Equities

Global Portfolio Advisory Group

Canadian & U.S. Morning Comments

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Scotiabank GBM DailyEdge Summary by Warren Hastings and Sunny Singh

Portfolio Strategy – May Strategy Update – Equity Overweight Signal Intact, TSX Lagging in Emerging Market-driven Cycle

- Our recommended Asset mix and Sector Strategy recommendations are unchanged. Our asset mix stance is Equity Overweight (OW)/Bond Underweight (UW), and we continue to believe the risk/reward outlook is tilted in favour of equities. In our view, equities are better positioned because the macro supports rising EPS and bonds look unattractive as stronger GDP/rising inflation pushes yields up.
- Our asset mix model has been stuck near a maximum equity OW signal since Q3/16. U.S. 10-Yr yields Fair Value stands at 2.9% based on our model (vs. 2.3% currently). We expect the equity OW signal to fade in 2H17, but in the absence of an upward adjustment in yields, the likely result may be a rising Cash signal from the model.
- Global preference remains EM (OW) and Europe (OW) over the U.S. (UW). We recommend using U.S. equity exposure as a source of cash and focusing on EM and EAFE. Within the Americas, the bias is LatAm and Canada over the S&P 500.
- EM and LatAm are outpacing the S&P 500 in 2017, but it has been much tougher for Canada/TSX. Lower oil, trade policy risks, and housing fears have culminated recently, and the TSX has not participated in the recent risk-on rebound (Australia +9% YTD). ***Canada/TSX definitely needs WTI to bounce for leadership to come back, but barring a global hard landing, we believe the Trump/Nafta/HCG storm may be priced in.***
- The April PMI hit a 6-year high in Canada and our CDA LEI also stands at a 6-yr high. If HCG's woes are company specific, the pendulum should swing back towards the TSX. Financials and Energy underperforming in non-recession/growth periods has rarely been seen.
- ***TSX strategy and Strategic Edge Portfolio (SEP).*** For our May update, we are adding EMP. Overall, the SEP is overweight Financials, Discretionary, Technology, Energy, Base metals, Lumber/Packaging, and Industrials

Agrium Inc. (AGU, US$93.61, SP, US$110.00) – Nothing Stands Out in Q1; Agrium Nearing A Floor

- Q1 Adj. EPS of -$0.03 slightly beat the Street's -$0.07, we were at -$0.05. Q1/17 takeaways: (1) 2017 mid-point of guidance unchanged at $5.25, but slightly below consensus at $5.35; (2) the Street will need to lower Q2 EPS by about 7%; (3) production operating rates disappointed for all three nutrients; (4) exceptionally strong Q1 Brazilian demand in all nutrients could leave weaker demand for the balance of the year; (5) Landmark hits Q1 EBITDA record; (6) increased sales of proprietary products continue to underpin Retail strength; and (7) the merger with PotashCorp remains on-track for a mid-year close.
- ***We see Agrium nearing a floor.*** Weak nitrogen pricing has likely overshot fundamentals, although a debate exists as to how material Chinese marginal cost of urea is post-spring. The risk/reward profile has improved meaningfully since our February downgrade, especially given the de-risking of Borger/Vanscoy.
- ***A valuation case is building for MergeCo.*** Our base case yields ~$4.75/sh of long-term FCF, assuming 70% of synergies are realized. This suggests MergeCo fair value is ~ $50/sh vs. an implied price of $42 today (and ~3.7% yield). Using an 8% to 9% target FCF yield, our base case could see MergeCo valued at almost $60.

Capital Power Corporation (CPX, $24.91, SP, $26.00) – On Track to Deliver on 2017 Guidance

- Capital Power reported an in-line quarter, helped by portfolio optimization (Marketing) and coal compensation. It increased its funds from operations (FFO) guidance by 6% on the back of recent acquisitions, with no material changes to its outlook for the base business. Adjusted EBITDA of $134m was in line with our $134m estimate, and slightly ahead of consensus at $130m. The company beat on free cash flow, mainly due to very low maintenance capex in Q1, which we view to a timing issue. Shares are currently trading at 7.9x EV/2018E EBITDA, a 0.7x premium to TransAlta which we view to be fair. With no material changes to our estimates, we maintain our Sector Perform rating, and $26 price target.
- U.S. renewables continue to be an area of focus. Management noted that they continue to bid on U.S. renewable opportunities as demand for capital in the space remains strong. Capital Power is becoming increasingly competitive on the natural gas-fired side, and still has the ability to utilize its tax shield in the U.S. We could see more M&A activity if opportunities arise. Given the recent appreciation of its share price, management could also tap the equity markets for large opportunities.

