SO MUCH FOR THAT CHILLING EFFECT: THE FIRST YEAR UNDER THE NEW HOSTILE TAKEOVER REGIME

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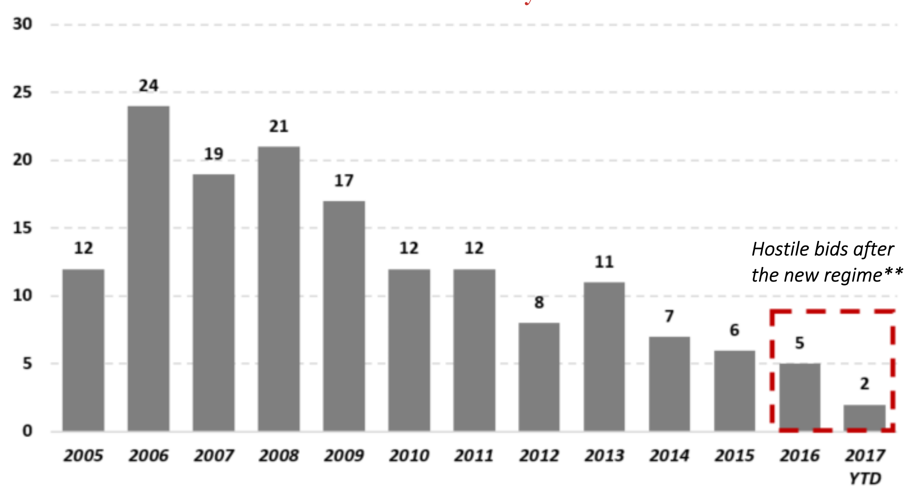
Exactly one year ago today, the new takeover bid regime came in effect across Canada. Many legal pundits, advisors and commentators predicted that the new rules would mark the end of hostile takeovers in Canada. They were wrong.

Seven hostile bids were launched in the last 12 months, the same as in 2014 and one more than in 2015. Not much of a chilling effect, that's for sure.

Where and how are the new takeover rules being felt? Are hostile bidders and targets using different approaches than in the past? Have the new rules affected outcomes? Let's take a deeper look at the deals to date.

Number of Hostile Bids* by Year of Initiation



**Includes all hostile bids that targeted Canadian-listed public companies from January 1, 2005 to April 24, 2017.*
***All 2016 deals were commenced after the new regime.*

TWO BIDS FAILED

Hecla Mining's unsolicited bid for Dolly Varden Silver at $0.69 cash per share (55% over market price) launched on June 27, 2016, was unsuccessful. Shortly after the bid was made public, Dolly Varden announced a dilutive private placement that Hecla challenged at the securities commissions as an inappropriate defensive tactic. The OSC and the BCSC sided with Dolly Varden and found that the company had legitimate business reasons for the private placement. At that point, Hecla withdrew from the deal. The decision is worth reading because it lays out a road map for a private placement by the target in the face of a bid.

Omnia Holding's hostile bid for Nordex Explosives also failed because Omnia couldn't outbid the friendly bidder.

Date Bid Launched	Target	Hostile Bidder	Industry
July 6, 2016	Dolly Varden Silver	Hecla Mining	Commodities
August 3, 2016	Nordex Explosives	Omnia Holdings	Other
October 6, 2016	Canexus Corporation	Chemtrade Logistics Income Fund	Chemicals
October 28, 2016	Franchise Bancorp	WTF Holdings	Financials
Friday December 9 2016	Savanna Energy Services	Total Energy Services	Energy
January 17, 2017	Apivio Systems	Nuri Telecom	Technology
April 19, 2017	Innova Gaming	Pollard Banknote	Gaming

Here's what happened: EPC offered to acquire Nordex for $0.18 cash per share in a friendly deal. Omnia then launched a hostile bid on August 3, 2016, for $0.22 per share (a 22% premium over market price). The friendly bidder matched it. Omnia increased its offer to $0.25 per share. The friendly bidder matched it again. Ultimately the friendly transaction, at the matched price with the hostile bid, but 39% higher than the original price, was endorsed by Nordex's Board and accepted by Nordex's shareholders.

THREE BIDS SUCCEEDED BUT ONLY AFTER THE TARGET BOARD'S BLESSING

Chemtrade Logistics Income Fund's hostile bid for Canexus Corporation launched on October 3, 2016, at $1.50 cash per share (a 21% premium over market price just prior to the announcement of Chemtrade's initial proposal) was successful, but only after Canexus' Board blessed a bumped up offer in December. Chemtrade ultimately agreed to a pay $1.65 per share (a 33% premium and a 10% premium over the $1.50 initial offer) in a Canexus-Board approved transaction. The fact that Canexus was also under pressure from shareholders who requisitioned a meeting didn't hurt Chemtrade's position. *(See page 4 for complete details.)*

Nuri Telecom's hostile bid for Apivio Systems at $0.40 cash per share (a 51% premium) launched on January 17, 2017, was initially rejected by Apivio's Board. But Nuri continued to buy Apivio shares on the open market, reaching 5% ownership by April 10, 2017. During this period, Apivio's share price traded at Nuri's offer price, indicating that the market's perception that the bid price was reasonable. On April 16, 2017, a few weeks before the 105-day bid period expired, Nuri and Apivio reached a friendly deal for $0.45 per share (a staggering 70% premium over the closing price of Apivio on January 16, 2017) in an Apivio Board approved transaction.

