Income trust balloon quickly deflating

Strongco, Arctic Glacier and GMP have all cut or suspended distributions in recent days citing softening economic conditions

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Times are tough, especially for income trusts, a situation underlined by the fact that three income trusts have cut or suspended their distributions over the past four days.

Yesterday, industrial equipment distributor **Strongco Income Fund** suspended its monthly distributions, blaming "a slowing economic environment, current operational challenges to profitability, and Strongco's balance sheet leverage." Its chief executive officer resigned.

And **Arctic Glacier Income Fund** announced yesterday that it was temporarily lowering its distribution by 18 per cent. Arctic Glacier, which is in the packaged ice manufacturing and distribution business, also cited softening economic conditions along with increased legal costs relating to a U.S. antitrust investigation.

Last Thursday, **GMP Capital Trust**, the parent of GMP Securities, lowered its monthly distribution to 10.42 cents a unit from 14 cents in the face of the continuing tough markets.

But as independent analyst Diane Urquhart pointed out, distribution reductions and suspensions are nothing new. It isn't a problem that just manifested itself in the past six months, she said. Ms. Urquhart believes the trust issues were sold at inflated prices because of high cash distributions that time has shown could not be sustained. In fact, according to data going back to 2003, original distributions for 41 per cent of the entire trust market have proven unsustainable.

Thirty-five of the 244 trusts have suspended their distributions and another 66 have reduced them. Energy service trusts have been the hardest hit, with six of the 19 trusts in that category having suspended their distributions and another 10 having cut them. Furthermore, those energy service trusts have made the biggest changes: The average cut is a hefty 70 per cent.

The problem with the energy service trusts is that they came out with cash distributions that were far too high and therefore unsustainable, especially in an industry that is very capital intensive, Ms. Urquhart said.

Energy trusts - the resource-related trusts - have fared much better than their service counterparts, with 40 per cent of that group forced to make changes to their distributions, with the average reduction coming in at 40 per cent. But that group had the advantage that as the price of oil climbed, they didn't increase their distributions, so the payout ratios decreased, she explained.

"So they are going to have more sustainability here compared to the business sector, where if your revenues and profits go down, your cash flow is down, and if you have compulsory projects that you can't raise money in the market for, you are stuck, you have to cut."

Ms. Urquhart said it was always surprising to her how quick income trusts were to lower their distributions in robust economic times. And now the economy is deteriorating, "so there are going to be bigger problems ahead," she added.

At one time, income trusts were the biggest game in town, with investors flocking to buy them and corporations rushing to convert themselves into trusts to accommodate the demand. But then trusts became a political hot potato because of their preferential tax treatment. The government responded by announcing that trusts will face new taxes beginning in 2011, which shook up the market in a big way.

Ms. Urquhart said there is demand for energy trusts, but beyond that, demand is very limited, even among seniors and people seeking income and capital preservation - the groups to which trusts were primarily targeted.

With the reduced demand for trusts and the tax changes, the market for new trust issues has disappeared. It used to be that trusts would offer high cash distributions, drew in heavy demand and then that in turn would boost the market for new issues and those new issues would fund the high distribution; "you didn't need to earn it; you would just go and raise it," she said. Now, "when there isn't demand, you can't do new issues and ... then you are forced to cut."

Investors punished both Arctic Glacier and Strongco yesterday, dropping the former $1.41 to $6.05 on the Toronto Stock Exchange and the latter $1.86 to $2.94. Arctic Glacier shares stood as high as $14.40 in July, 2007. And Strongco units were changing hands at more than $22 in July, 2006. GMP units dropped 95 cents to $11.85 last Thursday and closed yesterday at $12. They peaked at $28 set in

May, 2006.

Income trusts' distribution cuts

Income trusts' distribution suspensions and cuts

	Number	Distribution suspension	Distribution cuts	Combination	%
Energy Trusts	48	2	17	19	40%
Energy Services Trusts	19	6	10	16	84%
Utilities Trusts	21	0	4	4	19%
Other Business Trusts	156	27	35	62	40%
Total Business Trusts	196	33	49	82	42%
All Energy and Business Trusts	244	35	66	101	41%

Income trusts' distribution suspensions and cuts, average % cut

	Number	Distribution suspension	Distribution cuts	Combination
Energy Trusts	19	-100%	-33%	-40%
Energy Services Trusts	16	-100%	-52%	-70%
Utilities Trusts	4	-100%	-23%	-23%
Other Business Trusts,	62	-100%	-41%	-67%
Total Business Trusts	82	-100%	-42%	-65%
All Energy and Business Trusts	101	-100%	-40%	-61%

Strongco Income Fund

SHARE PRICE, DAILY, (SQP.UN-TSX)

Yesterday's close

$2.94, down $1.86

Arctic Glacier Income Fund

SHARE PRICE, DAILY, (AG.UN-TSX)

Yesterday's close

$6.05, down $1.41

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