Canadian Research Updates

Our latest thoughts on Morningstar's Canadian coverage universe

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November/December Canadian Updates

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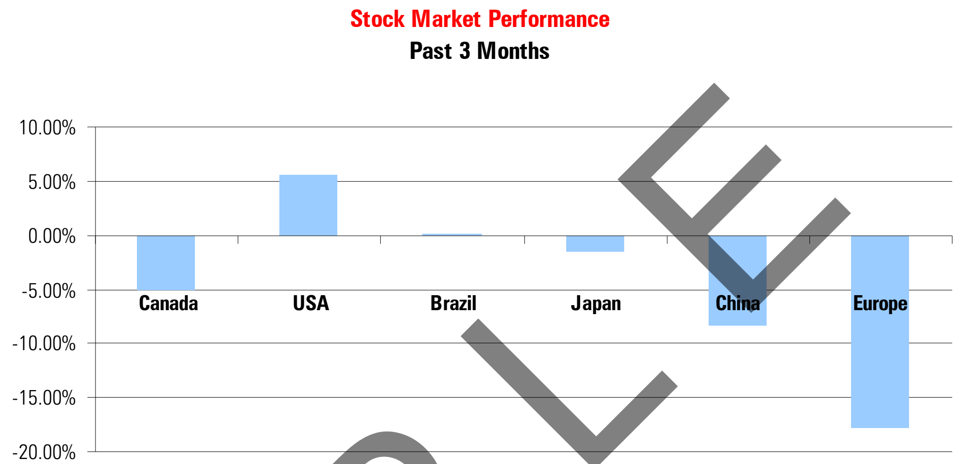
Canadian Economic Outlook

Worrisome economic data points continued to drag down the TSX, which has been one of the worst-performing stock markets over the past three months.



Source: Morningstar

For the first time since 2009, employment in Canada fell for consecutive months, as unemployment rose from 7.3% to 7.4% in November. Instead of getting the 17,000-plus job addition that was expected, the economy actually lost more than 18,000 jobs--after losing 3 times that amount in October. The economy hasn't had a month of aggregate job creation since June. Worse yet, real wages continue to drop, meaning the people who are able to hold on to jobs are still seeing their spending power decline. Inflation--which continues to outpace wage growth because of poor productivity--was up nearly 3.0% in October. The central bank is sure to keep tweaking its monetary policy framework in order to curb inflation down to its ambitious 2.0% target for 2012.

Although growth in exports rebounded last quarter (up to an annualized pace of 14.4% after a 6.4% decline in the second quarter), it wasn't enough to prevent the Organization for Economic Cooperation and Development from trimming its 2011 GDP growth projection for Canada from 3.0% to 2.2%. Worse yet, it dropped its 2012 projection by 90 basis points to 1.9%. The rationale behind the downgrade was that the country's "sluggish external demand" is handcuffing export growth. Coupling this with muted domestic spending on the back of higher debt and weakening consumer confidence, we wouldn't be shocked to see those projections come down again.

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BANKS

Credit Rating Initiation: National Bank of Canada

Morningstar is initiating credit coverage of **National Bank of Canada (NA)** with an issuer rating of A. With CAD 153 billion in assets, National Bank of Canada is the smallest of Canada's big six banks. Unlike the other large Canadian banks, National Bank of Canada focuses almost exclusively on the domestic market, with a large portion of its business in Quebec. It has three operating segments: personal and commercial (48% of net income in 2011), wealth management (13%), and financial markets (39%). National Bank's sound underwriting continues to produce few loan losses. However, it is one of the more expensively run Canadian banks, having efficiency ratios regularly in the mid-60s compared with the average of 60% for the other large Canadian banks. National Bank maintains strong regulatory capital positions, with a core Tier 1 ratio above 10% and a Tier 1 ratio above 13%. Like all Canadian banks, National Bank's actual capital levels are significantly lower, with its tangible common equity/tangible assets ratio at about 3.4%.

In our Stress Test analysis, we assigned an above-average underwriting rating for National Bank of Canada's domestic loans and securities due to the conservative underwriting profile for Canadian mortgages and the highly regulated nature of Canadian banking. National Bank of Canada received a score of very good in the Stress Test as its strong starting regulatory capital position was able to withstand a slight loss of capital under our stress-case assumptions. National Bank of Canada achieved a very good Solvency Score as it scored well in all of our metrics. We awarded National Bank of Canada a good Business Risk score as its narrow economic moat and funding mix overcame its equity uncertainty. These factors led to a rating of A.

BASIC MATERIALS

Steady 3Q for Agrium--Volume Momentum the Key Going Forward

Agrium's (AGU) retail business performed steadily in the third quarter, as farmers are buying more fertilizers, herbicides, and seeds with a backdrop of lofty grower economics. Further, the sizable addition of the Landmark retail business in Australia contributed heavily to higher year-over-year sales and gross profit. Retail gross profit leapt 56% from the prior-year period.

