CHAPTER SIXTEEN

THE IMPORTANCE OF SCALE

Northern Tigers Positioned for Global Growth

THERE HAS BEEN A SERIES OF DRAMATIC EVENTS in the Canadian corporate landscape that have unfolded in the last decade in finance, energy, technology, agriculture and mining.

Around the time the first edition of this book was published, a company called Research in Motion became the most valuable company listed on the Toronto Stock Exchange. Trading under the symbol RIM, the company had revolutionized how the world communicated. Their Blackberry device was the world's first smartphone, allowing individuals to receive and send emails.

But RIM failed to recognize the threat of another company south of the border, Apple, and more specifically, the introduction of Apple's iPhone in June 2007. One of the company's co-founders, Jim Balsillie, famously called the iPhone a toy. Some toy. A decade later it's the iPhone that dominates the smartphone market, with RIM—now known as Blackberry—having a market share that is so low it no longer registers. To be fair, the company, under the leadership of current chief executive John Chen, has embarked on a plan to re-invent the company as a software and systems provider, rather than one focused on hardware, but it is unlikely Blackberry will regain its stature as one of Canada's most valuable publicly traded companies.

The last 10 years saw another once-iconic Canadian company, Nortel Networks—which at one time had 94,500 employees

around the world and was synonymous with telephone switching systems—file for bankruptcy protection in January 2009. Nortel was a global provider of telecommunications and networking equipment, whose market capitalization at the height of the technology bubble in 2000 accounted for one-third of the value on the Toronto Stock Exchange. As a result of the bankruptcy, the company was liquidated and its assets sold to various competitors.

These two examples are illustrative of the fact that the expertise and knowledge exist to broaden Canada's economy from being overly weighted towards the natural resources. But both, ultimately, failed. Where Nortel arguably failed was in the context that it was caught up in the tech market bubble, lacked sufficient cash resources to weather the downturn, focused on acquisitions they did not integrate properly, did not meet the demands of their customers—which was for new products.

If anything, its story stands as a lesson to Canadian corporations in two contexts: one positive, the fact it was, for a time, a Northern Tiger—a successful Canadian company with a global reach—and the second being negative—because it no longer exists. Blackberry, on the other hand, relinquished its dominance because it failed to recognize and respond to a competitor; that is a situation ubiquitous in the corporate world—no matter where a company is headquartered.

But there have also been some incredibly positive and exciting examples of Canadian companies continuing to build their markets and brands—both within the country and outside.

One almost didn't happen.

In August 2010, Australian mining giant BHP made a $40 billion (CDN) unsolicited offer for Saskatchewan's Potash Corp.

It was something Dick Haskayne was dead against and started working behind the scenes, alongside his longtime friend Steven Jarislowsky, to make the case that Potash needed to stay in Canadian hands for a number of important reasons.

"Potash Corp.," said Haskayne, "was the owner of one of Canada's most important natural resources. It was a well-managed company, and I thought it was the wrong thing to do. If we had

let it go, from this country's point of view, we would have lost control of the resource."

Factoring into Haskayne's thinking, beyond the fact that the company owned the largest potash reserves in the world, was that it would be another signpost in what was seen as a hollowing out of Canada as a global mining centre, not to mention eliminate an important investment option on the Toronto Stock Exchange. By the time the bid was announced, the country had seen other iconic companies, including Inco, Falconbridge, Alcan, Stelco, be swallowed by foreign entities, becoming line items on the balance sheets of companies based in Brazil, Switzerland and the U.S.

While the bid was subject to the usual fiduciary oversight demanded by securities regulations, the federal government also had to determine whether the deal would be of net benefit to Canada.

In a letter published in the *Financial Post,* Haskayne argued convincingly that the government should not approve the deal for a number of different reasons, including the fact Potash was well-positioned to play an important role in meeting the world's growing need for fertilizer, that a sale would send a signal Canada was willing to sell 'any its prized resource companies' and that the disappearance of a company the size of Potash would eliminate an important investment opportunity of size for both Canadian and global investors.

Those arguments are no more diminished today than they were when the letter appeared in 2010.

