

GET OFF THE POT

eResearch is pleased to provide an article written by Edmond G. Eberts of RAPPORT Capital Formation Strategists Inc.

This latest treatise by Mr. Eberts discusses the actions (or inactions) of our politicians and chief executive officers.

Some of the key excerpts from the article are quoted below:

“Though colourful and passionate when standing tall on the stump, all too many members of provincial legislatures and parliament turn into little more than silly putty once in office, bouncing awkwardly from one poll to the next.”

“Few of the members (of the House of Commons) seem to have any idea as to what the real world is all about. The idea that corporate tax rates should be kept relatively low to encourage investment and job formation seems to be beyond their scope of comprehension. Nor do they appear to understand that competitive capital gain and dividend tax rates would spur investors to assume more risk, critical to financing the wealth begetters of the future, those able to make large donations to worthy causes.”

“Whereas all-star hockey players learn to cope with competition, many of our senior corporate executives are scared stiff to go into a corner and fight for the puck preferring, instead, to pass it to someone else and head for the bench.”

“Instead of applying the brakes to change, governments should do whatever they possibly can to encourage corporations to get with it, by upgrading the efficiency of their facilities and looking afield to expand. Otherwise, they stand little chance of remaining competitive, subject to being acquired at what, in the end, will prove to be a bargain price by those willing to do what needs to be done to grow and prosper.”

“If our politicians hope to get re-elected and CEOs be acclaimed, they must pull up their socks.”

Mr. Eberts is interesting to read, thought-provoking, challenging, and always entertaining.

We hope you enjoy the article.

Bob Weir,
Director of Research

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Edmond G. Eberts

Chairman

RAPPORT Capital Formation Strategists Inc.



RAPPORT CAPITAL FORMATION STRATEGISTS INC.
703, 141 Adelaide Street West
Toronto, Ontario M5H 3L5

Telephone: 416-366-9264
Toll free: 800-363-8134
Fax: 416-366-1855

rapport@rapport.ca
www.rapport.ca

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A new economic world is emerging and Canada seems primed to take on a wallflower role. When compared to the assertiveness of China, India, Brazil and Russia, we are but fence-sitters, living off the avails of the country's abundant natural resources. Our cozy world is fast becoming obsolete, our cult of middleness beginning to take its toll. We are without a worldwide consumer hallmark setting an example to others striving to escape the taint of ubiquity. With the possible exception of Research in Motion's BlackBerry, we have steadfastly remained brandless. The idea we are a significant adversary, able to do battle with ferocious competition, is mostly a myth. With the loonie headed for par with the greenback, and the United States likely to buy less from us than before, we can no longer afford to have most of our eggs in one basket. Finding and developing new markets is essential.

WHERE ARE OUR PIED PIPERS?

It was George Bernard Shaw's contention that a promising public service career beckons for those who know little but think they understand everything. The process of learning the craft of good judgment takes time, and few ever achieve a passing grade. Academics, particularly political scientists, are as useless as pulled teeth! So it is little wonder why Canada lacks inspirational political leadership. Though colourful and passionate when standing tall on the stump, all too many members of provincial legislatures and parliament turn into little more than silly putty once in office, bouncing awkwardly from one poll to the next. Only a handful have the smarts or backbone to address the electorate face-to-face, and prevail.

As to the House of Commons, spare me! Few of the members seem to have any idea as to what the real world is all about. The prime minister has not abided by the principles for which his party was elected. Given any number of gaffes, the minister of finance's onanistic self-regard is unwarranted. Rather than admitting to their shortcomings, they plod ever downward, digging a deeper hole as they go. Instead of devising a strategy that will better position domestic companies to compete against the Americans and globally, they persist in getting in the way. The idea that corporate tax rates should be kept relatively low to encourage investment and job formation seems to be beyond their scope of comprehension. Nor do they appear to understand that competitive capital gain and

dividend tax rates would spur investors to assume more risk, critical to financing the wealth begetters of the future, those able to make large donations to worthy causes.

Meeting expectations is a critical aspect of our daily lives. Governments, like corporations and income trusts, must manage their financial affairs in an expeditious manner or suffer severe consequences. There is evidence that “nests” are being feathered at an alarming rate. Public servants are paid an average salary higher than their private sector counterparts, and also receive rich benefit packages. Since 1999, the cost of the federal bureaucracy has increased by an astounding 50 percent, 14 percent in the last two budgets alone. Rather than eliminate redundant programmes and pay down the national debt, which they promised to do, the Conservatives are finding new ways to spend the ever-increasing amount of money the government collects. Surplus denials, “tax fairness,” and relief rhetoric have become tedious. Coupled with Stephen Harper’s penchant for control, and his refusal to allow cabinet members to strut their stuff and enhance the party’s appeal, it is not surprising the voters are unwilling to give him the convincing majority he so desperately seeks.

