Equities

Global Portfolio Advisory Group

Canadian & U.S. Morning Comments

August 8, 2017

Scotiabank GBM DailyEdge Summary by Warren Hastings and Sunny Singh

Power Corporation of Canada (POW, $30.49, SP, $35.00) – Income from Non-Public Investments Continues to Be Positive

- POW’s second quarter results came in better than Street and our expectations resulting from higher-than-anticipated contributions from Power Financial and income from corporate activities.
- Stronger-than-expected income from corporate activities was driven by positive income from investments in hedge funds. The non-public holdings continue to generate positive income. We believe continued positive gains generated from these investments should garner more attention from investors.
- POW’s NAV discount remains historically wide and currently stands at 22%, just over 1.5 standard deviations above its historical average. We expect POW's NAV discount to narrow over time as investors take a closer look at the company’s enhanced disclosure on its non-public investment portfolio.
- Maintaining target price of $35.00 and Sector Perform rating. With a greater level of embedded strategic and financial optionality, steep NAV discount, and one-year expected return of just under 20%, we prefer POW over PWF (Sector Perform).

Cominar REIT (CUF.un, $12.41, SP, $13.25) – Undergoing Medically Necessary Treatment to Restore Health

- Q2 marked among CUF’s most difficult quarters with FFOPU down 17% YOY, a 22% distribution cut, and loss of its investment grade rating. Still, the cut and distribution reinvestment plan (DRIP) suspension mark key steps forward in restoring financial health. However, we believe stronger operational strides are required for its absolute and relative valuation discounts to compress. The backlog of committed leases provides an encouraging window into stronger NOI growth ahead, though hitting expectations has proven difficult. Our target price fell on lower estimates, partly offset by a 0.25x higher multiple for its improved payout ratio. At 9.9x NTM AFFO/6.9% implied cap/15% below NAV, CUF’s discount to the sector is well in excess of historical levels. Although we’re sidelined on its subpar growth outlook, its high yield may appeal to patient investors.

- ***Credit rating downgrade certainly not ideal, but with setbacks come opportunity.*** At $3.6B, CUF's unencumbered asset pool appears sufficient (albeit at high loan-to-value) to refinance unsecured debt as it rolls. Moreover, the lost rating has actually expanded capital allocation options under review. Although we favour deleveraging through asset sales for structural benefits to valuation, we recognize potentially attractive accretion from ramping up unit buybacks (every $250M could add 4% AFFOPU & 1.5% NAVPU).
- ***Would bigger have been better?*** The distribution cut is painful, but medically necessary for stronger financial health, while the DRIP's suspension eliminates the dilution. However, considering operational pressures to work through, a desire to reduce leverage, and still high 2018E AFFO payout ratio (88% vs. sector's 81%), a larger cut (~25%-30%) would have provided better financial flexibility, in our view.
- ***Fundamentals take another step back, but leasing benefits should become more visible; estimates reduced.*** Same property net operating income (SP NOI) fell 3.2% YOY on further weakness in retail and office. The softer than expected 1H/17 and CUF's assumed closure of all 7 Sears stores, pushed 2017 SP NOI guidance to flat to -1% (from +1%-2%). Still, with $26M of NOI expected to come on line in the next 5 quarters, we expect 2018E SP NOI to rebound to +4%. Our 2017E-18E AFFOPU declined to $1.21 (-$0.06) and $1.30 (-$0.08) with reductions for lower NOI and higher interest costs, partly offset by the DRIP suspension. Our 2016A-18E AFFOPU CAGR fell to -2.6%, with weak 2017E growth (-12%), followed by a decent 2018E rebound (+7%). Still, our CAGR sits well below the sector (4%). Our NAVPU also declined 7.5% to $14.60.

First Capital Realty Inc. (FCR, $20.00, SP, $22.00) – Operationally Advancing, though Valuation a Little Behind

- Post an in-line Q2, our steady view of FCR is intact. We continue to expect its high barrier to entry, urban, and "everyday needs" portfolio to remain operationally resilient in the face of a shifting retail landscape. Indeed, results reflected incremental momentum, with a modest acceleration of internal growth and development initiatives. Our AFFOPS estimates and NAVPS modestly increased, though our target price held steady. On balance, we believe FCR's in good form for a steeper yield curve, albeit with a bit of work still to do on the balance sheet. The shares are trading at 18.4x NTM AFFO/5.4% implied cap/3% below NAV, with its premium to the sector modestly below historical levels (Exhibits 1-3 in the analyst's full comment available on Scotiaview.com). With a tailwind forming for stronger growth in 2018 and a modest NAV discount, we see a reasonable spot for longer-term investors to add. All else equal, we would buy more actively at $19.50.