Summary of target price / rating changes:

- **Brookfield Property Partners LP (BPY, US$22.25, SO, US$25.25)** – Target price decrease from US$25.50
- **Equitable Group Inc. (EQB, $47.35, SP, $61.00)** – Target price decreased from $71.00
- **Martinrea International Inc. (MRE, $10.98, SP, $15.00)** – Target price increased from $13.50
- **Sherritt International Corporation (S, $0.91, SP, $0.75)** – Target price decreased from $1.15

In terms of companies reporting results:

- **Fortis Inc. (FTS)** – FTS reported Q1/17 adjusted EPS of $0.69 vs consensus of $0.71 (range $0.67-0.74). The main under performance versus the SGBM analyst's estimates related to higher corporate expenses ($0.02) due to higher than expected taxes and operating expenses. FortisAlberta was also weaker than his estimate ($0.01) in part due to the soft economic conditions in Alberta. The company noted that ITC added $0.01 to EPS in Q1/17 ($0.06 in full-year 2016) after financing costs and share dilution. The company reiterated its expectation that it will increase its dividend at a 6% CAGR out to 2021. It also maintained its $13bn five-year capital plan that would drive a three-year rate base CAGR of slightly over 5%.
- **Encana Corp. (ECA)** – ECA reported Q1/17 cash flow per share (CFPS) of $0.29 vs. consensus of $0.24. Production was 318 mbbl/d, 1% above consensus of 316 mbbl/d and liquids production was 111 mbbl/d, 1% below consensus of 112 mbbl/d. 2017 capital spending maintained at $1.6-$1.8B with total production of 320-330 mbbl/d. Big four production is expected to grow by >20%. Well costs remain flat as inflation is being offset by continued efficiencies.

- **Cineplex Inc. (CGX)** – CGX reported Q1/17 adjusted EPS of $0.35 vs consensus $0.28. Adjusted EBITDA of $59mm was in line with consensus. Consolidated revenue was of $394mm was ahead of consensus of $382mm. CGX increased their dividend by 3.7% with the company's overall dividend yield at now 3.1%.
- **WestJet Airlines Ltd. (WJA)** – WJA reported Q1/17 EBITDAR of $223mm vs consensus $239mm. However, the SGBM analyst points to $25.5mm in extraordinary expenses related to a catch-up adjustment to maintenance provisions ($18.5mm) and severe weather ($7mm). WJA is guiding to RASM up 2.5%-4.5% in Q2 which is a positive move vs Q1. WJA announced a new order for 787's with first deliveries pushed out to Q1/2019. The firm order is for 10 787-9s with options for another 10.
- **Norbord Inc. (OSB)** – OSB reported Q1/17 adjusted EBITDA of $103mm vs consensus of $109mm. Shipments came in at 1,431 MMsf in North America, above the SGBM analyst's 1,390 MMsf estimate.). In Europe, shipments were also ahead of the analyst's expectations, coming in at 479 MMsf vs. us at 440 MMsf. Cash production costs increased 7% QOQ due to the timing of annual maintenance shuts, fewer fiscal days in the Q, and higher resin prices. The company tripled its dividend level to C$0.30/share (C$1.20 annually), which brings the current dividend yield up to ~2.7% (based on last night's close).
- **Colliers International Group Inc. (CIGI)** – CIGI reported Q1/17 adjusted EBITDA of $29.3mm vs consensus of $22.7mm. Adjusted EBITDA margin stood at 6.9% (6.0% SGBM estimate) compared with 5.9% in the same period last year, largely due to the change in revenue mix in EMEA and benefits from operating leveraged (higher revenues) in the Asia Pacific region. Management expects low double-digit revenue growth in 2017, supported by the acquisitions completed year to date and low single-digit organic growth. The company also forecasts stable adjusted EBITDA margins as well as low double-digit adjusted EPS growth.
- **Wajax Corporation (WJX)** – WJX reported Q1/17 EBIT of $11.2mm and EPS of $0.31, compared with consensus of $11.5mm and $0.32, respectively. Revenues came in at $318mm, vs consensus of $288mm, primarily driven by 25% y/y growth in Western Canada related to higher volumes in construction, mining, and forestry.
- **Alacer Gold Corp. (ASR)** – ASR reported Q1/17 adjusted EPS of $0.03 vs consensus of $0.04. Q1/17 Gold production of 32,918 ounces, total cash costs $711/ounce and all-in sustaining costs $898/ounce.

