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Some winners, few losers, no apologies

Some investors won't touch a stock that doesn't have equal voting rights, but others insist the structure has concrete benefits, DEREK DeCLOET writes

BY DEREK DECLOET

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Every day, Jay Hennick can look outside his office and see a reminder of the scandals that shook the business world three summers ago.

Four consultants are camped out in a boardroom at **FirstService Corp.'s** headquarters in midtown Toronto, giving advice on how to meet the rules of the U.S. Sarbanes-Oxley Act, the massive, post-Enron corporate reform bill signed into law by President George W. Bush on July 30, 2002.

Mr. Hennick estimates that FirstService, which runs property management and service companies in the United States and Canada, will spend $2.5-million a year to stay in line with the law. He doesn't like it, but he's willing to pay it, just as he was willing to remove his father from the board after FirstService was criticized for weak corporate governance. But there's one concession he will never make to the governance brigade: He won't give up the multiple-voting shares that entitle him to control FirstService with just 9 per cent of the equity.

"I have a very firm belief that today, more than ever, dual-class shares are important to keep a great company . . . doing the right thing," says Mr. Hennick, who founded FirstService in 1989.

"Investors today are not Warren Buffett investors. A much larger percentage of the market today is about immediate gratification." Multiple-voting shares, he says, "allow us to manage our business in the best long-term interests of the company and its shareholders."

It could hardly be a less popular time to take that view. Shareholder democracy has taken root in Canada and has spawned a growing impatience for companies that don't give all shareholders an equal say. Pension funds and money managers are objecting, often loudly, to the kind of inequity that allows Frank Stronach to control Magna International Inc. with an ownership stake of less than 1 per cent, or that allowed Conrad Black and his cronies to take tens of millions in management fees before an extraordinary series of court decisions removed their grip on the Hollinger group.

Two more dual-class companies have found themselves under fire in recent weeks. New York hedge fund Greenlight Capital Inc. filed suit against Mr. Stronach and several insiders of MI Developments Inc., a Magna real estate spinout, for killing a popular proposal to divest MI's 59-per-cent position in Magna Entertainment Corp. Meanwhile, a group led by Toronto hedge fund JC Clark Ltd. turned up the pressure on Caldwell Partners International Inc., the executive recruiting firm, to enfranchise all shareholders equally. "By converting to a single class of shares, you will demonstrate . . . a basic principle of good corporate governance -- shareholders are partners, not lesser owners," the group said in a letter to controlling shareholder Douglas Caldwell.

And yet, for all the hue and cry about the unfairness of it, Mr. Hennick has a point. Most large

Canadian companies with dual-class shares have done remarkably well for their shareholders, in the long run.

Forty-four of the 221 companies in the S&P/TSX composite -- 20 per cent -- have more than one class of shares. Of those, 41 have been public for at least 10 years. Their average annual return in the past decade (to June 30) is 16.1 per cent, far higher than the composite's 10-per-cent gain. More than two-thirds of them beat the index.

By themselves, these numbers don't prove much. The sample of companies is small and heavily skewed to media companies, which tend to use multiple-voting shares to avoid breaking foreign-control rules. A bigger problem is survivor bias: High-profile disasters, such as Hollinger Inc. and ice cream maker CoolBrands International Inc., aren't included in the list because they've been kicked out of the index for being too small.

Still, there is little hard evidence, at least in Canada, that multiple-voting shares bring inferior results. The Shareholder Association for Research and Education (SHARE) -- a non-profit group that works with pension funds -- opposes multiple-voting shares but conceded in a 2004 paper: "There is no clear-cut proof that dual-class companies either outperform the market, as their controlling shareholders suggest would be the case, or that they underperform."

One of the few Canadian studies on the subject was conducted in 1996 by Burgundy Asset Management Ltd., a Toronto investment firm that manages money for pension funds, foundations and wealthy individuals.

Burgundy looked at 413 Canadian companies over five- and eight-year periods, and found that companies with a democratic, one-share-equals-one-vote structure did slightly better (between 0.5 and 0.7 per cent). The difference was "small but not insignificant," the firm concluded.The fight against multiple-voting stock has been fuelled by several ugly corporate meltdowns, each involving executives who appear to have used their power and voting control to profit at other shareholders' expense. In two cases, the former controlling shareholders are under criminal investigation -- Lord Black at Hollinger International Inc. and Vic De Zen at Royal Group Technologies Ltd. And some of the worst-performing companies in Canada, such as Bombardier Inc. and CoolBrands, have held tight to dual-class schemes that have made it impossible for their investors to kick out the directors and change things.