The third deal that was successful—but may not be worth tallying—is WTF Holding's bid for Franchise Bancorp Inc. An insider bidder, WTF had already acquired 67% of FBI's common shares prior to formally launching its takeover bid. WTF controlled over 85%, including locked up shares, of common shares of FBI at the time it launched its takeover bid at a market premium of 25%. Not surprisingly, FBI's directors recommended in favour of the bid, and WTF was able to successfully close on the transaction on January 3, 2017.

ONLY ONE BID SUCCEEDED WITHOUT OBTAINING THE TARGET BOARD'S SUPPORT

Total Energy Services' hostile bid for Savanna Energy Services was ultimately successful, even though it wasn't able to get the target Board's endorsement and despite some other roadblocks along the way. It started on December 9, 2016, when Total offered Savanna shareholders 0.1132 share of Total (worth $1.54) for each Savanna share, with close to 43% of Savanna shares already having been locked up. The challenge was that Savanna had recently entered into a term loan of $200 million with a significant change-of-control fee that could have acted as a deterrent to getting the deal done.

In late February, 24 days before the bid was to expire, Total sweetened its offer. But then on March 9, Savanna revealed white knight Western Energy Services, which offered a share exchange deal at a higher premium than what Total had offered. However, it was uncertain whether Savanna had the requisite two-thirds approval of its shareholders for the friendly transaction, especially because of the market concern about Western Energy's capital structure.

THE NEW TAKEOVER BID RULES IN BRIEF

- **105-day bid period:** Bids must stay open for at least 105 days unless (i) the target Board reduces the bid period (to at least 35 days); or (ii) the target announces a friendly transaction, reducing the minimum deposit period to 35 days.
- **50% mandatory minimum tender condition:** Over 50% of the target's securities held by individuals other than the bidder must be tendered prior to take-up by the bidder.
- **10 day extension:** Once all bid conditions have been met, bids must be extended for an additional 10 days.

By the time the bid expired, Total had achieved the 50% minimum tender condition, and it was successful at a price of $1.95 by virtue of the fact that it had already secured 43% support at the time of launch and continued to purchase another 5% of the shares on the open market. On April 5, Total announced that it would reconstitute Savanna's Board of directors and terminate the agreement with Western Energy.

ONE BID WAS EXCLUDED FROM OUR ANALYSIS

Pollard banknote's hostile bid for Innova Gaming at $2.10 cash per share (39% over market premium) was launched on April 19, 2017. Because this situation is still live, we have excluded it from our analysis.

In light of the deals that have been initiated *and* completed in the last 12 months, here is what we can conclude:

1. **Acrimony is out; collaboration may be in:** There is no shortage of bids being initiated, but the focus has changed. Gone are the days when a hostile bid routinely triggered enacting a poison pill, which was then followed by the inevitable run to the OSC, ASC or BCSC by the bidder to challenge the pill and argue as to when it should be cease traded. Inevitably both sides' focus revolved around the pill and more of the target's time and resources was spent on defending the pill than the ultimate objective of trying to surface a better value. Now are the days (105 in fact) for the target's Board to methodically consider the bid and other value enhancing options in an effort to do what's in the best interests of the company and its shareholders. Given the less directly hostile nature of the relationship between targets and bidders, now is also the time for potential bidders to strategically approach the target with a win-win value proposition. We know that obtaining the target Board's blessing leads to greater success. Both bids that failed (Dolly Varden and Omnia) didn't get the target Boards' support. Potential acquirers should carefully strategize with their advisers on how to get buy-in from the target's Board.

2. **Lock it up:** Going into a hostile bid situation with a larger number of shares locked up clearly helps get to the new 50% minimum take-up requirement. Remember, a soft lock up (one that is subject to a better offer) will count towards the minimum 50%. At the end of the day, all the bidder needs is the difference between 50% and the locked up shares to take control of the company.

3. **Cash is king:** All of the offers in the last 12 months were cash except for one. Cash offers reduce uncertainty for the acquirer because they don't have to bear the risk of market fluctuations over the extended 105-day period. An acquirer is well advised to consider the volatility in the target's industry when structuring the consideration for a proposed bid.