On November 2, 2010 the federal government issued its decision, supporting the company and agreeing with Haskayne, Saskatchewan premier Brad Wall and other corporate leaders that it was in Canada's best interest for Potash to remain as a separate entity, owned by Canadians.

It was an end to a chapter in Canadian corporate history that had been hotly discussed and debated across the country centered on one question: was Canada open for business, or not?

That decision arguably paved the way for the creation of a global fertilizer giant, based in Canada and operating around the

world. In September 2016, Potash agreed to a friendly deal with Calgary-based Agrium, a fertilizer producer with retail operations.

The deal, which create a new company, to be called Nutrien, with an enterprise value of $36 billion, means the merged company will operate in 20 countries around the world, with 20,000 employees, generating $20 billion in revenues. It also makes it the third largest publicly-traded agriculture company in the world.

That's quite a calling card.

But that might not have happened, either, had the New-York based hedge fund, Jana Partners LLC, that wanted to break up Agrium, been successful.

The Jana saga consumed Agrium for 10 months, between 2012 and early 2013, as it worked with shareholders to understand the strategy and not buy in to Jana's vision of the company that involved selling off Agrium's retail division. That chapter closed after a dramatic shareholder vote that took place in the ballroom of Calgary's Sheraton Hotel on April 8, 2013, which saw Jana's plan to install two board members soundly defeated.

Tough as the activist experience was, Agrium CEO Chuck Magro believes it did help the company re-think its allocation of capital, which is important in the context of setting and executing any company's strategic direction.

Haskayne, needless to say, is very pleased with what has transpired.

"It's a super company and it proves my theory that we can be global players in certain businesses in the world as long as we capitalize on what we have. This is a classic example of that," he said.

Magro said the deal was not done as a defensive move, rather made at a time when it saw a window of opportunity to leverage its relative market valuation and find a merger candidate whose assets and operations would be accretive to the bottom line and provide future growth opportunities.

"It was centered on long-term value creation. It was nice to have a Canadian partner, but that was not the first criterion. The first was, does this make strategic sense? Can we create not only

short-term value—through synergies—but long-term value," said Magro.

Agrium is a company that has grown through acquisitions—which means it has a strong culture of integrating people and operations and capturing the associated synergies. Merging with Potash transforms Agrium into a global agriculture player and positions it to take advantage of future opportunities.

"The winds are changing globally," says Magro, "the Americans are pulling back and the world is looking for leadership. I don't see why Canada can't be part of that. The nice person 'Canadian' culture plays very well around the world."

But that's not the only growth story that needs to be highlighted.

By virtue of both foresight and the ability to take advantage of relative balance sheet strength, a consolidation has taken place within the oilpatch, and more specifically, amongst the oil sands producers.

Suncor arguably kicked it off in 2009, when it acquired Petro-Canada in a deal valued at $19 billion and billed as one aimed at consolidating oil sands assets, even as Petro-Canada's assets were 55 per cent weighted towards conventional production. The market liked the transaction and by 2011 Suncor was the fourth largest company by market capitalization traded on the Toronto Stock Exchange.

And Suncor didn't stop there.

As a result of the downturn in oil prices that began in 2014, the company saw other opportunities to boost its oil sands reserves and production; the endgame in the oil sands continues to be one of economies of scale.

Not that Suncor's overarching goal was to become a global player, but the transactions it has completed—along with getting its costs down to $22/barrel (Cdn)—and strengthening its balance sheet means it is well positioned for future growth.

Suncor acquired Canadian Oil Sands for $6.9 billion in January 2016, a company whose primary asset was a 37 per cent interest in the Syncrude mining project. Acquiring Canadian Oil Sands boosted Suncor's ownership of that asset from 12 per cent

to 49 per cent. The price paid, said Williams, was between 20 and 25 per cent of the original cost of building the operations.

From there, four months later, the company moved to buy Murphy Oil's five per cent interest in Syncrude for $932 million, giving Suncor an ownership stake of 53.74 per cent in the Syncrude operation capable of producing 350,000 bbls/d.

