

INCREASING RELATIVE VALUE AND LIQUIDITY THROUGH US CAPITAL MARKETS ACCESS

TaylorRafferty

By Liz Cohen

Introduction

Investor relations officers must balance investor outreach with an appropriate allocation of management's time while communicating with the maximum amount of current and potential investors. This balancing act often leads to the question of whether or not outreach beyond the home market is beneficial and, indeed, whether or not it is practical. If the management of a firm is satisfied with their relative valuation, stock price performance, and liquidity, the initial reaction may be that there is no need to look beyond the home market.

In the case of the Canadian issuer, that is closest to the US market but perhaps simultaneously satisfied with their Canadian shareholder base alone, the question can be more acute. Is there any evidence that gaining access to the US investor base, combined with a coherent US investor relations program, generates tangible benefits to Canadian issuers? Based on a basic comparative analysis of Canadian-based companies with publicly traded equity in the US and Canada versus in Canada alone, the answer is a resounding yes.

Over 18 trillion dollars (US) are invested in equities by US retail and institutional investors, \$12 trillion of which is attributable to institutional investors¹. By accessing a greater pool of investors, companies are simply leveraging the law of supply and demand: when supply is constant and demand increases, price goes up proportionally.

Quantifying the Value of Accessing the US Capital Markets

The goal of our analysis was to determine whether or not Canadian issuers that trade in the US as well as Canada enjoy any liquidity or valuation premium relative to issuers that list solely in Canada. What specifically can be attributed to a company's trading volume and price to earnings (PE) ratio?

Methodology

We believe the most appropriate measure of relative valuation for this analysis is the price to earnings ratio and, for liquidity, the average monthly trading volume as a percent of shares outstanding.

As a starting point, we examined all Canadian issuers and divided them into two categories: those listed solely on the Toronto Stock Exchange (TSX) or the Toronto Venture; and those listed on a Canadian exchange that also trade in the United States (either on the NYSE, Nasdaq, or OTC).

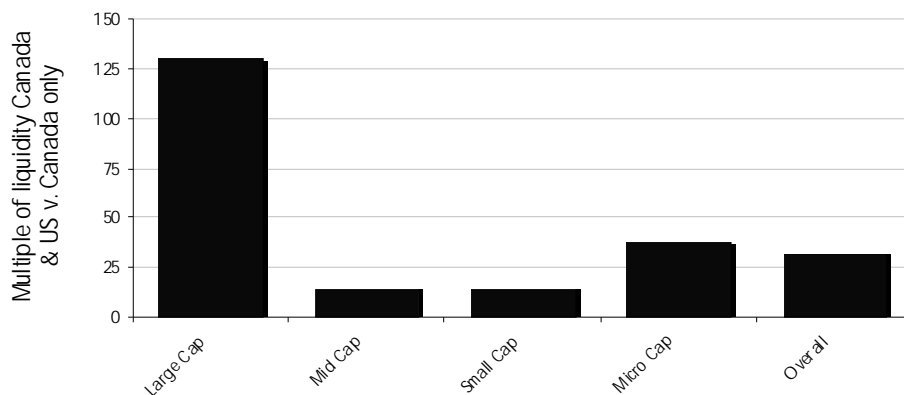
For the relative valuation portion of the analysis, we grouped the companies by industry in order to make the valuation comparison as relevant as possible. We also narrowed our focus to three industries: metals and mining, oil and gas, and financials. Companies with negative or unavailable P/E data were excluded from the analysis, as were the high (P/E of greater than 200x) and low.

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Findings

Canadian-based companies with publicly traded equity in both the US and Canada, regardless of market capitalization, enjoy a notably greater level of liquidity.

Liquidity by Market Capitalization: Canadian Exchange Only Versus Canadian and US Exchange Traded By Market Capitalization



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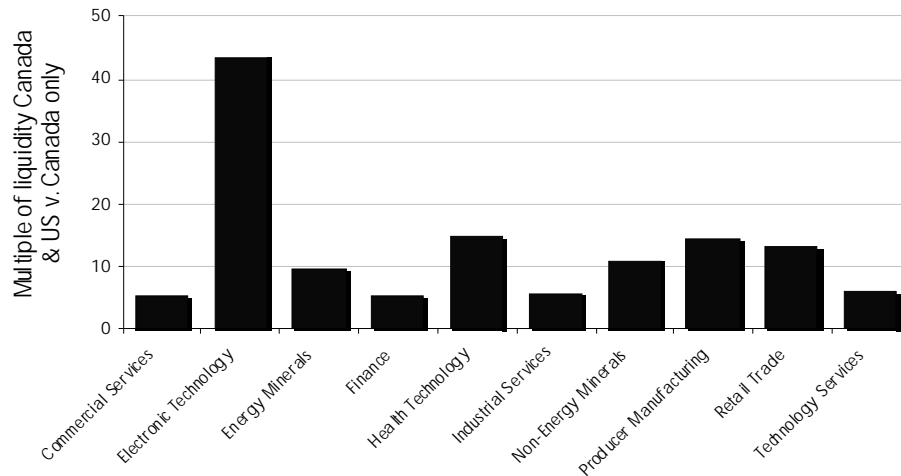
Figure 1. illustrates, by market capitalization, the disparity between Canada-traded only stocks and Canada and US traded stocks, expressed as Canada and US liquidity as a multiple of CA only liquidity.