Outside of earnings related news, we would highlight the following items:

- **Veresen Inc. (VSN)** – Raised to Buy from Hold at Canaccord
- **Veresen Inc. (VSN)** – Cut to Sector Perform from Outperform at RBC
- **Enbridge Inc. (ENB)** – Rated new Equalweight at Morgan Stanley
- **Pembina Pipeline Corp. (PPL)** – Raised to Outperform from Sector Perform at National Bank
- **Finning International Inc. (FTT)** – Raised to Buy from Hold at Canaccord
- **Trinidad Drilling Ltd. (TDG)** – Raised to Strong Buy from Outperform at Raymond James
- **Sherritt International Corp. (S)** – Raised to Speculative Buy from Hold at TD
- **Timmins Gold Corp. (TMM)** – Rated new Speculative Buy at Cormark

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

Credit Suisse Research:

Carnival (CCL, OUTPERFORM, Target Price: US$ 69)

Positive read across from Royal Caribbean Q1

< Positive update from Royal Caribbean: Following a positive Q1 update from RCL we re-iterate our Outperform rating on Carnival noting strong pricing trends, the cash return potential and our medium term optimism regarding China's growth potential. Our $69 target price implies 13% potential upside.

< Key sector themes reflected in Royal Caribbean Q1s: 1) Booking trends and the pricing outlook are encouraging. RCL beat its Q1 guidance with yields up 6.0% vs guidance of +4.5-5.0%. Q2 yields are expected to rise 10-10.5% with half of that growth from LFL increases on existing ships (the balance due to new ships and the deconsolidation of Pullmantur). The company noted it has 15% less to sell than a year ago. We forecast CCL yields of 3.3% (vs guidance of 3.0%). 2) RCL announced a $500m share buyback. For Carnival we see scope for 35% of today's market cap to be returned to shareholders by 2021E via dividends ($7.9bn) and buybacks ($7.7bn). Our 2018E DPS for Carnival is still 20% above consensus despite the recently announced 14% rise in the quarterly dividend. 3) China was a key focus of the RCL call given Korean travel restrictions that have emerged in the quarter. The company noted this was a drag (offset by European strength) but noted trends are stabilizing. RCL's enthusiasm for the long term growth potential in China is underlined by the deployment of Quantum Plus to Asia in 2019. We believe industry success in China is key to absorbing an average industry capacity growth of 6.5% between 2016-21E.

< Catalysts and Risks: CCL Q2 in late with key risks around pricing discipline.

< Target price implies 13% potential upside: We maintain a positive view on Carnival given 13% potential upside to our target price and the 2018E PE of 14x vs a through cycle average of 17x.

Earnings: *Source CNBC*

Merck (MRK) — The drugmaker reported adjusted quarterly profit of 88 cents per share for the first quarter, five cents a share above estimates. Revenue exceeded Street forecasts, boosted by surging demand for its cancer drug Keytruda, and Merck also raised its full-year outlook.

Pfizer (PFE) — Pfizer earned an adjusted 69 cents per share for the first quarter, coming in two cents a share above estimates. The pharmaceutical company's revenue fell short of analysts' estimates, but its full-year outlook falls within the range of current Street forecasts.

Aetna (AET) — The insurance company reported adjusted quarterly profit of $2.71 per share, beating estimates of $2.37 a share. Revenue beat forecasts, as well. Aetna reported an overall loss due to costs associated with the termination of its deal to merge with Humana, but said its business got off to a strong 2017 start.

Hilton (HLT) — The hotel operator came in 10 cents a share above estimates, with adjusted quarterly profit of 38 cents per share. Revenue was above forecasts and the company raised its full-year guidance, as customers book more rooms at higher prices.

Becton Dickinson (BDX) — The medical supplies company beat estimates by seven cents a share, with adjusted quarterly profit of $2.30 per share. Revenue was also slightly above estimates.

Advanced Micro Devices (AMD) — The chipmaker matched Wall Street estimates with a quarterly loss of four cents per share. Revenue matched, as well. AMD did give strong current-quarter revenue guidance, but investors are expressing concerns over profit margin forecasts.

Coach (COH) — The handbag and accessories maker earned an adjusted 46 cents per share for its latest quarter, two cents a share above estimates. Revenue fell somewhat short of expectations. The bottom line, however, was helped by a reduction in discounting.