In short, the new takeover bid rules have not changed the number or frequency of take-over bids initiated in Canada. What has changed are the tactics that may make for a successful outcome. Private placements may be the new deterrent in the target's arsenal and locked up shares may be the new ammunition in the bidder's arsenal. The extended 105 day period may however lead both to put aside their arsenal and come to friendly terms as did two of the three successful bids in the last twelve months.

ABOUT THE AUTHORS

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HOSTILE BID SPOTLIGHT: THE CHEMTRADE/CANEXUS DEAL

Chemtrade Logistics Inc.'s unsolicited offer for Canexus Corporation was the first hostile bid for a TSX-listed issuer under the new takeover bid regime in Canada. While a consensual deal was ultimately reached, the transaction had a number of interesting features, including public bear hug letters, shareholder pressure on the Canexus Board and a requisitioned meeting by one of Canexus' largest shareholders to replace the Board.

Kingsdale recently participated in a panel discussion entitled *The Chemtrade/Canexus Deal: Issues, Challenges and Strategy Under the New Takeover Rules* designed to explore the historical transaction with those involved. The panel was moderated by Amy Freedman, CEO, Kingsdale Advisors and included Arthur Korpach, Director, Canexus; Mark Davis, President and Chief Executive Officer, Chemtrade; Jeremy Fraiberg, Partner, Osler, Hoskin & Harcourt LLP; Keith Chatwin, Partner, Stikeman Elliott LLP.

OVERVIEW

Following Canexus' failed transaction with Superior Plus for an all-share offer of $1.70 per Canexus share, that was blocked by the U.S. Federal Trade Commission, on Sept. 14, 2016, Chemtrade publicly expressed interest in acquiring Canexus for $1.45 per share in cash.

This expression of interest followed a proposal on June 15, 2015 by Chemtrade to acquire Canexus for $1.90 per share in cash that actually served to initiate the strategic review process that generated the Superior Plus deal. To complicate matters, a week later on Sept. 21, 2016, an activist shareholder, Stirling Funds, emerged owning 9% of Canexus and threatened to replace the Board.

Here is a timeline of key events:

- **September 14, 2016** – Chemtrade expresses interest in acquisition of Canexus for $1.45/share in cash. Canexus plans to pursue $75,000,000 senior unsecured notes offering and acknowledges interest by Chemtrade.
- **September 21, 2016** – Stirling Funds, a shareholder owning over 9% of the outstanding common shares requisitions a special meeting of shareholders to remove the current members of the Canexus Board, and if passed, to set the number of directors at five and to elect five new individuals to the Board.
- **September 26, 2016** – Chemtrade again urges Canexus to engage in discussions on a potential value maximizing transaction. Chemtrade announces that it increases its proposal to $1.50/share on September 15, 2016.
- **October 3, 2016** – Chemtrade announces hostile offer to acquire Canexus for $1.50/share.
- **October 6, 2016** – N. Murray Edwards discloses 9.5% ownership in Canexus.
- **October 12, 2016** – Canexus sets shareholder meeting for January 31, 2017 in response to Stirling's meeting requisition.

- **November 29, 2016** – The Competition Bureau advises that its review of the transaction is ongoing.
- **December 15, 2016** – Chemtrade enters into agreement to acquire Canexus for $1.65/share in cash in a Board-supported Plan of Arrangement. Stirling and certain other shareholders agree to lock-ups aggregating approximately 20%.
- **December 21, 2016** – The Competition Bureau indicates that its preliminary conclusion is that the proposed transaction will likely result in a substantial lessening of competition for the sale of sodium chlorate in Western Canada. Depending on several factors, including a definitive conclusion from the Competition Bureau, the Commissioner of Competition may challenge the transaction.
- **January 5, 2017** – Withdrawal of Stirling meeting requisition following a settlement agreement effective as of December 29, 2016.
- **February 8, 2017** – Canexus receives shareholder approval of Plan of Arrangement with Chemtrade (84.51% support).
- **February 9, 2017** – Canexus receives Plan of Arrangement approval from the Court of Queen's Bench of Alberta.
- **March 8, 2017** – The Competition Bureau confirms that it has issued a No Action Letter stating that it will not challenge the proposed transaction. The Competition Bureau determines that the anti-competitive effects of the transactions will be outweighed by efficiencies resulting from the transaction.