What's next for Suncor is completing its next project—Fort Hills oil sands mining project with its minority partners, Total S.A., a French multinational company, and Vancouver-based Teck—which most observers say is the last mining project of scale that will be built in Canada's oil sands.

Williams also notes that other acquisition opportunities are bound to surface—but these will not be pursued for the sake of growth; it all has to fit within the construct of the company's long-term strategy and over-arching capital discipline.

"We didn't write the strategy and say we want to be a global champion. It was more of what are we good at? What do we do well? What do we think the opportunities are and how do we work that agenda?" said Suncor CEO, Steve Williams.

"It's about capital discipline, getting the base business reliable and getting the costs low," he added.

Suncor's growth to date, however, has afforded it another role—that of being a credible voice within the industry to address issues of climate change and what needs to be done in order to ensure Canada's energy sector remains competitive.

While Cenovus, another major player in Canada's oil sands, has been very focused on technology—and that is something critical to ensuring the long-term competitiveness of the industry—Suncor, while also committed to developing new technologies, has actively taken an advocacy role.

Because of its size, Williams says Suncor has been able to engage alongside a few of the other larger companies—credibly—on behalf of industry, with non-governmental organizations that have been opposed to oil sands and pipeline development and with the Alberta and federal governments.

"There was not a 'do nothing' option. Things were not going to stay the same. Pipelines were not going to be built. What we now have is oil sands, Alberta and Canada are actually in a global climate leadership position and we can start to call the shots," said Williams, referring to Alberta's Climate Leadership Plan announced in late 2015, the commitment to carbon pricing by the federal government and the fact there are two pipelines that have been approved in Canada since those two policies have been put forward.

When oil prices collapsed in 2014, the comment being made in Calgary was that bottom of the downturn would be signalled when Murray Edwards and Canadian Natural Resources began buying assets.

That happened in March 2017, when Canadian Natural Resources announced it was acquiring for $12.74 billion (Cdn) the oil sands assets of Royal Dutch Shell, which was still in the process of selling assets to pay for its hefty acquisition of BG Group in early 2016 for $49 billion (U.S.). As part of that deal, Royal Dutch committed to selling $30 billion in assets between 2016-2018—and the oil sands piece was clearly part of that plan, not to mention another step towards Shell's goal of becoming a natural gas company.

The transaction was announced at the annual CERAWeek Conference—the premier annual international gathering of energy industry leaders, experts, government officials and policymakers, leaders from the technology, financial, and industrial communities, and energy technology innovators—the same morning that Shell's chief executive Ben van Beurden was set to give a presentation.

He said that the move was about looking at the relative size of the oil sands assets and recognizing there were other opportunities in the company's portfolio where it would rather allocate capital.

"We felt the position we had in oil sands mining was not material and we were not advantaged enough for it to really fit in our long-term portfolio design," he said.

For CNQ—as Canadian Natural Resources is often referred to because of its ticker symbol—the deal meant it was buying assets at a 40 per cent discount from what it would cost to build a new mining operation. But it had been modestly bulking up prior to the Shell acquisition. In February 2014, just before oil prices started their downward slide, the company paid $3.1 billion (Cdn) for Devon Energy's assets, including the oil sands reserves and production, as the Oklahoma-based company moved to downscale its exposure in Canada.

The exit of Shell from the oil sands, where it had played a strong role in the development of extraction processes and was a key proponent of the establishment of carbon pricing and an oil sands emissions cap, was received somewhat bitterly by Canada's oilpatch. The sentiment was that both the carbon pricing and emissions cap gave Shell the social license to continue operating in Canada's oil sands. At the same time, the fact the assets were staying in Canadian hands and in fact consolidating ownership positions was seen as positive.

CNQ, which had become Canada's largest natural gas producer in 2016, had further solidified its position as a leading energy company in North America with the Shell deal.

In addition to commodity price swings and transformational technological developments, the last 10 years were marked by a cycle of investment and divestiture in Canada's oil sands by foreign players.

