Diane Urquhart

From: Joe Killoran [killoran@sympatico.ca]
Sent: Saturday, January 19, 2008 8:36 AM
To: Undisclosed-Recipient:;
Subject: [Bulk] 01-19-08 FP: Eveready 'in-kind' unwelcome

FINANCIAL POST

Eveready 'in-kind' unwelcome

Barry Critchley, Financial Post

Saturday, January 19, 2008

Atest case has been conducted and, as far as income-trust investors are concerned, the hope is that it won't be repeated.

The reason:

> The market doesn't view so-called "in-kind" distributions as favourably as it views cash distributions.

Indeed, based on two days of trading for Eveready Income Fund, the market regards payment in new units as about 20% less attractive than cash distributions from the fund "that provides industrial and oilfield maintenance and production services to the energy, resource, and industrial sectors."

The test case occurred this week. After the markets closed on Wednesday, Edmonton-based Eveready issued a four-and-a-half-page statement detailing its 2008 growth plans and the approval of "strategic changes to distribution policy." As with a number of releases, the first almost two pages were given over to spin. The content came later on.

The spin:

> Eveready, which went public via a reverse takeover in April, 2005, would be spending $78-million on capital this year and generate more than $600-million in revenues, up from an estimated $515-million in 2007.

The content:

> As part of its plan to "maximize the retention of operating cash flow to reinvest in growth," it was planning to eliminate its current monthly cash distribution of 6¢ per unit (or 72¢ a year) replacing it with a quarterly "in-kind" distribution of 18¢ per unit (or 72¢ annually). Paying distributions "in kind" means unitholders will receive additional units instead of cash.

"The market has been sending us a strong signal that our current distribution policy is not the most effective use of our cash," said Peter Lacey, chairman. "... Reinvesting the fund's cash in growing our business will maximize Eveready's long-term value. Essentially, our new distribution policy will provide the benefits that a corporation enjoys of being able to reinvest its profits in growth, yet retains the positive flow-through tax characteristics of an income trust until our likely conversion to a corporation in 2011."

And paying in-kind distributions would allow Eveready to retain more than $60-million in operating cash flow, as well as avoid the need to raise capital -- a move Lacey said would "be very dilutive to existing unitholders."

If that was the thinking, the market took a different view. The price of the units fell, a move that would make an equity issue even more dilutive.

Indeed, Diane Urquhart, an independent analyst, argues that converting to an in-kind distribution "is effectively a distribution cut, since the investors owning income trusts for cash income are now forced into the lesser-value proposition of substituting a certain monthly cash income with the uncertain cash realized from the sale of the additional shares received in kind each quarter. They need the cash."

Urquhart isn't that surprised. She argues the income trust model works only because "retail investors are willing to pay higher price multiples for cash distributions received than for the earnings that are retained in the corporation."

At week's end, Eveready (EISu/ TSX) units closed at $3.86. On their first day of trading in April, 2005, they closed at $3.31.

bcritchley@nationalpost.com

----- Original Message -----
From: Diane Urquhart
To: 'Joe Killoran'
Sent: Thursday, January 17, 2008 2:41 PM

Subject: **Eveready Income Fund Conversion to In-Kind Distribution:**

- **Is Effectively a Distribution Cut**

The inability for most income trusts to sustain their distributions continues, with Eveready Income Fund announcing a new twist for preserving distributions despite falling cash flows and earnings.

> On January 17, 2008, Eveready Income Fund announced that its current monthly cash distribution of $0.06 per unit ($0.72 per unit on an annualized basis) will be eliminated and replaced with a quarterly "in-kind" distribution of $0.18 per unit ($0.72 per unit on an annualized basis).
>
> Distributions settled "in-kind" means that unitholders will receive additional Fund units instead of cash. "In-kind" Fund units will be issued at a deemed price equal to the volume-weighted average price of all units traded on the Toronto Stock Exchange on the ten trading days preceding the applicable record date.

I have concluded that the conversion from a cash distribution to an in-kind distribution is effectively a distribution cut, since the investors owning income trusts for cash income are now forced into the lesser value proposition of substituting a certain monthly cash income with the uncertain cash realized from the sale of the additional shares received in-kind each quarter over the year as they need the cash.

Eveready Income Fund has a market capitalization of only $239 million, so this is a very illiquid security with significant uncertainty about future sale proceeds should the majority of owners seek to realize cash by selling newly issued units on a periodic basis.

In my research report, **"Heads I Win, Tails You Lose,"** published on October 16, 2006, I showed that the income trusts model only worked because retail investors are willing to pay higher price multiples for cash distributions received than for the earnings that are retained in the corporation (plus there was the ruse of paying distributions much more than earnings tricking unsophisticated investors into paying inflated prices).

