September 2023

UW FARMSA Newsletter

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Financial Institutions

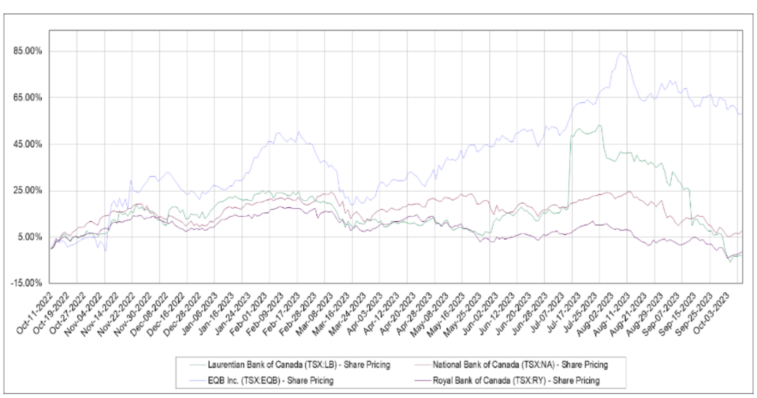
Industry Commercial Real Estate and Multi Single Family Homes

The financial services industry has been witnessing significant changes in recent years, driven by technological changes, customer preferences, and an ever-changing competitive landscape. Equitable Bank's acquisition of ACM Corporation is a reflection of this and represents a response to the constant evolution of the financial services sector. Equitable Bank looks to expand their revenue generating streams through the acquisition and incorporation of ACMs products into their own services. EQB expects EPS accretion from the acquisition within the year following transaction closing.

The Deal Specifications

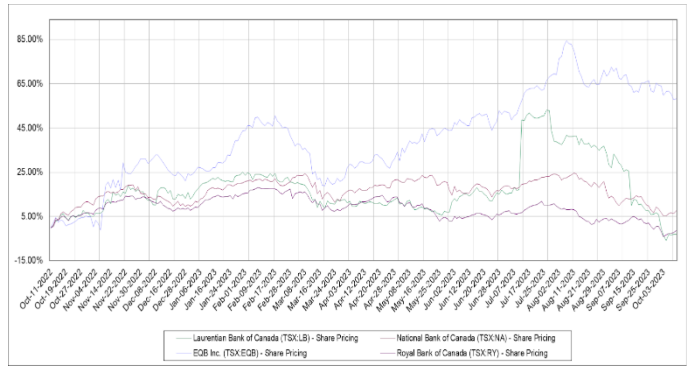
The deal, pending regulatory approval, will be a cash and share deal resulting in Equitable bank holding a 75% controlling ownership of ACM advisors. ACM will continue to function as an independent subsidiary of Equitable Bank with top management continuing their placement. The deal is expected to close prior to the end of the 2023 calendar year. The acquisition is expected to bring in ~4.8B in AUM, and to Equitable Bank's ~103B and will also garner the ability to serve a new demographic of Canadians. ACM will add 2,000+ client relationships, both investors and borrowers, to EQB.

Share Price of EQ Bank and Competitors (Last 10 Years)



Source: Capital IQ

Share Price of EQ Bank and Competitors (LTM)



Source: Capital IQ

Our Predictions For The Deal

ACM currently holds short-term commercial mortgages for institutional and private accredited investors. We believe that Equitable Bank is looking to assimilate these products into their services and will leverage these to create stable income for the foreseeable future.

Furthermore, Equitable Bank can utilize their underwriting teams and ACMs advisory teams to potentially start a fund investing in a specific area of real estate and charge a management fee for their services. Additionally, Equitable Bank can also create an asset securitization group and use ACM relationships to issue asset-backed bonds underwritten by themselves to ACM clients.