In early 2007, Norway's Statoil bought North American Oil Sands, followed by Total S.A. buying UTS Energy in 2010, and China's CNOOC buying Nexen Inc. in 2012 for $15.1 billion. This added to the presence of other foreign players already established in the oil sands, including ConocoPhillips, Chevron and Imperial Oil.

The downturn in commodity prices however, saw Statoil, Shell, ConocoPhillips, and Marathon Oil exit the oil sands as they sought to allocate capital in other areas of their global portfolios.

So much for long-term investing.

Statoil sold to Athabasca Oil Sands, Shell, as previously mentioned to CNQ, and ConocoPhillips sold its joint venture interest in Foster Creek and Christina Lake to its 50 per cent partner, Cenovus, in March 2017. Eighty per cent of oil sands production is now controlled by companies headquartered in Canada.

And Cenovus is a story in itself.

As previously highlighted in Chapter 11, Encana was created through the merger of PanCanadian Energy and Alberta Energy Corporation (AEC) in 2002. The intent was to create an oil and gas company of size that would be too big to be bought by another company.

But that direction was dramatically reversed in 2009, when Encana's then-CEO Randy Eresman announced the company would split into two separate entities—Encana, which would be a pure play, natural gas producer, and Cenovus, an oil sands company with some conventional natural gas assets.

It was a deal that was seen as mistake by many, including Haskayne, who had served as a director of Encana and its predecessor company, AEC, for 20 years.

"Had I been on the board, I would have fought like hell because it was a well-balanced company—with the land holdings it had, the balance sheet it had and the production it had. The issue of splitting didn't make sense to me. That was why we put it together in the first place," said Haskayne.

The argument against breaking up the company was that the energy business is cyclical and therefore being a pure play on one commodity was to be too exposed to the commodity cycle.

No matter.

Cenovus began trading as a public company in December 2009, led by Brian Ferguson, who had formerly held a series of executive positions at Encana and AEC. Haskayne had known Brian since he had held the position of Treasurer at AEC and Dick was the Chair of the Finance and Audit Committee.

By all accounts, Cenovus was in the elite of the oil sands group with its 'beach front' assets. The collapse in oil prices in 2014,

however, hit Cenovus, like so many other oil and gas companies, very hard, and the company focused on strengthening its balance sheet by selling assets and issuing equity.

But in early 2017, Cenovus saw an opportunity to take advantage of the cyclical exit of the bigger players; in its case, to buy the 50 per cent interest in Foster Creek and Christina Lake (FCCL) that it didn't own, but was operating on behalf of ConocoPhillips.

The $17.7 billion transaction announced in late March marked another step in what was becoming a Canadian corporate nationalization of the oil sands. In addition to the FCCL assets, Cenovus acquired significant exposure to natural gas prospects in the deep basin of AB and BC.

To outsiders it looked like Cenovus had realized the folly of being a pure play company—and that it was trying to recreate the old Encana, which had exposure to both oil and natural gas.

But for Cenovus CEO Brian Ferguson this was about increasing scale, being able to take advantage of the technological changes that lie ahead in the oil sands and to better position the company for future growth through a more balanced portfolio and be competitive on a global basis.

"It's about achieving greater financial resilience because we have better cash generation capacity under a range of commodity prices," said Ferguson.

Despite Ferguson's best efforts, the market took a negative view of the ConocoPhillips deal, but there is little doubt that the transaction—which was supported by the Cenovus board of directors—positions the company to be competitive over the long term both from its ability to harness technology and diversify revenue streams.

"Scale is important in terms of taking advantage of technology … it's a myth that large companies cannot be innovative and cannot be leaders in innovation and the application of technology. At the same time, and in the context of this transaction, adding in the complement of short-cycle cash generation to rival the medium and long-term opportunities under a variety of oil price scenarios is important," said Ferguson.

Despite Ferguson's—and the Cenovus board of directors'—conviction the deal was the right one for the company, and that having control over resource base, which is what the deal brought, is important for the long term, the market was not as keen on it as it was for Suncor's and CNQ's transactions. To the surprise of many, Ferguson announced he would be retiring in the fourth quarter of 2017; the sentiment around the oilpatch was that he took the fall for the negative market reaction to the transaction.