An industry segment analysis yielded similar results: regardless of the industry vertical, Canadian companies that access the US capital markets are significantly more liquid than those that do not. For example, in the three industry segments we focused on for the relative valuation data, (financials, metals and mining, and oil and gas), the companies who have a US investor following/trade in the US are between nine and 21 times more liquid than their Canada-only traded peers. Liquidity is defined as the percent of shares outstanding traded monthly (using a three month trading average).

We also analyzed the top ten Canadian industry segments, based on number of companies per industry, and even across this broader industry analysis the liquidity differential between companies that have some form of US presence from those that do not is staggering.

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Liquidity by Market Capitalization: Canadian Exchange Only Versus Canadian and US Exchange Traded By Industry Segment



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Figure 2. illustrates, by industry segment, the disparity between Canada-traded only stocks and Canada and US traded stocks, expressed as Canada and US liquidity as a multiple of CA only liquidity.

From a relative valuation standpoint, Canadian issuers that choose to access the US capital markets and augment their shareholder base with a US investor component enjoy a significant valuation premium to their peers that trade only in Canada. We used the P/E as a measure of relative valuation and have expressed the valuation disparity by the percentage increase in P/E garnered by companies that trade in both Canada and the US relative to their peers that only trade on the TSX or Toronto Venture:

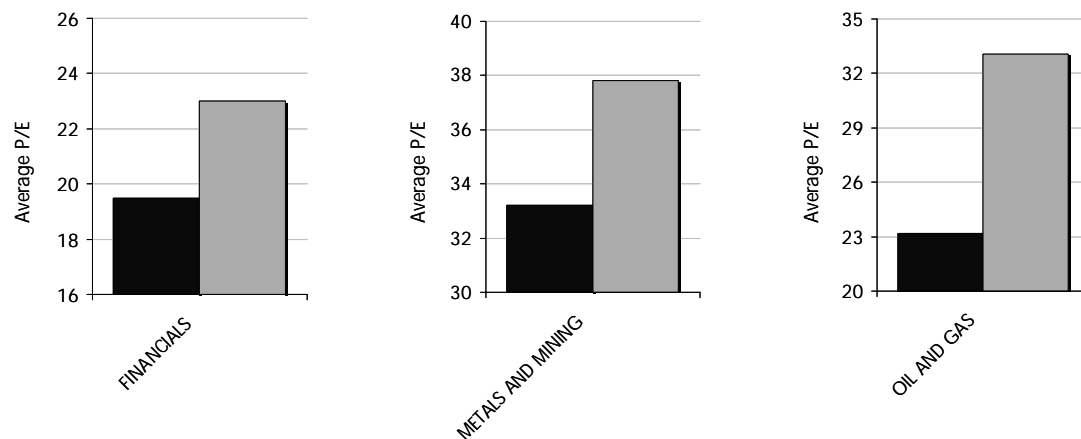
Industry	Valuation Premium
Metals and Mining	13.9%
Financials	18.1%
Oil and Gas	42.7%

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Figure 3. illustrates the percent P/E premium associated, by sector, with having a US listing versus a Canada-only listing.

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Valuation Gap Between Canada-Only and US and Canada Listed Companies Case Study of Three Premier Canadian Sectors



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Figure 4. illustrates comparative average P/Es by sector for Canada-only (black) and US and Canada-listed (grey) companies.

Areas for Further Inquiry

This initial analysis provides compelling evidence of the benefit to accessing the US capital markets. However, areas of further inquiry remain. For example, what are the differences between the typical US investor relations programming and Canadian investor relations programming? Are there significant programming variations that might account for part of the valuation discrepancy? We believe this is possible but hypothesize that a significant valuation gap would remain even if this factor were somehow quantitatively accounted for (the ability to quantify this element presents significant challenges, if not impossibility, as well).

Is there more turnover in the shareholder base of one group versus the other? Is there a volatility gap between the Canadian-only and Canadian-US issuer? If so, what are the implications to cost of capital of the disparate volatilities of the two groups? These are all questions that can be examined in addition to the analysis we have done thus far.