Mosaic (MOS) — The fertilizer producer came in 15 cents a share below estimates, with adjusted quarterly profit of four cents per share. Revenue also missed forecasts. Mosaic was hurt as phosphate and potash prices fell, and a plant outage also impacted results.

CVS Health (CVS) — The drugstore operator and pharmacy benefits manager beat estimates by seven cents a share, with adjusted quarterly profit of $1.17 per share. Revenue beat forecasts. Profit did drop from a year earlier on fewer filled prescriptions and lower front-end sales.

Altria (MO) — The tobacco products company fell a penny a share shy of estimates, with quarterly profit of 73 cents per share. Revenue also fell short of the Street's outlook. Altria said its smokeable products segment did well, but there were negative effects from a voluntary smokeless product recall, as well as from its beer-related investments.

News: *Source CNBC*

United Continental (UAL) — The airline is in the spotlight today, with Chief Executive Officer Oscar Munoz scheduled to testify before the House Transportation Committee on the widely publicized recent incident in which a passenger was dragged off a flight.

AstraZeneca (AZN) — The drugmaker won Food and Drug Administration approval for the use of its immunotherapy drug durvalumab as a treatment for bladder cancer.

Infosys (INFY) — Infosys announced plans to hire 10,000 U.S. workers in the next two years. The India-based IT services firm will also open four new U.S. technology centers.

Morgan Stanley (MS) — Morgan Stanley is cutting commissions on trades involving stocks, exchange-traded funds, and annuities, capping them at 2.5 percent of the trade's value.

Microsoft (MSFT) — Microsoft executive Julie Larson-Green is pulling back on her duties for health reasons, according to The Information. She had once been considered a possible successor to former CEO Steve Ballmer, but will now take on the role of "chief experience officer."

Fixed Income

Morning Comment

U.S. Cabinet Comments Encourage Selling

< **Yields finished higher on technical factors despite weak U.S. data.** Yesterday morning the U.S. March core y/y PCE deflator, March m/m personal spending and April ISM manufacturing data all missed expectations. Despite the soft data, yields moved higher following comments from U.S. Treasury Secretary Steven Mnuchin that indicated ultra-long issuance of U.S. government bonds “could absolutely make sense.” This also led to speculation that the U.S. Treasury may increase the sizes of 10Y and 30Y auctions to test the market. Yields ended higher by as much as 5bps with the long end outperforming.

< **Little in the way of headline risk for markets today**. The only scheduled release from either Canada or the U.S. today are U.S. April vehicle sales. Expectations are for a rebound following the worst result since early 2015. Behind the scenes, the U.S. FOMC will begin its two-day meeting ahead of tomorrow’s rate announcement. No data is scheduled for release from Canada today.

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Research Analyst Ben Isaacson visited an Agrium retail distribution centre in Illinois, U.S., as part of the 2014 Scotiabank Agricultural and Fertilizer tour in June 2014. No payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Agrium Inc.**

Research Analyst Ovais Habib visited Çöpler Gold Mine, an operating mine, on September 24-25, 2014. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Alacer Gold Corp.**

Research Analyst Mario Saric visited various U.S. industrial and retail assets, operating assets in New Jersey and Los Angeles, in January and March 2014, respectively. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Brookfield Property Partners LP**

Research Analyst Mario Saric visited various U.S. office assets, operating office buildings in New York, Los Angeles, and Houston, in August 2013, March 2014, and June 2013, respectively. No payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Brookfield Property Partners LP**

Research Analyst Mario Saric visited various properties in the London, UK, office portfolio, operating office buildings, in October 2012. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Brookfield Property Partners LP**

Research Analyst Mario Saric visited BPY's City of London and Canary Wharf assets, operating office buildings, on May 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. **Brookfield Property Partners LP**

Research Analyst Jason Bouvier visited the Permian Field, an oil well site, on November 20, 2015. No payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Encana Corporation**

L. Scott Thomson, a Director of the Bank of Nova Scotia, is a member of the Board of Directors of Finning International Inc. **Finning International Inc.**

Research Analyst Orest Wowkodaw visited Ambatovy, a nickel mine, on March 28-29, 2014. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Sherritt International Corp.**

Research Analyst Ovais Habib visited the San Francisco project, an operating mine, on October 22, 2012, and May 20, 2014. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Timmins Gold Corp.**

Research Analyst Turan Quettawala visited WJA's Pearson Airport system operations centre, baggage handling facilities, on November 12, 2014. No payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **WestJet Airlines Ltd**

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