The 2014 downturn in oil prices that persisted for more than two years undoubtedly created a lot of pain in Canada's oilpatch, but not every segment of the sector was negatively affected.

For the midstream players, there were opportunities to take advantage of.

TransCanada had been consumed in a protracted and challenging process to gain approval for an oil pipeline, Keystone XL, which would be an addition to the first phase of Keystone that began transporting oil from Alberta into the U.S. in 2010. This was TransCanada's first pivot from being only a shipper of natural gas.

Building XL would take oil sands production directly from Alberta into the refining complex of the U.S. Gulf Coast. But despite studies from the U.S. State Department affirming that the pipeline would not significantly add to greenhouse gas emissions nor encourage more production from the oil sands, then-U.S. president Barack Obama turned down TransCanada's application for the project in late 2015. The current U.S. administration under President Donald Trump has since approved the project, but at the time of writing, it has yet to proceed.

There was a similar story being played out with Enbridge as it sought approval for its Northern Gateway pipeline, which would carry oil sands crude from Alberta to the coast of British Columbia, thereby opening new markets for the country's oil production. While Enbridge had received approval for the project from the National Energy Board—with 209 conditions it was confident could be addressed—and the federal cabinet of Stephen Harper—it was officially rejected by Prime Minister Justin Trudeau in November 2016.

Both TransCanada and Enbridge were coming to see the world through the same lens: that buying existing infrastructure—as long as the economics made sense—was a better route through which to grow their respective companies in the shorter and medium term, than it was to build new pipeline projects. It was simply taking too long to gain approvals.

For this reason, it was tough to refute the logic behind TransCanada's decision to buy Columbia Pipelines in March 2016 in an all-cash deal valued at $13 billion (U.S.)—a move that gave it significant exposure to the prolific natural gas production in the Utica and Marcellus formations in the U.S. and brought with it another $7 billion in expansion opportunities. When the deal closed, TransCanada had more employees south of the border than it did in Canada.

"It was really a $30 billion (Cdn) bet, [with the Columbia system] backed by lesser known companies—not the big guys but the smaller players. The same is true in the Western Canadian Sedimentary Basin. The marketplace is transforming. We have to figure out how to transform our company to be able to capture that," said TransCanada CEO Russ Girling.

The Columbia deal built on other acquisitions TransCanada had made in the U.S.—including Gas Transmission Northwest (2004) and ANR Pipeline in 2007. It was the demand for space on ANR as production in the Utica and Marcellus was growing that was the signal for the company to look for expansion opportunities.

Among the reasons TransCanada was able to buy Columbia—which was in a position of needing to raise money and not having access to capital—was its ability to come forward with an all-cash bid.

TransCanada had learned, following the Nova deal in 1998, what it was like to operate with a stretched balance sheet that ultimately pushed the company to cut its dividend in 2000. Since then, capital discipline has been a core focus of both board and management; having financial strength at the bottom of the business cycle is when companies can make transformative moves for the future—which is what TransCanada has done.

Girling sees the next big opportunity for TransCanada being tied to natural gas development in the Duvernay and Montney formations.

"The conventional thinking today is that the growth in natural gas production will go from 17 billion cubic feet per day to 19 bcf/d. Why aren't we thinking about 30 bcf/d—as a country, and as a company?" asked Girling.

His point—and it should be heeded—is that without connecting the shale gas production in Alberta and British Columbia to the continental marketplace Canada cedes the potential to supply the eastern part of our country to U.S. natural gas.

Not to mention the prospect of developing the resource—estimated to contain 1,000 trillion cubic feet of natural gas—and the opportunity cost in terms of the lost investment opportunity.

If the difficulty in building new projects factored into TransCanada's thinking on the Columbia deal, the same logic held for Enbridge and its blockbuster deal to buy Spectra Energy in September 2016 for $37 billion (Cdn). The deal made Enbridge the largest energy infrastructure company in North America, while also giving the company plenty of room to generate future growth from the assets that were bought.

While some might think this was something the company needed to do—after Northern Gateway was effectively killed by the federal government—company CEO Al Monaco said that was absolutely not the case.