With the Landmark acquisition only affecting the retail arm, it's easier to judge progress in the firm's wholesale fertilizer business. Sales in this segment were up 36% year over year, as price increases fully offset weaker volume. Fertilizer sales volume was subdued by several factors: a very strong June resulted in lower beginning potash inventories for the third quarter, some distributors held back on phosphate purchases in resistance to higher pricing, and planned and unplanned nitrogen outages led to lower production volume. Massive price gains covered up weaker volume, but we'll be keeping an eye on volume momentum over the near term; particularly, we'll be looking for more signs of elevated prices leading to demand destruction (as seemed to occur in phosphate this quarter). Benchmark fertilizer prices have more or less leveled off recently, and while realized selling prices may push a little higher next quarter because of a lag effect, it looks like fertilizer prices are taking a breather. That said, we expect robust planted acres across the United States in 2012, and as a result, fertilizers should be in high demand in the coming year--a factor that could test already tight supply and provide support to prices.

Fertilizer production costs generally met our expectations for the quarter. Not surprisingly, nitrogen costs per ton rose year over year as a result of plant outages and slightly higher natural gas costs. Phosphate unit costs were up because of higher prices for key inputs, ammonia, and sulfur. Potash

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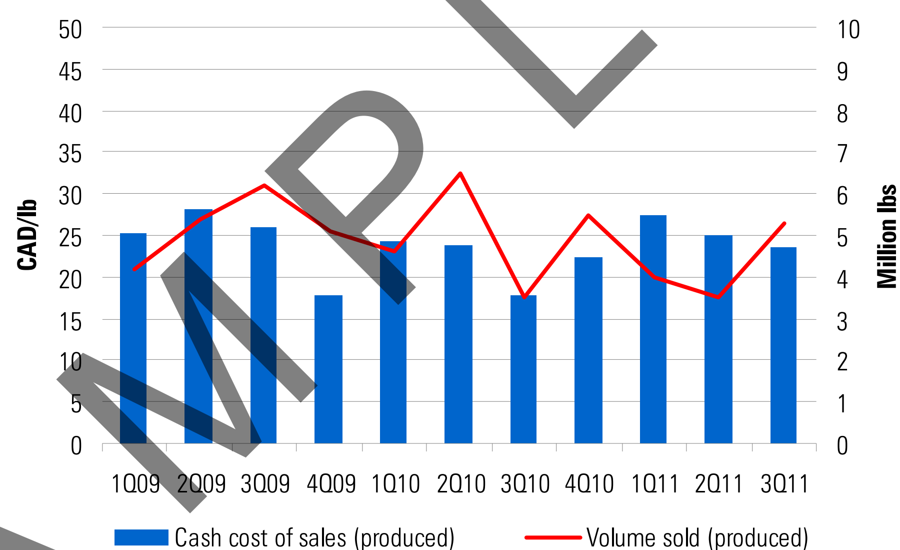
costs per ton were relatively flat year over year. Potash costs are generally less volatile than the other primary crop nutrients because the production of the potassium fertilizer does not require the purchase of volatile inputs such as natural gas or sulfur.

Cameco Reiterates Full-Year Targets, Despite Trimming Long-Term U.S. Forecasts
Higher volume in the always lumpy uranium segment (65% of trailing-12-month consolidated sales) boosted **Cameco's (CCJ)** performance versus the second quarter. Total uranium sales volume was 7.2 million pounds in the third quarter (second quarter 2011: 5.8 million), in line with management's expectations and reflecting the timing of deliveries rather than any sequential uptick in utility demand, which remains a bit on the tepid side. Operating performance was strong, as unit costs of production declined to CAD 23.60 a pound from the second quarter's CAD 24.90. For the remainder of the year, management reiterated its outlook of a modest 0%-5% unit cost increase from 2010 (2010 was CAD 22.45), which would put full-year costs at CAD 22.45-23.57 and imply further declines from third-quarter levels.



Source: Company filings, Morningstar

Looking beyond 2011, the recently announced milling agreement with Cigar Lake joint venture partner Areva bodes well for Cameco's cost profile. Whereas Cameco had previously intended to process Cigar Lake ore at both Areva's McClean Lake and Cameco's own Rabbit Lake, the new deal allows for McClean Lake to process and package 100% of Cigar Lake's uranium. Taking into account the more favorable underlying economics at McClean Lake, management now expects Cigar Lake can achieve average cash operating costs at $18.60 a pound, down significantly from the $23.14 articulated in the March 2010 Cigar Lake technical report. Cameco continues to expect production startup at this massive operation, a critical component of its growth plans, by mid-2013.

In the U.S., news was more negative, as production fell to 0.3 million pounds (second quarter was 0.7 million pounds) owing to a slower regulatory approval process for bringing new wellfields into production (a continuous undertaking necessitated by the operations' in situ recovery technology). The slow pace prompted management to reduce its longer-term production forecast for the unit, but the valuation impact is modest given the relatively small contribution U.S. operations make to total volume (about 10% of the total on a trailing-12-month basis).