The rhetoric is heating up. At a shareholder meeting this spring, Greenlight president David Einhorn compared Mr. Stronach, memorably, to Cuban dictator Fidel Castro. Others are expressing their complaints in less-colourful ways, like closing their chequebooks. The Ontario Teachers Pension Plan now refuses to participate in most new financings for dual-class companies. "The main way to eliminate them is by controlling the supply of capital," says Brian Gibson, the fund's senior vice-president of public equities.

Veteran stock analyst Rob McConnachie, a portfolio manager with Dixon Mitchell Rae Investment Counsel Inc. of Vancouver, believes companies with unequal votes will find themselves shunned by a growing number of investors, now that Ottawa has freed pension funds and retirement accounts to invest without restriction in foreign markets. If you want to invest in a large auto company, it's no longer necessary to own Magna. Mr. McConnachie's firm is a shareholder in just two Canadian companies with a dual-class structure -- St. Lawrence Cement Group Inc. and Torstar Corp. -- and that's not by accident. "Every company that absolutely blew up in my face -- every single time it had really poor corporate governance," Mr. McConnachie says.

But defenders of the dual-class model say the debate is misguided. It's not that dual-class companies are inherently evil. What matters is not the structure, they say, but whether the controlling shareholder is competent and careful with the shareholders' money -- and whether he has a lot of his own wealth on the line.

"I have only one investment and that's the one I run every day," says Mr. Hennick, whose FirstService shares are worth about $77-million. "And I am not prepared to allow my huge stake to be exposed to the exigencies of the market in an environment like this."

By "exigencies," he means hedge funds and short-term investors who buy large positions in companies, then push for structural change -- conversion to an income trust, divestiture of a struggling asset -- to get a quick lift in the stock price. Mr. Hennick argues that managing a company for the short-term stock price can lead to bad decisions. "You may have to spend. You may have to do some R&D. You may have to keep a division of your company when everybody says, 'Sell it.' "

Or, if you're Craig Dobbin, you may want to do a deal that bets the company. In 1999, Mr. Dobbin's **CHC Helicopter Corp.** decided to make a $177-million bid for Norway's Helicopter Services Group SAS. CHC was still tiny -- its market capitalization was about $60-million. A deal of that size could hurt the company's share price for a while, but with voting control in his hands, Mr. Dobbin knew CHC wouldn't be vulnerable to a hostile takeover.

"It put our debt-to-equity at a staggering 6½-to-one. That was pretty frightening for investors and for us, but we could see beyond the short-term risk for the long-term gain," says Mr. Dobbin, who moved from CEO to executive chairman last year. The Norwegian deal trebled CHC's size; the stock price, then $2, is now just under $25. To Mr. Dobbin, that's enough proof: "You can never run a goddamn company by consensus, you know?"

Even those who oppose dual-class shares concede that they don't have to be a problem if they're handled responsibly. Mr. Gibson of Teachers points to Quebec drugstore chain Jean Coutu Group (PJC) Inc. as an example. "The family already owns a lot of shares" -- more than 45 per cent -- "and they exclude themselves from participating in the stock-option plan, things like that."

When lecturing to students, University of Toronto professor David Beatty often cites five prominent Canadian families as examples of long-run business success -- the Desmarais family, the Southerns, the Jackmans, the Westons and the Thomsons. Two of the five use multiple-voting shares: the Desmarais' Power Corp. group, and the Southerns' Atco Ltd. and Canadian Utilities Ltd. But their success, Mr. Beatty says, has nothing to do with voting control; it's that those families "live their businesses" and act like owners, not corporate monarchs. "It's exactly what a shareholder would want," says Mr. Beatty, who moonlights as the managing director for the Canadian Coalition for Good Governance (and, coincidentally, is a director of FirstService).

As for whether dual-class shares actually allow executives to make better decisions, as Mr. Hennick and Mr. Dobbin claim -- well, it's crystal clear that most investors disagree. In June, FirstService shareholders voted on a resolution to eliminate the dual class; a majority said yes (although it was defeated anyway by Mr. Hennick, who gets 20 votes for each of his 1.3 million multiple-voting shares). And in case after case, when a company has decided to get rid of its multiple-voting shares, the market has greeted the news by driving up its share price.

There's no better example than **Home Capital Group Inc.,** a Toronto-based mortgage provider that's been one of the best investments a Canadian investor could own. If you had invested $10,000 in the stock on June 30, 1995, your would have had nearly $1.4-million after 10 years. No dual-class company even comes close. For that, Home Capital's shareholders can thank a strong housing market, but also CEO Gerry Soloway's decision to give up his multiple-voting power in May, 2003.

