Equity Morning Update | Global Portfolio Advisory Group
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Scotia Wealth Management™

Canadian Market Summary by Warren Hastings and Sunny Singh

Scotiabank GBM Comment
Portfolio Strategy

The Slides – 2018 Strategy Outlook – Late-Stage Positioning

- ***Macro scenario for 2018.*** Global purchasing managers' index [PMI] momentum moderating, EPS growth slowing to high single digits, and yields rising. Recession probabilities remain low; inflation upside could spark volatility.
- ***U.S. 10-year Treasury yields.*** Upside risk to fair value above 3%, core consumer price index (CPI) up >2% (1.8% now).
- ***U.S. dollar: more modest losses in 2018 (U.S. Dollar Index [DXY] -10% in 2017).*** DXY range of 90-95 (now 92) as U.S.-EU yield spreads narrow. C$ trades around US$0.80 in 1H/18.
- ***WTI*** crude oil averaging >US$58/bbl in 2018; ***Gold*** benefits from fading PMIs in 2H/18.
- ***Recommended asset mix.*** Equities > Bonds preference intact, but with declining conviction. Rising yields + fading PMIs = less-attractive equity risk/reward outlook.
- ***Global equities.*** LatAm/Canada/Europe preference over United States. Canada/LatAm usually outperform S&P 500 during Fed tightening cycles.
- ***Sectors.*** Overweight (OW) Financials, Industrials, Mining, Energy. Value (XLF-US) > Growth (QQQ-US).
- ***What is our asset mix model saying?*** The overweight equities signal from our model is still strong, but most "equity indicators" are peaking. Our recommendation is more conservative than our model.

Scotiabank GBM Comment
Telecommunication Services & Cable

Converging Networks - Key Industry Themes for This Week

- With earnings season kicking off this week with Corus Entertainment Inc. (CJR.B-T; Wednesday), Cogeco Communications Inc. (CCA-T) and Shaw Communications Inc. (SJR.B-T; both Thursday), in this edition of *Converging Networks* (available on Scotiaview.com) we summarize some of what we see as the important overriding industry themes:
- ***We believe that the distributors (i.e., telcos and cablecos) will continue to fare better than the content producers and broadcasters.*** Even with the current media fragmentation, we believe the "pipe" still has tremendous value. For cablecos such as Cogeco and Shaw, we expect their Canadian cable revenue-generating units (RGUs), which include the combined count of video, Internet and phone subscribers, to remain relatively stable, with growth in Internet more than offsetting the decline in video and phone.
- ***Geographically, between the United States and Canada, we believe U.S. cablecos will continue to fare better than their Canadian counterparts.*** We attribute this to the higher Internet growth driven by lower market penetration in the United States, and the U.S. cablecos' greater competitive advantage over U.S. telcos. We believe this will become evident in Cogeco's U. S. cable segment.
- ***Given that we expect cable revenue per RGU, a proxy for average revenue per user (ARPU), to remain positive, which should result in positive cable revenue growth, Cogeco should fare better than Shaw in this area.*** Geographically across Canada, we believe Q1/F18 results will reflect a better pricing environment in Cogeco's market than

in Shaw's due to the attractive bundle promotions that the latter had in the market. Shaw has, however, pulled back on the promotions slightly since mid-November. In Eastern Canada, we believe Cogeco's overlap with fibre-to-the-home (FTTH) is still the lowest among Canadian cablecos.

- ***For content producers and broadcasters like Corus, we expect fragmentation to continue to affect advertising and subscription revenue streams without major offsetting factors.*** As this trend continues, we believe more media consolidation will be necessary over the medium and long term.

SGBM Rating Changes

- **SSR Mining Inc. (SSRM)** – Cut to Sector Perform from Sector Outperform

Earnings

- **None to report**

Other Rating Changes

- **Pure Industrial REIT (AAR.UN)** – AAR.UN announced that it has entered into an arrangement agreement with an affiliate of Blackstone Property Partners, pursuant to which Blackstone will acquire all of the outstanding trust units of AAR.UN for $8.10 per unit (21% premium to yesterday's closing price) in an all-cash transaction valued at $3.8bn including debt. The transaction is expected to be completed in Q2/18, subject to customary conditions.
- **Keyera Corp. (KEY)** – Raised to Strong Buy from Buy at Industrial Alliance
- **Methanex Corp. (MX)** – Cut to Neutral from Outperform at CIBC World Markets
- **NuVista Energy Ltd. (NVA)** – Cut to Sector Perform from Outperform at National Bank Financial
- **Tamarack Valley Energy Ltd. (TVE)** – Raised to Buy from Hold at Canaccord Genuity
- **Horizon North Logistics Inc. (HNL)** – Cut to Market Perform from Outperform at Raymond James

U.S. Market Summary by Paul Bhangu and Rakesh Gupta

Credit Suisse Comment
Carnival PLC
Ticker: CCL
Price: US$66.05
Rating: Outperform
Target: US$78.10

Stepping back onboard; UPGRADING to OUTPERFORM (from Neutral); Raising Estimates and Target Price to $78.1 (from $72.4)

- Upgrading to Outperform as concerns abate leaving attractive total shareholder return (TSR) story: We reverse our more cautious stance on Carnival given 33% underperformance of cruise vs lodging since Sept, resilience of bookings (despite disruption), scope for 32% of mkt cap to be returned by 2022E, an attractive TSR (2017-20E EPS CAGR 14% & 3% yield) and 18% potential upside to our $78.1 Target Price.
- Four areas of focus: We raise 2018-20E EPS by 3-5% given: 1) The earnings and yield momentum dynamics are intact with Q4 the 18th consecutive beat and future bookings again reaching record highs (confounding our previous fears regarding Caribbean and Chinese disruption). The outlook is underpinned by the full roll out of new revenue management tools and the 19% price gap that has opened between cruise and U.S. resort pricing. We forecast 2018E yield growth of 3.0% (from 2.5%). 2) Cost discipline adds a self-help angle with cumulative 2014-18E savings now $370m (27% of 2013 EBIT) limiting unit cost inflation to ~1%. 3) Cash return potential is significant, we model $2bn of buybacks by 2019E, a 2019E dividend 19% above consensus and see scope for a further 14% EPS enhancement by 2022E from further stock repurchases. 4) The risk of disruption is low (linking to our key theme from our Global Strategists), with scope to actually increase controlled sales distribution from a modest 25%.
- The key risk remains supply growth: 2017-22E industry supply growth of 6.1% remains a concern but this looks captured in valuation plus near term trends are encouraging. Next news is RCL/NCLH results February and CCL in March.
- Target price raised to $78.1: We set our target price based on our DCF and historic multiples. We note the significant underperformance sees CCL trade at a 15% discount to the S&P 500 (10 yr average 4% premium). With 18% potential target price upside we upgrade to Outperform.

Rating Changes

- **PayPal Holdings Inc. (PYPL)** – Raised to Outperform from Market Perform at Cowen
- **Union Pacific Corp. (UNP)** – Raised to Buy from Neutral at UBS
- **FedEx Corp. (FDX)** – Raised to Buy from Neutral at UBS
- **Allstate Corp. (ALL)** – Cut to Market Perform from Outperform at Wells Fargo Securities

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Research Analyst Jeff Fan visited Cogeco Data Services, a data centre operation, in November 2013. No payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Cogeco Communications**

Research Analyst Benoit Laprade visited Geismar 1, a methanol plant, on May 11, 2015. No payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Methanex Corporation**

Research Analyst Pammi Bir visited the FedEx ground assets, income-producing industrial properties, on January 19 and 20, 2015. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Pure Industrial REIT**

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