Ahmed Aamir, Tamir Landa

Real Estate

Amidst a rapid series of interest rate hikes, soaring inflation levels not seen since the 1980s, and a precarious global political landscape, the Canadian real estate market is facing and looking towards a period of significant disruption. Notable trends for 2023 include a heightened focus on sustainability and other ESG concerns, rising challenges around costs and capital availability, and an urgent demand for effective solutions to Canada's affordable housing crisis.

Impact of Rising Rates on Real Estate Investment Trusts (REITs)

Real Estate Investment Trusts (REITs), known for their relatively high dividend payouts, faced decreased investor interest rising rates made fixed-income assets more attractive. REITs, heavily reliant on borrowing, were particularly vulnerable to higher rates, impacting their profit outlook. Despite the sector appearing inexpensive by some measures, investors remained cautious. The real estate index was the second weakest performer among the S&P 500's major sectors this year, declining by 6.5%, surpassed only by the 10.3% drop by utilities. Some experts believe that REIT stocks could rebound if Treasury yields stabilized around current levels. However, a significant rise in yields could intensify pressure on REIT stocks. Historically, during economic slowdowns, REITs have outperformed as the Federal Reserve's efforts to curb economic growth often led to declining earnings for companies, creating an opportunity for REITs to shine.

Trudeau's policy and the Canadian housing market:

Trudeau's $4-billion accelerator program which was first announced in 2022 was finally accepted until July. The announcement comes as the Liberals are facing unflattering polling numbers to respond to the depressed housing market. More than 2,000 new housing units will be built in London, Ont. and other cities will follow the same step as the program forwarding.

But Trudeau's plan seems only to be effective on long-term issues or just exhibit diligence to assuage popular indignation. The sore point of the Canadian housing market is on the demand side instead of the supply, the high interest rates cause high mortgage rates which not only make homeowners suffer but also discourage underlying buyers from entering the housing market. Compared to the US where customers can snag a 30-year mortgage, homeowners in Canada can only take out a five-year mortgage. This means many Canadians have to prepare for renewal letters with a steep rise in interest rates. Since early September, the Canadian 5-yield rate has increased 68 basis points to touch a 16-year high at 4.46%. With roughly $200 billion in home loans coming up for renewal, it is not hard to imagine the desperation of homeowners.

Here is another proof that the supply side is not the main issue, Per Toronto Regional Real Estate Board (TRREB) data, the supply of the housing market is sufficient; there were 16,258 new listings, 44.1% higher than a year ago. But the home sales were down 12% from August and 7.1% year over year. A similar situation happened in Vancouver where there is enough inventory but flagging demand. Theoretically, as the supply increases the price will decrease. Yet attributing to the low liquidity trait of real estate, it may take a long time for the price to adjust back to reasonable value.

Easing the high inflation seems the priority for the Liberal Party and it seems no other better option than increasing the interest rate. Yet the impact of high-interest rates far exceeds the purchasing market. The high rate makes people who were supposed to be underlying homeowners flooded into the rental market and based on the latest National Rent Report, average rents in Canada hit a record in June of $2,042. Overall, increasing the housing supply cannot quickly jolt the Canadian housing market effectively. The overvalued housing prices and unprecedented mortgage rates make people feel impossible to get affordable housing and finally blame the government. Moreover, the surge in rental payments puts pressure on an already fragile situation for renters.

