Investment bankers face a terrible drought

DON MACDONALD
The Gazette

Monday, June 18, 2007

There's a terrible tragedy in the making and one we haven't heard nearly enough about.

I was only vaguely aware of it before a Toronto newspaper brought this grim story to my attention the other day.

The details were horrifying.

The article told of a landscape transformed by a terrible "drought" where once mighty rivers had dried up to just "a dribble."

Even worse, the victims have been beset upon by "hungry" scavengers who have even helped push them "off a cliff."

It's not an ill-starred sub-Saharan country we're talking about here, but Canada's initial public offering market.

It seems the multi-million-dollar bonuses for the nation's investment bankers have rarely been in more danger.

The IPO market has been hit hard by both the federal government's decision to kill the income trust market and "deal hungry" private investors from the south ready to pounce on companies that would otherwise go public.

What is our plucky Canadian underwriting industry to do? IPOs have totaled a miserable $770 million so far this year, according to Bloomberg.

That's a far-cry from last year when Canadian firms issued stock worth $4.6 billion in the first half and $6.2 billion for the full year.

Clearly, this isn't good news for the investment bankers who shepherd new issues to market or the lawyers, accountants and assorted other professionals who toil on the deals.

They've been feeling the pain since last year, especially since Ottawa turned off the income-trust tap on Halloween.

For ordinary investors, the impact will be slightly less dramatic.

Certainly, there should be some relief on Main St. that the parade of dubious business income trust issues has been brought to a screeching halt.

Independent analyst Diane Urquhart says we shouldn't be feeling any sympathy for the investment bankers, lawyers and accountants, given the carnage in the trust market - the main source of Canadian underwritings in recent years.

That may seem a little cold- hearted, but Urquhart has studied business trust IPOs and found them to be more than wanting. In fact, she goes so far as to call them "a ripoff."

Almost one-third of business trusts have cut their dividends or eliminated them altogether, leading to searing market losses of more than $8 billion for the mostly retail, often elderly, investors who purchased them.

The brokerage, legal and accounting firms, on the other hand, have enjoyed some of the most lucrative years in the history of the IPO industry over the last three years, she notes.

The fees they gathered from the trust issues were higher than traditional IPOs, ranging from seven per cent of the proceeds up to 12 per cent, if you include fees for financial restructuring of the firms before they were taken public, she says.

As for the IPO market as a whole, the situation is unlikely to get better soon, says Vijay Jog, a Carleton University finance professor and a leading authority on the Canadian market.

Interest rates remain relatively low and the world is awash in money, meaning companies can meet their financing needs either by taking on debt, attracting private investment or being acquired by a larger company.

Rising rates will only make the situation worse by depressing stock markets and making share issues even less attractive, he said.

So spare a thought this morning for those poor, unhappy underwriters wandering through the desert. It may be a long time before they make it back to the land of milk and honey.

dmacdonald@thegazette.canwest.com