Whereas all-star hockey players learn to cope with competition, many of our senior executives are scared stiff to go into a corner and fight for the puck preferring, instead, to pass it to someone else and head for the bench. A case in point is China. Thanks to the missionary endeavours of Dr. Norman Bethune, we once played prominent diplomatic and economic roles. Despite seemingly endless debates about what to do to make up for lost market share, our exports have not kept pace with imports. Nowadays, the Chinese prefer to purchase commodities from African and Latin American producers, while we have no choice but to buy their high-quality, low-cost goods. Their principal focus of the past thirty years has been to expand commercial and military might, knowing every other form of power will eventually fall into place. There have been no concessions based on nostalgia, not even the issue of human rights, a touchy subject for most Canadians. We have done just the opposite, reflected in their superior rate of growth in GDP and position in the pecking order of the world’s most respected nations. We have no one but ourselves to blame, our political and corporate leadership less than adequate by any measure. The recent loss of up to 300,000 manufacturing jobs, primarily in Quebec and Ontario, is but the tale of labour leaders, government interference and high corporate taxes. Despite the bitching, everyone should realize that nobody is ever in business to provide as many jobs as possible, only as few as necessary. As success is never guaranteed, all suggestions of saving jobs or assuring their security is nonsensical. Let us also not forget that Canada is experiencing the lowest unemployment rate in thirty-plus years. Many of the new jobs being created pay more than those which were lost, the very reason why income tax revenues are increasing by leaps and bounds. It is time the complainers put their crying towels away and got in step with the facts.

HOME-RUN HITTERS ARE HARD TO FIND

Every free market is exposed to takeovers. It is part and parcel of doing business these days. According to Citicorp, the merger and acquisition frenzy has a way to go before it reaches the record set in 1999–2000, being 10.7, compared to 12.7 percent, of global market capitalization seven years ago. Were it to measure up, the tally would have to rise from US\$2.7 trillion in the first half, to \$6.5 trillion by year end 2007. The investors who reap large gains are more than likely to reinvest the cash to the benefit of the many up-and-

coming hotshots in need of additional capital. It is vital we champion those who have the confidence to compete worldwide.

As to the claim that the purchase of an iconic Canadian company by others is not to our advantage, few amongst us have thought the equation through to its rightful conclusion. Had Inco Ltd. and Falconbridge Ltd. banged their nickel-hardened heads together, which they could have done years ago, would the combined company have survived the current wave of buying by foreign interests? The fact is, we will never know. Had Alcan Inc. and Alcoa Inc. not been split apart by the US anti-trust authorities back in 1928, might the combined company have become a home-run hitter? Maybe, but the financial performance of the sum-of-the-parts has seldom produced above-average results, so I doubt it. Rio Tinto PLC's subsequent "bite the bullet" bid for Alcan is based on the stronger-for-longer commodity price theory. For the sake of its shareholders, let us hope management's decision proves right. One thing for sure is that the acquirers believe they have the wherewithal to realize a superior return on the capital employed.

Bell Canada was brought to my attention as a "sure-bet" investment opportunity as far back as 1965. In 1974, my first letter announcing the launching of Rapport Capital Formation Strategists Inc. was addressed to the chairman and CEO. It noted the loss of more registered shareholders in the preceding decade than any other Canadian company had every had. This was an indication of serious problems of investor perception needing to be addressed. Though several subsequent and related chief executive officers have been elected to the Canadian Business Hall of Fame, the plan of attack has remained inconsistent. Management has failed to gain a solid reputation, attract, develop and motivate quality people. Its relationship with the media and its customers is still iffy. Despite the takeover bid, neither the value of the shares nor the dividends have kept pace with those of its competitors, and now the bondholders are taking a pasting because of the probable demise of the company's credit rating. There is no reason why the senior executives, or Alcan's, deserve a change-of-control bonus. The money should go to the long-suffering investors. A lesson many other boards of directors would be wise to act upon before the private equiteers strike again. Be this the last slice of "belloney" for many years to come!

FESSING UP TO REALITY

Canadians are complacent, unwilling to take chances for fear of failure. As a consequence, we punch well below our weight. Inadequate research and a lack of innovation explains our mediocracy. Creating wealth depends on increasing productivity. New capital investment is imperative in the face of an aging population, which threatens our prosperity while putting additional demands on social programmes. The federal and provincial governments must stop littering the system with a plethora of concessions to specific sectors, because it confuses matters without improving economic performance. Leaving it up to politicians to pick winners from losers has never worked in the past, and is bound to fail in the future. They simply do not have the savoir faire to be successful entrepreneurs. If they had, they would be. And they are not!