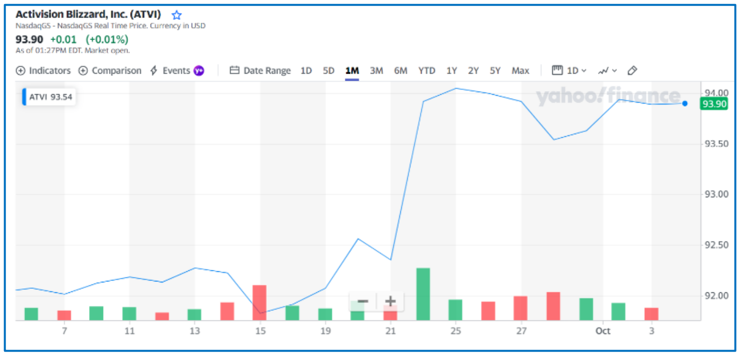
Valerie Ko, Tom Tang

Technology

Introduction

September proved to be a challenging month for the technology sector. The S&P 500, a key indicator for the tech market performance, witnessed a notable decline. It started high in early September, from its peak of approximately 3140 on Sept 5th, the index descended to 2897.89. By Oct 4th, dropping 242 points during the period. Nonetheless, the challenges persisted into October as tech stocks kept sliding after closing the worst month of 2023. Factors such as rising interest rates and elevated bond yields, have promoted investors to pivot away from the volatile tech sector, and instead favor fixed income investments which are much more stable. Looking ahead, the tech industry's prospects remain uncertain, largely influenced by investor's concern about the potential recession and economic downturn.

September's IPOs



Over the last four weeks, technology has been the most dominant sector for new issues. Among the 25 companies who joined the stock market, Arm Holdings, a leader in chip technology, marketing automation company Klayiyo and the popular grocery delivery service app Instacart together raised more than $6 billion in their September's IPOs, which was over one fifth of the total proceeds in the US and Europe market. By the end of Sept 29th, all three of them experienced varying degrees of decline, Instacart's price even fell below its IPO for the first time, dropping 1.65% to $29.89 compared to its issuing price at $30 on Sept 26th, potentially indicating increased investor caution. Arm has faced analyst scrutiny, with many believing the IPO price represented a full valuation and little upside as it may struggle to replicate its success in the smartphone sector in other technology sectors. What's worse, the Federal Reserve's announcement of another interest rate rise this year and fewer cuts in 2024 than expected has significantly increased investor concern. Consequently, the backlog of 80 or so tech IPO candidates from 2023 that were hoping to follow the three companies may not receive the desired investor support. At the same time, considering consumers' increasing use of e-commerce companies like Instacart and Klaviyo, both can still have high market potential. For Arm Holdings, by securing cornerstone investors like Apple and Nvidia, it mitigated the risk of insufficient demand and can potentially more stabilized post-IPO performance.

Microsoft acquisition of Activision Blizzard

Microsoft is moving forward with its $68.7 billion acquisition of gaming company Activision Blizzard, overcoming concerns from the UK's Competition and Markets Authority by giving some gaming rights to Ubisoft. This deal could strengthen Microsoft's position in the tech and gaming world. However, with Activision Blizzard's share price close to the buyout price ($93.63 compared to $95), investors like Warren Buffett see limited profit potential, with only $1.37 gain per share. On the positive side, the gaming industry, especially cloud gaming, is showing promise for the future, offering investors diverse opportunities and the chance to explore other growing gaming companies. Despite some challenges from regulatory bodies like the FTC, it's unlikely that the acquisition will be blocked, highlighting the growing importance of cloud gaming in the tech sector.

Cisco to Acquire Splunk

In other acquisition news, networking behemoth Cisco is to acquire cybersecurity company Splunk for $28 billion in a bid to diversify its business beyond its traditional backend products, which has suffered from a post-pandemic slowdown in demand, by combining AI and data management capabilities. With Cisco's growth rate expected to be flat in 2024 and the Splunk deal resulting in 1.3% of the company's, investors are hesitant on investing in Cisco, as shown in its stock price (-5.88% last month).