At the time, the stock was $9; now it's $39.50. "We've done very well, but I think that abolishing the dual class has been a real boost to investor confidence," Mr. Soloway says.

So, how about it, Craig Dobbin? Isn't CHC, with a $1.1-billion market cap, mature enough to enter the age of corporate democracy, and let go of the dual class?

"I'll tell you when I'm going to give it up," he says. "When I give up myself . . . when I'm ten toes up."

Five who've done it right...and five who haven't

DESMARAIS FAMILY

Power Corp.

You can argue that they've built their empire with help from friends and benevolent regulators in Ottawa. But it's hard to argue with the results: Over the past decade, Power Corp.'s shareholders have done better than Berkshire Hathaway's.

COUTU FAMILY

Jean Coutu Group

The family of the Quebec drugstore chain acts as an owner should. The Coutus pay themselves modestly and don't take stock options or rich pensions. And the performance has been stellar: Only six dual-class companies in the S&P/TSX composite have done better since 1995.

JAY HENNICK

FirstService Corp.

Okay, so he'll never win any awards for governance. But Mr. Hennick has $77-million of his own money invested in the business, has accepted no stock options for three years and made improvements to the board, such as appointing an independent chairman.

ALAIN BOUCHARD

Alimentation Couche-Tard Inc.

The chief executive officer and three other executives collectively own about 20 per cent of the convenience store chain. When the four men reach age 65, or if their voting power shrinks to less than 50 per cent, the dual-class structure disappears automatically.

REMI MARCOUX

Transcontinental Inc.

In a tough industry - printing - Transcontinental has somehow put together a 10-year record that rivals the big banks; with annual returns of 20 per cent. Compare it to Quebecor World, and it's easy to see what a difference good management can make.

PIERRE KARL PELADEAU

Quebecor Inc., Quebecor World Inc.

The man has the distinction of controlling not one, but two of he worst-performing dual-class companies; Despite his family's already-large share ownership, he took a million stock options last year from Quebecor World. For what?

FRANK STRONACH

Magna International Inc., MI Developments Inc. and Magna Entertainment Corp.

Where to begin? The $50-million-plus paycheques? The spending on horse racing? Maybe it wouldn't be so bad, except that he owns less than 1 per cent of Magna International, enjoying all the benefits of control with little of the risk. Shareholder returns have been mediocre.

BOMBARDIER FAMILY

Bombardier Inc.

They care deeply about the company, yet still came close to wrecking it. Laurent Beaudoin expanded too aggressively and drove the Bomber into a financial straitjacket. To raise cash, the company sold its snowmobile division to - guess who? - the family (and other investors) at a very good price. Then he drove out Paul Tellier, one of the most highly regarded Canadian executives.

CONRAD BLACK

Hollinger International Inc. and Hollinger Inc.

Richard Breeden, the former SEC chief who helped break Lord Black's grip on his newspaper company, said that if he were "philosopher king for one day," he would get rid of multiple-voting shares. After the related-party deals with Breeden committee found at Hollinger, it's no wonder he feels that way.

VIC DE ZEN

Royal Group Technologies Ltd.

Here's a swell idea: Buy a piece of land for $21-million, flip it to your company the same day for $27-million, and pocket the difference. When Mr. De Zen decided to give up voting control, the stock jumped 13 per cent in a week. As with Lord Black, his insider deals have led to a criminal investigation.

	Ten best performers...	10-yr compounded annual return*
1	CGI Group1nc.	50.3%
2	Alimentation Couch-Tard Inc.	45.1%
3	CHC Helicopter Corp.	34.7%
4	Reitmans (Canada) Ltd.	28.1%
5	Dorel Industries Inc.	25.5%
6	Transat AT Inc.	25.4%
7	Jean Coutu Group (PJC) Inc.	25.2%
8	FirstService Corp.	24.5%
9	Metro Inc.	22.4%
10	Shaw Communications Inc.	22.1%

	And the ten worst...	10-yr compounded annual return*
1	Bombardier Inc.	-10.1%
2	International Forest Products Ltd.	-5.7%
3	Extendicare Inc.	3.8%
4	Agricore United	4.3%
5	Falconbridge Ltd.**	4.5%
6	Quebecor World Inc.	5.0%
7	Quebecor Inc.	5.1%
8	Teck Cominco Ltd.	5.7%
9	Alliance Atlantis Communications Inc.	6.6%
10	CanWest Global Communications Corp.	7.1%

*Total shareholder returns, including dividends, from June 30, 1995 to June 30, 2005

**Formerly Noranda

TEXT: DEREK DeCLOET/THE GLOBE AND MAIL; CHART SOURCE: BLOOMBERG