Regulation is like putting a bridle on a horse: it allows politicians with nothing to lose to control the speed and direction of change, and prevents those with ambition to set the pace. It gives the lazy and incompetent an excuse for their lack of drive and underperformance. Countries which put roadblocks in the way of progress will be the

losers in terms of economic development. Our banking system is a perfect example of what not to do. In 1997, the Royal Bank of Scotland was half the size of the Royal Bank of Canada, now it is more than twice as large, far more sophisticated, and able to provide advice and services wherever a customer wishes to operate, anywhere in the world. Its earnings have also kept pace and, given a far better balance of loans, the risk of being caught offside is much lower. Riven by regional jealousies, our entrepreneurs remain burdened by inter-provincial trade restraints and a patchwork of thirteen separate securities commissions, all a blot on our international-credibility copybook. It is passed the time when we can rightfully blame others for our made-in-Canada foolishness. Instead of applying the brakes to change, governments should do whatever they possibly can to encourage corporations to get with it, by upgrading the efficiency of their facilities and looking afield to expand. Otherwise they stand little chance of remaining competitive, subject to being acquired at what in the end will prove to be a bargain price by those willing to do what needs to be done to grow and prosper.

In addition, expansion here and elsewhere will result in employment gains and an increase in tax revenues in Canada. If it takes debt-dumping and double-dipping of interest expenses to do the trick, it is still a better option than wasting many billions of dollars in subsidies to keep otherwise marginally successful companies afloat. A case in point is the recent deal made between the Quebec government and Alcan, whereby the company will receive the equivalent of \$274,000 per job per year over the next thirty-five years in the hope of safeguarding 740 positions at the new two-billion dollar smelter to be built in Arvida, a key reason why Alcoa and subsequently Rio Tinto decided to jump aboard the interest-free loan, tax-break, and cheap-hydroelectric-power bandwagon. Despite its generosity, the provincial Liberal Party was unable to hold on to its majority in the subsequent election, none of its candidates successful in the Saguenay region. What do you suppose its next campaign goodies will cost the disillusioned taxpayers? While you wait, watch out for how much money their Ontario counterparts will commit to spending in the hope of staying in office.

PAYING FOR COMPETENCE

The magnanimous compensation paid Wall and Bay Street all-stars has triggered a demand to increase the take of private-sector executives, civil servants, and politicians. There is every chance the consultants will go along with the gig, assuring themselves of a continuing stream of advisory fees. Not a one has ever suggested there be cutbacks, the savings shared by underlings. Nor has there been any mention made of the relative worth of each grouping, its contribution to containing costs, gaining new customers, increasing margins, earnings, share or income trust unit prices. Obviously the bureaucrats fail on all accounts, reason why so few have been hired away by the private sector.

Some misguided souls have alleged that highly paid corporate leaders create a disproportionate share of wealth and play a pivotal role in spawning new ventures. If that were so, why are Canada's largest employers shedding thousands of jobs? How much of an outfit's success is due to smart management decisions? How much because of better times? What happens when luck runs out? Will the CEO's compensation be reduced, as the payout to investors might well be? As noted earlier on, comparative improvement in productivity is a key consideration. Difficult to measure, but no more so than figuring out what a chief

executive officer should get. It is time the best interests of the shareholders and unitholders be considered first, not second, third or whatever.

The disparity between the rich and poor in Canada is growing. The middle class is shrinking and the needy are getting nowhere fast. The gap from top to bottom in household income has increased to \$20,000 per year. High-achieving women striving to get ahead in life are the driving force. They tend to marry influential men, and power couples make a considerable amount of money. Economists refer to it as assortative mating, the children sent to private schools and given many opportunities not afforded others. In time, the phenomenon becomes entrenched. Regrettably none of the government policy prescriptions seem to make up for the difference. Knowing there is a great advantage to being clever and gaining wisdom, a good start would be to broaden the country's base of knowledge by offering skills-training programmes, and scholarships to the less-fortunate who deserve and wish to go on to university. Rather than increase the tax rate charged the rich to supplement the poor, with governments wasting a great deal of the money arranging to do so, there would be greater wealth created for everyone if the successful amongst us were encouraged to expand the scope of their endeavours, hiring and promoting additional employees and paying them well in cash and kind. Certainly a more promising scenario than having those who are struggling just to get by do little else than sit on a park bench waiting receipt of their next welfare cheque.

THE ULTIMATE MEASURE

Since bottoming out in October 2002, the S&P/TSX Composite rose fully 150 percent before being cut down to size by the US sub-prime credit-crisis buzz saw. Its recovery will depend on earnings gains. Further upticks in interest rates, aiming to curb the curse of inflation, carry the risk of causing a downshift in consumer confidence. Nonetheless, the North American and world economies can be expected to continue growing at a reasonable clip for the next year or two, which bodes well for patient equity investors. Due to an increase in volatility, short-term traders may not fare quite as well. If our politicians hope to get re-elected and CEOs be acclaimed, they must pull up their socks. Given as a recent United Nations study has found that the lot of us smoke four times more marijuana than the citizens of any other industrialized country, it is time we stopped deluding ourselves, got off the pot and drove the cannabaristas away.