"The failure of Northern Gateway did not factor into the decision. It was based on the fact we were weighted so heavily to oil," said Monaco.

"It was the fundamentals of natural gas that really drove the thinking behind it. We have believed, for many years, in the fundamentals of natural gas … natural gas in North America is top notch. Technology is there to get it out at low cost. You have existing infrastructure, sustainability for power generation and storage capability. It's a natural for us to move into that and get to scale," he added.

But, at the end of the day, as Monaco and others point out, whatever the acquisition—it must also come with opportunities for organic growth.

"You need to be both an acquirer and be able to grow organically. Enbridge Gas got us into Vector (pipeline) and Alliance (pipeline) into the U.S. gas business, and the Alberta gas business," said Monaco.

Another company that has taken a big step onto the global stage is Edmonton-based Stantec, which has grown from being a small, regional player that started in 1954 to one employing 22,000 people in 400 locations across six continents. While the company has been on an acquisition spree since 2000, its transformative deal took place in 2016, when it bought privately-held MWH Global, a U.S. based design, engineering and construction firm that has worked on big infrastructure projects around the world, including the recently completed expansion of the Panama Canal. The deal put Stantec, which has been very involved in the oilpatch over the years, in the top three global design firms and means 70 per cent of revenues will come from outside the country. It also positions the firm to take advantage of the infrastructure boom that is underway around the world—whether in terms of new projects or those replacing what is out-dated and inadequate for today's needs, in Canada, North America and elsewhere.

And there is a coda to be written for Fording Coal.

Its history and transformation into the world's second largest metallurgical coal company was detailed in Chapter 12. But in 2008, Teck, which owned 19.9 per cent of what was still the Fording Coal Income Trust, whose primary asset was the Elk Valley Coal Partnership, made a successful $14 billion bid to buy Fording. It was a deal that solidified Teck's position as a Canadian-based global mining giant, set in motion by Haskayne back in 2003.

While much of the corporate activity has been in the energy and energy-related segments of the economy in recent years—by dint of opportunity, need or both—there is another company that

has defied expectations, is not resource-based and has expanded outside the country.

Once involved in the energy sector, Hudson's Bay—through Hudson's Bay Oil and Gas, of which Haskayne was CEO until it was sold to Dome Petroleum in 1981—has come through a restructuring in 2008 to be a major retailer in North America and Europe.

Hudson's Bay continues to be headquartered in Toronto and is traded on the Toronto Stock Exchange. Under the stewardship of Richard Walker—whose New York-based private equity firm NRDC Equity Partners owns 48 per cent of the company—HBC bought U.S. retailer Lord & Taylor in 2012 and the storied Saks Fifth Avenue in 2013. Since then, it has added retailers in Germany, Belgium and the Netherlands through deals done in 2015 and 2016 to its portfolio. There are those that say the value of HBC's franchise today is more tied to the real estate that it owns rather than the unique value proposition of what it is selling, but the fact remains, it, unlike Woodward's and Eaton's, has not only survived but expanded far beyond its roots as a fur trading company established in 1670

Another example of Canadian success outside the resource sector is Waterloo-based OpenText—a global leader in the world of Enterprise Information Systems, which came out of the University of Waterloo in 1991 and has continued to grow, primarily by acquisition. It boasts a footprint around the world and has signalled its intent to play a significant role in the growing world of Artificial Intelligence.

This is by no means an exhaustive list—but each of these companies was highlighted because of the corporate risks they have taken, through acquisitions that have vaulted them onto the global stage and by adhering to basic principles and pursuing organic growth opportunities.

And, as Enbridge's Monaco pointed out—being a Canadian champion doesn't necessarily mean needing to be a global player; more important is that the company is the best at what it

does—and from there, opportunities for growth do emerge. It's safe to say that all the companies we can call Canadian Tigers today have attained their current size and achieved success by focusing on opportunities that are both forward looking, within their strategic construct and don't lose sight of the importance of capital discipline and the need for optionality.

That way they can take advantage of where their respective industries are going; it's about the Wayne Gretzky adage of skating to where the puck is going, not where it just was.