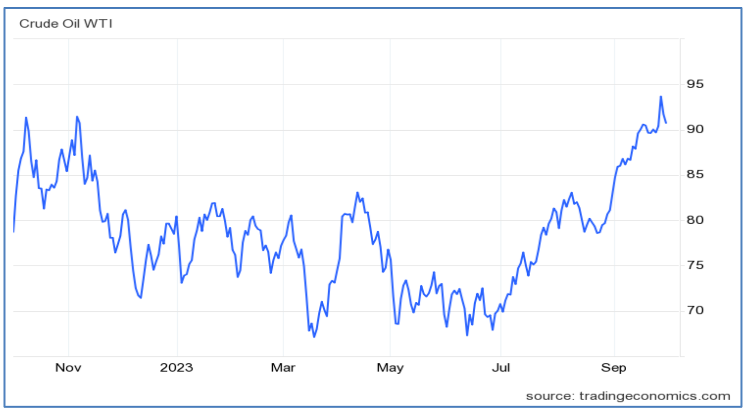
Tanya Lu, Jacob Tu

Energy

As demand for affordable energy continues to grow, and with continued inflation and instability of the fossil fuel market, the Government of Ontario has proposed ambitious investments into nuclear energy. With large arguments being made on nuclear dependability and cost-effective operation, the province's choice to further development of its largest energy source should be able to accommodate a growing population.

Energy Markets Face Soaring Prices & Instability

International sanctions have caused discourse within the fossil fuel industry, and with continued decrease in supply, prices will only inflate further.
Headlines in Crude Oil have shown that prices are reaching their highest levels since October of 2022. This propelled by two of the largest oil producers in the world, Saudi Arabia, and Russia, having announced major initiatives to cut production and exports indefinitely as of early September 2023.



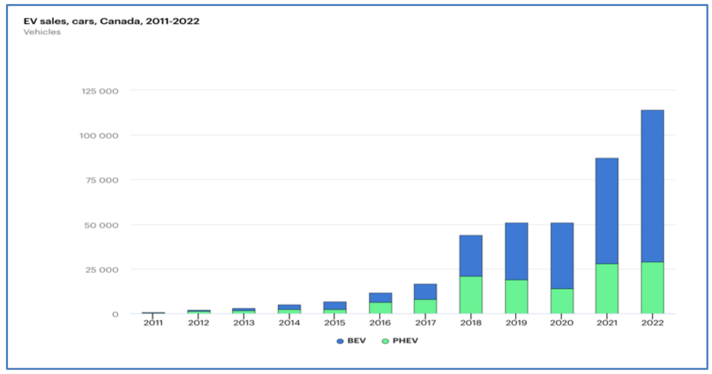
Current Initiatives & Proposed Plans

The Ford government has announced the following major projects and areas of interest for increased nuclear infrastructure:

- In July of this year, the government announced doubling production capacity of Bruce Energy plant, the world's largest nuclear generating station.
- Expansion plans for Darlington station, with more reactors being able to accommodate an additional 1.2 million homes.

Estimates by the Independent Electricity System Operator indicate the cost of this energy overhaul will cost nearly $400 billion1 over the next 3 decades. The province maintains its steadfast perspective on investing into Ontario energy sustainability and independence, with nuclear at the forefront.

Impact on Electric Vehicles Industry



Nuclear power plants in Canada can have a positive impact on the electric vehicle industry by providing low-cost, reliable electricity with zero greenhouse gas emissions. The federal and Ontario governments have pledged to give $28.2 billion in subsidies to Volkswagen and Stellantis-LGES for their electric vehicle (EV) battery plants in St. Thomas and Windsor1 represent a substantial investment in the Canadian economy. They create jobs, stimulate economic activity, and support the growth of the domestic electric vehicle (EV) industry. By reducing EV production costs, these incentives make EVs more accessible to consumers and promote sustainable transportation. Furthermore, they enhance energy security, reduce greenhouse gas emissions, and position Canada as a key player in the global EV market.

Ontario's substantial investments in nuclear energy amid volatile fossil fuel markets demonstrate a commitment to long-term energy sustainability. Despite the estimated $400 billion cost over three decades, these developments support growing energy demands. Moreover, substantial government subsidies to EV battery plants signal a significant boom in Canada's economy. While the upfront costs are notable, the long-term benefits in terms of energy resilience, economic growth, and environmental sustainability make these investments financially sound and forward-thinking.

Arwen Mao, Denis Goubkine

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