INSIDE CHEMTRADE'S THOUGHT PROCESS

Chemtrade's initial thought process was characterized as *"not liking to be first and not liking to be interesting"* but in order to get this deal done both would likely be required. In assessing whether or not to launch a hostile bid, Chemtrade considered six factors:

1. Deep knowledge of the target assets as they had had an eye on them since the late 90's.
2. Timing and failed previous process. They were following Canexus' failed deal with Superior Plus and were therefore not worried about a white knight emerging.
3. Canexus' recently stated business plan and earnings. The quarterly earnings that included debt reduction commitments and tepid earnings meant there wasn't a lot of upside potential for shareholders if Canexus continued to operate as a standalone. This effectively weakened one of the primary traditional defensive messages against a bid.
4. Value was bracketed with the Superior Plus deal of $1.70 that included a lot of anti-trust issues and was in a range they felt comfortable with.
5. Financing structure and timing. The longer bid period meant increased financial costs as well as market risk for the bidder. Philosophically, Chemtrade was prepared to take business risks but not financing risks. Accordingly they were committed and had financing locked down.
6. Engagement level. Board rejection of a 'reasonable' offer and failed engagement process coupled with increased clarity on where shareholders stood. Chemtrade characterized it as a 'unilateral bid' rather than a hostile one.

Clearly the threshold to go hostile has increased with the risk.

THE CANEXUS RESPONSE

The Canexus Board viewed its job as creating the best choices available for shareholders. It placed primary importance on being able to control the process following a year where they had essentially been locked up and increasingly focused on balance sheet issues. This took significant strategizing to manage the interplay of the requisitioned shareholder meeting to change the board and an announced—but not launched—hostile bid. Once the bid was formally launched, the requisitioned shareholder meeting and activist became facts to be managed as controlling the bid process took centre stage.

Bid Considerations

The launch of a formal bid and pronouncement it was not willing to bid against itself had the potential to scare away arbs who, amongst other things, bet on an improved offer. Drawing on the previous experience of Art Korpach while on the Board of Canadian Oil Sands in its defense against Suncor's hostile bid, consideration was given to assembling a coalition of shareholders who were supportive of Canexus remaining a going concern. Canexus believed they could potentially assemble a group of long-term value oriented shareholders representing 20-30% of the shares outstanding, including a well-known public figure, who could be used for leverage.

There was also discussion by counsel from both sides regarding the potential to reduce the length of time for the bid to remain open given the circumstances. Chemtrade's point of view was that given a comprehensive process was just run previously with Superior Plus and bid launched, they could apply to reduce the bid period to say 60 days. Canexus took an opposing view believing that given that the commission spent significant time to develop the 105 day regime, it would be unlikely that they would reduce the 105 day period on the first real test.

Activist Considerations

While no accusation was ever made of Chemtrade and Stirling acting jointly and in concert, the Canexus Board did have to give consideration to that possibility given the similarity of their motives and desired outcome.

The potential for Board change presented a number of issues. Canexus was worried about the potential for Board change before agreement as a new Board could agree to sell the company without obtaining any price improvement. Post agreement the concern was that a new Board could actually lengthen the process. A view Chemtrade shared whether the deal went friendly or not. Even if new Board members were supportive of the transaction they would need to take time to educate themselves and get comfortable that they have satisfied their fiduciary duties. Noting Air Products & Chemicals, Inc. failed tender offer for Airgas, Inc. in 2010, directors may change their mind regarding the adequacy of an offer once appointed and access to more information is provided.

CONSIDERATIONS FOR HOSTILE BIDDERS

1. The longer bid period not only increases the financial risk but also the potential to trip up over acting jointly and in concert and selective disclosure.
2. What precedes a hostile bid, such as a strategic review process that does not materialize anything or a failed transaction, may present an opportunity to challenge the 105 day rule on the basis that it is unlikely that any other bidders will emerge on more favourable terms.
3. With a clear timeline of 105 days, the bidder's strategy with regards to launch, press releases, solicitation etc., should be simpler to map out.
4. Critical to take into consideration a company's history, the shareholder experience,

and future prospects when crafting messaging.

5. Be prepared to counter any arguments and inferences that may be derived from past statements and actions.
6. On cash deals the target stock may rally eroding the implied current premium but the announced premium statement remains very real. On a stock deal the bidder's stock may trade down eroding the implied premium and that remains very real to target shareholders. 105 days is a long time on some stock graphs.
7. Often Board focus has been on "the bid" and attempts to sweeten it. We have seen both shareholders and proxy advisory firms focus on long-term value of the go-it-alone option.

CONSIDERATIONS FOR TARGET BOARDS

1. While engagement with shareholders is always a good best practice, leveraging competing shareholder views while subject to a hostile bid can surface additional value for shareholders and/or give you support for a go-it-alone stance.
2. Moving from a sprint to a marathon presents a number of practical considerations including internal 'process fatigue' from those working on the defense.
3. When agreement is reached, consider pushing for a reverse termination fee upon the bidder to boost the bidder's commitment for completion of the transaction.
4. Monitor the shareholder base closely throughout the entire duration. Your shareholders cease being your shareholders when the bid launches.
5. Understand different motives among shareholders, long-term holders vs. short-term arbs, and be prepared for proxy contests coming potentially from either the bidder or unhappy shareholders.