Urquhart

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FINANCIAL POST

Wellco distributions follow 'torpedo' trend

Energy services fail to deliver for income trusts

Barry Critchley
Financial Post

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Wellco Energy Services Trust, a company that converted to an income trust, has joined a dubious club: issuers that have cut distributions twice in their life.

Yesterday Wellco, which converted in September, 2002, cut its distribution to 3.5¢ per unit -- or half the level unitholders received the month before.

Last April, unitholders received 9¢ per unit. The issuer, which provides a variety of oilfield services, had paid 9¢ a share since May, 2006. From October, 2005, to March, 2006, it paid out 8.5¢ a unit.

The cut had a predictable effect on prices: The units fell by 58¢ to $3.49 and are down substantially from the $10.75 investors anted up to acquire a stake in February, 2006. Back then, Can-accord Capital raised $32.25-million for Wellco.

Diane Urquhart, an independent analyst, noted yesterday the income-trust business model has proven to be "unsuccessful" for new investors in the energy-services business. Her calculations show 42% of the energy-services trusts have suspended or significantly cut their distributions. "Energy services trust unit prices have correspondingly torpedoed lower, since it was their unsustainable distributions that propped up their prices in the market. Energy services trusts have had the worst distribution-performance record of all income trusts in Canada," she said. Her numbers show that there are 67 issuers in the energy-trust universe: 48 are in the production business and 19 in the oilfields-service business. Of the 19, one has suspended distributions while another seven have cut their distributions. But just 15% of the energy trusts (seven of 48) have either cut or suspended distibutions. Overall, 26% of energy and business trusts (64 of 244) have cut or suspended distributions.

"This is too high a distribution cut percentage for an income security that was marketed to seniors for the purpose of paying household expenses and where capital preservation was said to be paramount," she said.

"Unfortunately, the vendors, investment banks and their securities lawyers had far too high an incentive to convert corporations into income trusts for very large upfront fees, stock option proceeds and other cash proceeds to behave responsibly in the market in terms of not paying excessive distributions and legally in the market by making sure that new investors understood that distributions were above income and were at cycle highs."

The past two trading sessions haven't been great for other oil sector trusts.

- On Friday, Pengrowth announced a 10% reduction in its distributions. Unitholders will now have to get by on 22.5¢ per unit, versus 25¢ a month before

- Yesterday, Enterra said it was suspending distributions for at least six months. The units fell almost 50% to close at $1.99. And Enterra, a conventional oil and gas trust, said there may be more bad news given that the allowable borrowing base under its senior credit facilities is being reviewed by the lenders.

Last November, Enterra raised $40.33-million via an offering led by Scotia Capital where investors paid $8.10 per unit; last April it raised $29.18-million via units sold at $5.90. Scotia was the lead.

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