaround strategy in place; one investor was not going to thwart what they believed was in the long-term interests of the company.

Today, McCain offers a phlegmatic assessment of his rocky early days with Boland: "What's interesting is that first impressions are so often wrong: Activist shareholder comes in and just wants to come and flip it for a fast buck."

He adds, however, that West Face's first read of the company was just as wrong. This is what McCain calls activists' "mythology" about incumbent management. "He could come

FROM GREENMAIL TO GOOD GOVERNANCE: A SHORT HISTORY OF SHAREHOLDER ACTIVISM

'79

Wall Street's first raider, **Carl Icahn**, acquires 5% of stove maker Tappan Co., then launches proxy battle that leads to takeover by AB Electrolux. Icahn's profit: \$2.7 million (all currency U.S.)

'80

Drexel Burnham's **Mike Milken** emerges as raider's banker of choice by promoting junk bonds

'84

Saul Steinberg earns \$32-million profit and reputation as greenmailer when **Disney** buys back his 11% stake at a premium to make him go away

'84

T. Boone Pickens buys stake in Gulf Corp. and engages in legal shootout that culminates in takeover by Standard Oil of California. Pickens earns \$506 million

'85

Forestry company Potlatch buys out the **Belzberg** brothers' minority stake for \$50 million after they threaten takeover. The brothers repeat the tactic at Ashland Oil, Hartmarx Corp. and Arvin Industries

'87

Icahn hits the activist jackpot with \$700-million profit on 12% stake in **Texaco** after he gets it to reduce multibillion-dollar legal settlement with Pennzoil

'02

Greenlight hedge fund manager **David Einhorn** makes short-selling bet against Allied Capital, alleging it has overstated assets. The investment is a bust, but ultimately Allied is investigated and one of its units files for bankruptcy

'03

New York investor Tweedy, Browne calls for investigation into payments to **Conrad Black** and others at Hollinger International. Within months, Black resigns; criminal investigation leads to jail time

'04

Bill Ackman's hedge fund Pershing Square Capital acquires stake in **Wendy's** and successfully pushes burger flipper to spin off Tim Hortons

'07

Ontario Teachers' shakes up slumbering **BCE Inc.** by leading leveraged buyout. The bid collapses in wake of financial crisis, but fund wins its push for new management

'12

Consumer advocate **Ralph Nader** joins the movement, ripping a very liquid Cisco for not sharing the wealth with shareholders



in and say management is entrenched and just cares about their jobs and is not interested in shareholder value. I think we both recognized that we were probably both not exactly on the mark on first impression," he says.

That is a polite way of saying West Face and Maple Leaf Foods were at loggerheads for months. West Face partner Tom Dea, who had teamed up with Boland in 2006 after a career as an Onex Corp. dealmaker, shouldered the task of telling McCain and his team in painstaking detail how they were mismanaging the company. According to people familiar with these private discussions in the fall of 2010, Dea did not sugar-coat his message—that Maple Leaf had not done its homework regarding its ambitious overhaul. He pointed to the unimpressive precedent of the company's makeover of its primary meat-processing plant in Brandon, and cited other management lapses. Maple Leaf responded to its impertinent new shareholder by tasking a special committee of directors and advisers to examine options.

As the months dragged on with little communication, Boland and his team concluded they were being stonewalled. "There was some distance," Boland says in his usual neutral style. The silence was interrupted on Dec. 3, 2010, when West Face issued a manifesto. It called for a meeting of shareholders to vote for a smaller board of new directors that would not be dominated by McCain family friends and associates. "The deficiencies of Maple Leaf in critical areas such as board independence and corporate governance are well known," West Face said.

In the American activist playbook, such proxy contests are a frontal attack on the credibility of corporate directors. Private investigators are hired to dig up dirt on directors, embarrassing details are leaked to the media and proxy advisers are hired to solicit support for activists' proposed slates of directors. The assault, if successful, leaves incumbent directors humiliated.

But Boland's approach was more nuanced. West Face took many of the standard steps at Maple Leaf. Investigators unearthed ties between the company and some of its directors—that, for instance, Purdy Crawford's daughter was employed as a manager at Maple Leaf. Organizations that employed two other directors had received donations or contracts from either Maple Leaf or the McCain family. These details, according to sources, were spelled out in a proxy circular that was prepared but not deployed.