Summary of target price / rating changes:

- **Exco Technologies Limited (XTC, $11.05, SP, $12.50)** – Rating cut from Sector Outperform and target price decreased from $15.00
- **Westshore Terminals Investment Corporation (WTE, $23.04, SO, $27.00)** – Rating raised from Sector Perform and target price increased from $25.00
- **Black Diamond Group Ltd. (BDI, $1.94, SU, $2.50)** – Target price decreased from $3.00
- **Cominar REIT (CUF.UN, $12.41, SP, $13.25)** – Target price decreased from $13.75
- **Héroux-Devtek Inc. (HRX, $13.06, SO, $14.50)** – Target price decreased from $15.00
- **Hudbay Minerals Inc. (HBM, $9.71, FS, $11.50)** – Target price increased from $11.00
- **TELUS Corporation (T, $45.85, SP, $50.00)** – Target price increased from $48.00

In terms of companies reporting results:

- **Valeant Pharmaceuticals International Inc (VRX)** – VRX reported Q2/17 adjusted EBITDA of $951mm versus consensus of $894mm. Adjusted net income was $362mm (~$1.03/share) versus consensus of $329mm

($0.94/share). EBITDA guidance is unchanged at $3.6B-$3.75B. Management slightly lowered their revenue guidance to $8.7B-$8.9B from $8.9B-$9.1B to account for the divestiture of assets since its last update.

- **Brookfield Business Partners LP (BBU.UN)** – BBU reported Q2/17 funds from operations (per unit) of $43mm ($0.40) which compares with the SGBM analyst's $30.6mm ($0.28) estimate. The difference from the analyst's expectations is mainly due to lower corporate costs (mainly tax recoveries) as well as better-than-expected results from the Industrial business.
- **Ensign Energy Services Inc (ESI)** – ESI reported Q2/17 EBITDA of $44mm vs consensus of $42mm. ESI delivered cash flow per share (CFPS) of $0.28 vs consensus of $0.22. Capital program increased to $95mm, up from $61mm previously. ESI reiterated its new build plan for two rigs which are expected to be completed in Q3/17. Also, the company cancelled its dividend reinvestment program effective immediately based on improved business conditions and cash flows.
- **Martinrea International Inc (MRE)** – MRE reported Q2/17 EPS of $0.55 vs. consensus of $0.51; the company was guiding for EPS of $0.49 to $0.53. For Q3, the company is guiding to EPS of $0.40 to $0.44 vs. consensus of $0.39. The Q2 beat was driven entirely by margins as the company continues to exhibit its ability to expand margins – from operational efficiencies, mix of business, etc. – in a flat/down auto market.
- **Enercare Inc (ECI)** – EnerCare Q2/17 adjusted EBITDA of $84.3mm, largely in line with the SGBM's estimates/consensus at $82.1mm and $83.0mm, respectively. The differences with the analyst's estimates are attributable to lower than expected SG&A in the Home Services business which resulted in EBITDA of $65.4mm (vs. the analyst's $62.7mm). Results also benefited from the contribution of a full quarter from the Service Experts business, along with strong origination growth and a 14% increase in sales installation, with the segment coming in at $25.1mm (vs. the analyst's $23.1mm). Sub-metering EBITDA was in-line, coming in at $3.6mm (vs. the analyst's $3.9mm).
- **Ritchie Bros Auctioneers Inc (RBA)** – RBA reported adjusted EBIT (EPS) of $51.0 million ($0.33) vs consensus of $52.0 million ($0.32). Revenue rate was 13.22% vs consensus of 13.0%. As previously highlighted by the company, a severe shortage of equipment supply (especially in the U.S.), as end users achieve higher utilization rates, unfavourably impacted RBA's results. The company (and the SGBM analyst) expects supply conditions to remain constrained through 2017.

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

- **Blackberry Ltd. (BB)** – Resumed Sell rating at Goldman Sachs
- **Canadian REIT (REF.UN)** – Raised to Outperform from Market Perform at BMO Capital Markets
- **Black Diamond Group Ltd. (BDI)** – Cut to Underperform from Outperform at BMO Capital Markets

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

Credit Suisse Research:

Morgan Stanley (MS, NEUTRAL, Target Price: US$ 49)

What's New in the 10Q-One Loss Day; No Outsized Trading Revenue Days

- Last week Morgan Stanley filed its June 30th 10-Q report. Our focus was on incremental trading revenue detail (revenue distribution, Value-at-Risk, market outlook), fee trends on managed client assets, capital management, regulatory compliance and risk-weighted asset (RWA) progression. Our estimates and target price are unchanged.
- Trading revenue distribution. In 2Q17 Morgan Stanley experienced only one loss day (less than last quarter and the historical average); results would appear equally as impacted by the lower number of outsized trading revenue days.
- Other 10Q details: interest rate sensitivity increased, advanced approaches risk weighted assets (RWAs) up 6% qtr/qtr, notional value of derivatives down 2% qtr/qtr. Estimates and target price unchanged... Our 2017/2018/2019 estimates are unchanged at $3.45/3.95/4.30. Base case estimate risk/sensitivity is driven by the health of the capital markets-largely macro driven, but also dependent on client conviction and CEO confidence.
- What to do with the stock. Sustained share price outperformance relies on above average and improving ROE prospects consistent with what we've observed in recent results and what we expect going forward; we'd look to become more constructive on any pullback in the stock.

