

# TORONTO STAR

# BUSINESS

## ON SUNDAY



VINCE TALOTTA/TORONTO STAR

# ... or else

Hedge fund managers like this one will virtually take over a company if they think that management is messing up and letting shareholders down. **By Tony Wong**

was putting up high-profile Toronto hedge fund manager Jim MacDonald as a nominee for its board. MacDonald fought with the firm in the past and wants it turned into an income trust.

■ Intrust Corp., the ski developer, said it was considering how to increase its share price, likely prompted by pressure from shareholders like American hedge fund Pirate Capital.

■ Fairmont Hotels & Resorts, operator of such properties as the Banff Springs and Toronto's Royal York, agreed to a \$3.9 billion sale to Colony Capital and Kingdom Hotels. The sale was put in motion after a hedge fund headed by billionaire investor Carl Icahn put the firm in play.

"Shareholders are now a lot more willing to be active instead of passive investors," says Jim MacDonald, chair of Enterprise Capital Management Inc., and one of the godfathers of active investing in Canada. "I think this can only be a good thing because it creates a climate of better corporate performance."

Not surprisingly, some of the top talent from investment banking and fund management have struck out on their own.

And the reason is simple: Money. The take-home pay of the top hedge fund managers dwarfs that of CEOs of even the largest publicly traded companies.

The pay cheque last year alone for George Soros, perhaps the most famed hedge fund manager, was a staggering \$750 million U.S., according to *Institutional Investor*. And even when hedge funds lose their prey they can still drive up the stock price and win in the end.

Carl Icahn, for example, made a bid for Toronto-based Fairmont, saying the stock was languishing. He was trumped by deep-pocketed Saudi Prince Alwaleed Bin Talal. But Icahn bagged a cool \$116.5 million U.S. dollars on shares he has held since November.

"Sometimes you have to shake a few trees to make some value surface," says Puccetti. "Unlike say a mutual fund, the typical hedge fund isn't going to wait three years for management to get its act together."

From fewer than 1,000 hedge funds in 1990, there were close to 10,000 hedge funds globally by the end of 2005. Assets under management grew from an esti-

mated \$25 billion to more than \$1 trillion during the same period. In Canada, it is estimated that hedge funds control about \$30 billion in assets.

Still, with so many permutations of funds, even experts have a hard time figuring out a definition. "I'd like someone to tell me exactly what a hedge fund does," quips MacDonald. "I still don't know what the term means. I think sometimes it's a fancy name for charging too much to manage other people's money."

Corey Goldman, a Toronto-based senior editor at *MAR-Hedge*, an industry trade publication, says the real difference between a mutual fund and a hedge fund is that "a hedge fund is geared toward a more sophisticated investor and governed by fewer rules."

The classic hedge fund has its roots in the 1940s when *Fortune* magazine journalist Alfred Winslow Jones thought he could do a better job of managing money than the people he interviewed. Jones was the first manager to develop a leveraged long stock position with a portfolio of short stock positions.

Long positions make a profit

when a stock goes up; short positions when the stock goes down. Hence the term "hedge" fund, as in hedging your bets. The idea worked — and Jones' fund outperformed all mutual funds in that era. Since then, after decades of ups and downs, hedge funds have become fashionable again.

"At the end of the day, it's really about forcing cheap stocks to go up," says Puccetti, whose own fund has posted an impressive 22.5 per cent return over the last nine years after deducting fees.

Puccetti's latest conquest has been Cenveo Inc., a struggling envelope and packing firm based in Colorado. In the nine months his company has been buying shares, along with partner Burton Capital, Cenveo stock has increased by 153 per cent from around \$7 Canadian to \$17.50. That's a \$20 million windfall in just nine months.

Still, hedge funds have come under increasing scrutiny especially after the implosion of several in the U.S. and Canada.

Canadian authorities are still investigating Portus Alternative Asset Management Inc., pushed into receivership last March by

the Ontario Securities Commission. Portus had about \$800 million in investor assets. Receiver KPMG is trying to recover more than \$8 million in diamonds bought by one co-founder with company funds.

With less regulation, hedge funds are a riskier bet for most investors. Some critics say they can also be detrimental to the long-term health of a company.

A recent report by American investment bank The Taylor Companies warns that "Activist investing is not without risks."

The wrong strategy could result in no improvement or even a decrease in share price, or worse even if there is a short term bump in share price, the actions could cause harm to the company, said the report.

Ironically, Puccetti doesn't see hedge funds as the way of the future but another investing fad.

"We had the leveraged buyout funds in the '80s and everyone was worried they were going to take over the world. Then in the '90s it was the technology funds and the billions made by kids on skateboards. Now there are fears that hedge funds are getting too big and powerful and too influential, and that too will pass," says Puccetti, the son of a philosophy professor, who named his fund after the town of Goodwood, just south of Stouffville where he first started it.

What will eventually prick the balloon is "a dearth of solid returns that don't justify the fee structure," says Puccetti. "As fast as the money comes in, it can leave."

But not before tweaking the noses of a few CEOs and changing the Canadian corporate landscape for good.

**P**eter Puccetti doesn't carry a battle-axe to the boardroom. But he may as well.

The Toronto man may be personable and polite, but he wields a mighty stick when it comes to companies he invests in as the chair and chief investment officer for Goodwood Inc.

"I think there is a newfound sense in the corporate world that shareholders aren't going to put up with mismanaged or inefficient companies anymore," says Puccetti, one of Bay Street's star money managers. "And they're willing to do something about it."

Puccetti's weapons are proxies and lawsuits and a keen-eyed sense of the bottom line. Inept, fat, underperforming companies beware: Hedge funds such as Puccetti's are the new Barbarians at the gate — and the repercussions promise to transform corporations globally.

The warfare — make no mistake, this can be war — is being waged daily in boardrooms around the world. For companies that are perceived to be underperforming it pits shareholder against management in a struggle for power and profit.

Puccetti and partners Cameron MacDonald and Rob Kittel have become poster boys for the activist shareholder movement in Canada for their track record of unlocking value in companies with mired management.

But they've got a lot of catching up to do with the competition. The year may be young, but the Canadian corporate landscape is already being transformed because of hedge fund activism:

■ Last week Manitoba Telecom Services Inc., Canada's third-largest phone company, said it