Considerations for Canadian Companies When Accessing the US Capital Markets

Cost-Benefit Analysis

We see little downside to accessing the US market; however, it does require resource allocation, both in the form of management time as well as some financial costs. We would argue that, for the vast majority of Canadian companies, a well-run US investor outreach program will be beneficial from a cost-benefit standpoint. We find that listing fees can sometimes be prohibitively expensive to non-US issuers contemplating access to the US capital markets, and one

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solution to this is to list on the OTCQX. This relatively new listing option in the U.S. provides the necessary transparency, disclosure, and access to investors without the associated listing and disclosure-related Sarbanes-Oxley costs required of a traditional US exchange. From a cost-benefit standpoint, the OTCQX has changed the equation such that most non-US issuers can gain access to the \$18 trillion in equities held by US investors without the high costs previously associated with a US listing.

Transparency

As is the case in the home market, it is important to provide US investors with adequate disclosure and frequent investor communications. One perceived issue surrounding an IR program outside the home country is that no liquidity and valuation benefit will be sustained if a company does not list on one of the major exchanges. The reason for this perception is the relative lack of transparency that OTC-traded companies typically offer. We posit that OTCQX's disclosure requirements allow non-US issuers to gain effective transparency and disclosure at a lower cost relative to the major exchanges.

Importance of Communicating a Consistent, Clear, Value Proposition to US Investors

Whether targeting the home market or US investors, it is important that all investor communications convey a clear and consistent investment case that resonates with US investors. Investor communications channels, including media interviews, investor presentations, fact sheets, press releases, and website content, should promote the same value proposition. The repetition and ubiquity of this value proposition are a critical element of a successful US IR program (or in any market, for that matter). In addition, the message to the US market should be refined to better resonate with US investors specifically.

Elements of a Successful US Investor Outreach Program

Targeting: Accurate targeting can be the difference between effectively leveraging management's time to maximize valuation and wasting time and money on the wrong prospective investors. While the relationship building process certainly takes time—initial missionary outreach is unlikely to yield investment on the first visit—pre-qualifying the interest level of the right portfolio manager at the right fund and maintaining a consistent outreach program to these targeted investors will yield best results. Often when targeting investors outside the home market, companies elect to retain an IR consultancy firm in the new market in order to leverage their deep local expertise.

Sell-side Analyst Coverage: Investor interest and sell-side interest go hand-in-hand to some degree; the more sell-side coverage a firm has, the more investors they are likely to reach. The more investor interest a company has, the more likely a sell-side analyst will be interested in publishing research on that company. Our advice is for companies to build relationships with the sell-side in the same way that they do with institutional investors; continued and consistent outreach, coupled with the ability to show progress both operationally and in terms of an increasing US shareholder base, will facilitate sell-side coverage. This in turn will facilitate greater investor interest.

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Long-Term IR Programming Calendar: US investor outreach should be viewed as a long-term process, but one that will maximize valuation and generate additional demand for shares. We recommend a 12 to 18 month IR calendar as a starting point, with a thoroughly thought-out missionary investor outreach program, based on analytical targeting data that is realistic given a firm's time and economic constraints.

Appropriate US IR Infrastructure: In order to facilitate a consistent and clear value proposition to US investors, a US IR infrastructure is important. For example, organizing and tracking investor and sell-side analyst contacts and keeping track of prior meeting histories is even more critical than in the home market (since presumably companies will interact with US investors less frequently than investors in the home market). In addition, having a way to reach all the US contacts simultaneously allows the IR team to stay focused on the home market while still leveraging their push into the US market.

Concluding Thoughts

Clearly market capitalization, sector-specific issues and company-specific issues all impact liquidity and valuation; it is impossible to delineate the impact of each. However, by looking across market capitalization sizes and by looking across industries for this analysis, we believe that we have uncovered a true liquidity and valuation gap, some of which must be attributed to whether or not a Canadian company has access to the US investment community. Indeed, the analysis herein can perhaps act as a starting point for the management of Canadian companies to discuss the idea of a US listing and outreach program.

About Taylor Rafferty

Taylor Rafferty is a leading independent provider of investor relations and financial communications services and has helped more than 700 international companies effectively access the US capital markets. With 27 years of experience developing comprehensive communication strategies for its clients, Taylor Rafferty offers flawless execution of every aspect of investor relations and financial communications. Taylor Rafferty has more than 100 current clients, including Royal Dutch Shell, Chevron, Namakwa Diamonds, and Sasol Ltd.

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ⁱ Source: Factset. Liquidity is defined as average monthly trading volume (based on latest three months trading volume) as a percentage of shares outstanding. Industry segments defined using Factset industry segmentation.

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^v Source: Bloomberg. Share price and EPS data as of September 9, 2009.