CBS Corp. (CBS)

Full “stream” ahead: Raising Estimates. Retain Outperform rating.

We nudge up our 2017/18 EPS forecasts by 1% to $4.46/$5.06 (from $4.44/$5.03) following Q2 earnings. CBS' over-the-top streaming strategy is picking up pace; the core strength in retransmission fees and reverse compensation fees showing no signs of slowing down; and the emergence of targeted advertising platforms for linear TV and improved measurement are additional growth opportunities long term. In an industry where shifts in consumption of video content are upending some peers, CBS' execution, positioning and valuation continue to stand out.

Earnings: *Source CNBC*

CVS Health (CVS) – CVS earned an adjusted $1.33 per share for its latest quarter, two cents a share above estimates. Revenue also topped forecasts, boosted by strong performances in its specialty pharmacy and benefits management businesses.

Time Inc. (TIME) – The magazine publisher beat estimates by two cents a share, with adjusted quarterly profit of 13 cents per share. Revenue missed forecasts on a drop in ad sales. Time also announced a new cost-cutting initiative aimed at slashing up to $600 million in expenses over the next three to four years.

Norwegian Cruise Line (NCLH) – The cruise line operator earned an adjusted $1.02 per share for the second quarter, five cents a share above estimates. Revenue also beat forecasts. Norwegian said the current booking environment is among the strongest it has seen in recent history.

Fixed Income

Morning Comment

Yields Consolidating After Friday's Gains

Government bond yields finished higher on Friday after stronger-than-expected U.S. labour market data. U.S. companies added 209k jobs in July, beating economists' estimate of 180k and June's number was also revised up from 222k to 231k. Meanwhile, the unemployment rate fell to 4.3% in July, the lowest level since March 2001, from the previous month's 4.4%, matching economists' estimate. The July jobs report showed that the U.S. labour market continued to tighten and reaffirmed that the world's largest economy remains on sturdy footing at midyear. This should clear any obstacles for the Fed to move forward with its monetary policy tightening plan for the rest of the year as the central bank is expected to start shrinking its balance sheet in the fall. In terms of rate hikes, a September hike is still off the table, while the probability of a December rate hike rose to 42% after the strong labour market data. Government bond yields at the long end of the curves rose in the U.S. and Canada as of Friday's close.

Bond yields are consolidating this morning after Friday's gains. Government bond yields are little changed this morning on a lack of market-moving events. No tier-1 economic data releases are scheduled in the U.S. or Canada today. Looking forward, Canadian housing starts and new housing price index will be released later this week, meanwhile U.S. wholesale inventories, PPI final demand and CPI for July are also on this week's calendar. U.S. Treasury yields are flat on the short end of the curve this morning, while 10-years are 1bp higher. Canadian yields are down 1-2bp this morning.

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Research Analyst Michael Doumet visited AFX Industries, Polytech, and Texas Extrusion Tooling, manufacturing facilities, on September 14 and 15, 2016. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Exco Technologies Limited**

Research Analyst Anthony Zicha visited the Runcorn and Nottingham, U.K., plant facilities, on September 18, 2014. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Héroux-Devtek Inc.**

Research Analyst Anthony Zicha visited Héroux Devtek's Laval facility, a manufacturer of small to medium landing gear systems and components and for flight control actuators, on April 26, 2017. No payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Héroux-Devtek Inc.**

Scotiabank acted as a financial advisor for HudBay Minerals Inc. in a precious metals stream transaction with Silver Wheaton Corp. **Hudbay Minerals Inc.**

Research Analyst Orest Wowkodaw visited mining assets at Flin Flon, Manitoba, on April 15-17, 2013. No payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Hudbay Minerals Inc.**

Research Analyst Orest Wowkodaw visited Constancia, a mine under development, on October 2, 2013. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Hudbay Minerals Inc.**

Research Analyst Orest Wowkodaw visited the Constancia project, a copper mine, on September 8, 2014. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Hudbay Minerals Inc.**

Research Analyst Orest Wowkodaw visited the Rosemont project, an undeveloped copper asset, in April 2014. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Hudbay Minerals Inc.**

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