Not only did West Face keep its powder dry, but the proxy vote that it had called for would not be binding. This was not a full-scale revolt, but rather a message to the board that it had to fix itself by adding more independent directors and doing a better job of scrutinizing the company's operations. The tactic goes to the heart of Boland's investment approach. Reflecting his training at manners-conscious RBC Securities and his desire to be seen as a positive influence in troubled companies, he is loath to engage in public feuds. Before Maple Leaf, he had launched only one other proxy contest—against Air Canada parent ACE Aviation, a fight that was called off after Boland was offered a seat on the board. The less blood spilled in a fight with West Face, the easier it would be to peacefully convince targets that change was necessary. "Constructive criticism of a company is tolerated today," Boland says. "It is up to us to be viewed as constructive and reasonable."

The soft-punch approach hit the mark at Maple Leaf. Two months after the December call for a vote, the activist and the target announced a ceasefire. The directors, in the end, had little choice. West Face's rallying cry had galvanized shareholders, and a quick survey of investors by Maple Leaf directors revealed that the hedge fund had enough support to win its proxy contest. On Feb. 3, Maple Leaf announced that Boland had agreed to join its board, and new independent directors would be appointed by the spring of 2012.

HOW WEST FACE WINS



Stelco
West Face made a gutsy bet on the steelmaker, buying an 18% stake at \$5.50 a share, issued as part of the company's bankruptcy reorganization in 2004. West Face supported a restructuring on a bet that the stock would soar with recovering steel prices. Less than a year later, Stelco was acquired by U.S. Steel Corp. for \$38.50 a share.



UTS Energy
The oil sands producer's stock price collapsed nearly 90% in 2008. But West Face calculated UTS had more than \$6 a share in cash and asset value, and so bought a 15% stake, at less than \$1 a share. West Face pushed Total SA to make a takeover offer. UTS exits at \$3.60 a share.



Vector Aerospace
When the maintenance company's largest shareholder made a low-ball offer that would have given him a majority position, West Face saw opportunity and acquired a 19% stake at less than \$7 a share. Betting that the sector was ripe for consolidation, West Face nudged the board to consider alternatives. The company was acquired in 2011 by European giant EADS for \$13 a share.

PHOTOGRAPH: STELCO; DARRIN GRAY/CFP

Over the next six months, Maple Leaf's embattled directors and executives got a lesson in the restorative power of allowing an activist inside the tent. Boland led his West Face team on what could be called a corporate colonoscopy. ("Apparently he likes them," quips McCain.) To analyze whether the planned billion-dollar overhaul made sense, Boland and his team visited almost every meat processing facility, including—in a telling moment—a dusty crawl through some of the dungeon-like corners of the company's century-old Schneider factory in Kitchener, Ontario. They interviewed hundreds of employees and analyzed years of supply-chain data.

It is unusual for management to yield so much information, even to a director, because it leaves them vulnerable to second-guessing. But the more Boland asked "excruciatingly penetrating questions," the more McCain understood that his former adversary was an ally. "The last goddamned thing that I want is executing something that is flawed," McCain says. "If he can illustrate that it is wrong or make it better, frankly, I win." Most of all, McCain needed Boland's approval of a restructuring plan to reassure other shareholders that he was still the right CEO for the company.

Neither Boland nor McCain will discuss in detail how the largest infrastructure project in the company's history was altered as a result of the probe. But the \$560-million overhaul that was announced in October, 2011, is obviously less ambitious than the \$1.3-billion version McCain announced a year earlier. The new plan comes with the big human cost of 1,500 net job losses and the closure of eight plants and distribution centres, including the Schneider plant.

Perhaps the most surprising thing about the Maple Leaf announcement is that it was unveiled by McCain. Shareholders had grumbled for years about McCain's rich take-home pay and poor performance. It seemed inevitable that the CEO would head for the exits after Boland gained influence on the board. Boland credits

McCain's survival to his flexibility: He listened, and he understood that he needed to demonstrate that his interests were aligned with shareholders'. "He really, really wants to do the right thing," says Boland.

The right thing was announced last summer. As part of family estate changes in the wake of his father's death in May, McCain parlayed his inheritance into a 30% stake in the company. "I'm all in," McCain says with a trace of weariness. "I do so with a very significant level of personal confidence because I believe very deeply in the people and history of this company."

It could be said that McCain is telegraphing his faith in something else: his newest director. He clearly regards Boland, his former adversary, as one of the company's more important assets. It is a conversion that Boland hopes will send a message to other companies.

"We are making a good case to directors that activist shareholders no longer have to be seen as pariahs." 12

Alexandra von Schroeter, CFA
Partner and Portfolio Manager

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