The principle of paying lower price multiples for retained earnings also applies when investors get "in-kind" distributions, since they are leaving earnings in the corporation rather than taking them out in cash for immediate and certain use. The issuance of new units for "in-kind" distributions has an effect similar to a stock split, which is to say that it does not affect the overall value of your investment (The scenario of no distribution with 1000 units X $11 per unit value is the same total value as the scenario of an in-kind distribution 1,100 units X $10 per unit value, if there is $1 dollar retained in the corporation).

The market reaction to the change in Eveready's distribution policy has been -22% in the morning post announcement, but the speculators or manipulators had bid the price up before the announcement by +10%, perhaps expecting that the new capital spending program enabled by the retention of cash would cause future growth. The speculators or manipulators bidding the Eveready Income Trust units up believed that the change in distribution policy would enable higher growth and hence higher valuation. But, the retail investors' lower price multiples for retained cash has superseded the rise in price multiples one would expect for a higher growth rate.

The decline in Eveready's price since January 15, 2008 has been -15%. I will be interpreting the effective distribution cut % for the conversion from a cash distribution to an in-kind distribution to be the decline in the unit price for the income trust within 3 days of its announcement. Based on this approach, Eveready's conversion from a cash distribution to an in-kind distribution is equivalent to a -15% distribution cut at this time.

The cash distributions for Eveready Income Fund have been rising steadily since 2005 Quarter, first as income rose, but then continued to rise even after the income peaked in 2006 Quarter 3 and income steadily declined since then. So much for the theory that rising distributions are a sign of successfully growing businesses under the income trust model. The excessive cash distributions were clearly constraining the company's ability to sustain its business and fund growth, especially when it could no longer raise cash in the public capital markets.

The attached Reuters article "Eveready Income Fund - Approves strategic changes to distribution policy," dated January 17, 2008, says:

"The following points summarize Eveready's rationale in changing its distribution policy: The new policy should allow Eveready to retain in excess of $60 million in operating cash flow on an annual basis to reinvest in its capital expenditure programs, which are critical to its long-term success. Due to Eveready's current market price, Eveready is experiencing a very high cost of capital. As a result, raising additional equity capital in the public markets at this time would be very dilutive to existing unitholders. The new distribution policy should allow Eveready to complete both its 2008 and 2009 capital expenditure programs without raising additional external equity."

""Eveready continues to position itself as a leading provider of industrial and oilfield maintenance and production services to the Alberta oil sands," comments Rod Marlin, Eveready's President and Chief Executive Officer. "We are committed to retaining our market position in the oil sands, one of the largest remaining oil reserves in the world, and ensuring we continue to grow to meet the needs of our customers.""

Eveready Income Fund is the 88th income trust to suspend or cut its cash distributions. 36% of the energy and business income trusts have now suspended or cut their distributions. The average distribution cut in this group is -58%.

Income Trusts' Distribution Suspensions & Cuts (# and % of Each Type)

17-Jan-08	Number	Distribution Suspensions	Distribution Cuts	Combined	%
Energy Trusts	48	2	17	19	40%
Energy Services Trusts	19	4	11	15	79%
Utilities Trusts	21	1	2	3	14%
Other Business Trusts,	156	21	30	51	33%
Total Business Trusts	196	26	43	69	35%
All Energy and Business Trusts	244	28	60	88	36%

Eveready Income Fund was formerly River Valley Income Fund, who had acquired Eveready Industrial Group Ltd. at about November 10, 2004. Eveready Income Fund traded at $3.45 per unit after release of documents about the Eveready Industrial Group purchase on December 22, 2004. So, with Eveready Income Fund now trading at $3.42, investors have been on a round trip over a three year period. Investors in the secondary offering of units at February 23, 2006 at $7 per unit, are down -52% since then or -$29 million.

	Date	Price	No. of Units Millions	Size of Offering $ Millions	Investment Banking Fee $ Millions	Other Expenses $ Millions	Last Price	% Change	Change $ Millions
EVEREADY INCOME	2/23/2006	$7.00	8.000	$56.0	$3.1	$0.2ca;IPL.UN	3.42	-52%	-$29.1

Underwriters: Lead - Blackmont; Syndicate - Acumen Capital, BMO Nesbitt Burns, Sprott
Auditor: Jestin Gibson
Legal Counsel: Underwriters - Burnett Duckworth; Trust - Shea Nerland

Diane Urquhart
Independent Analyst
Mississauga, Ontario
Tel: (905) 822-7618
Cell: (416) 505-4832