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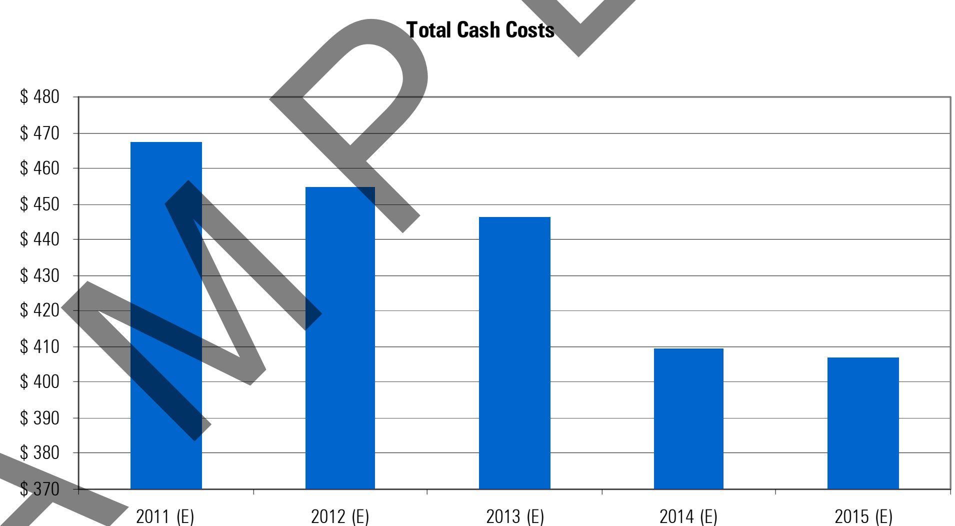
Eldorado's Lower Production Guidance Disappoints
Eldorado Gold (EGO) reported good third-quarter results, exhibiting excellent cost control. However, the firm gave reduced production guidance for 2011 as production ramp-ups for the Efemcukuru and Eastern Dragon mines are running slightly behind schedule. Nevertheless, we think these delays are only minor hiccups for Eldorado's high-octane growth strategy. The firm delivered rock-bottom total cash costs of just $463 per ounce during the quarter, representing a 7% increase from the year-ago quarter and a 3% sequential decline. After stripping out royalty and other government fees, Eldorado's operating cash costs during the quarter were only $397 per ounce, just 3% higher that the year-ago quarter. While the company is pulling all the levers it can to contain costs, we are somewhat concerned that factors outside management's control are starting to pressure production costs. For example, Eldorado's Tanjianshan mine is subject to ecological remediation fees, provincial royalties, and resource compensation fees by the Qinghai province in China that added almost $200 per ounce in additional costs on top of the firm's operating cash costs for the mine during the quarter. While the firm's other Chinese mines are subject to much lower fees and royalties, there is some risk that other provinces could follow in Qinghai's footsteps to collect a greater proportion of the economic rents generated by Eldorado's Chinese gold mines.



Source: Morningstar estimates

Eldorado reduced its 2011 production guidance to 650,000 gold ounces from a prior range of 700,000-725,000 given during the second-quarter earnings release. We mostly attribute this decrease to slower-than-expected progress at the firm's Efemcukuru and Eastern Dragon mines. Efemcukuru did produce small amounts of gold during the quarter, and we think this mine will ramp up to design capacity over the next several quarters, especially since the concentrate treatment plant is expected to be completed in the fourth quarter of this year. Eldorado is also experiencing some delays at Eastern Dragon, which management had hoped to start up by the end of the year. We now believe that Eastern Dragon will not pour its first gold until mid-2012, since Eldorado must still construct the tailings facility and waste dump at the mine. While these project delays are disappointing, we think the firm's high-growth trajectory is intact, as we project Eldorado's gold production to expand from roughly 650,000 ounces in 2011 to more than 1.1 million ounces in 2015.

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First Quantum Cuts Its Full-Year Production Guidance…Again

First Quantum (FM) reported sequentially weaker (albeit still remarkably strong by historical standards) results for the third quarter, as higher operating costs ($1.85 a pound before credits versus $1.78 a pound) and weaker copper prices offset the benefits of higher sales volume of copper (158 million pounds versus 144 million pounds) and gold (47,458 ounces versus 38,426 ounces). All told, segment operating profits came in at $325 million, down from $364 million in the second quarter.

Most of the quarter-over-quarter weakness was attributable to First Quantum's main asset, Kansanshi in Zambia. While the operation posted modestly higher copper and gold volume compared with the second quarter, lower copper prices and higher operating costs pushed profit contribution from $333 million (64% margin) to $275 million (53% margin). The smaller Guelb Moghrein mine in Mauritania had a comparably stronger quarter, as much better copper and gold volume lifted segment profit contribution from $36 million (46% margin) to $50 million (49% margin).

Management cut its full-year production outlook for the second quarter in a row, this time paring its estimate of 2011 copper output to 617 million pounds (previously 584 million pounds) and gold to 175,000 ounces (previously 190,000 ounces). The company pointed to lower-than-expected ore grades at Kansanshi and lower acid availability in Zambia (a vital consumable) as the culprits. Because the revision only modestly affects current-year cash flows and does nothing to alter our long-term production outlook, it's essentially a non-event from a valuation perspective.

Finally, it's worth noting that First Quantum's key growth projects--Ravensthorpe in Australia and Kevitsa in Finland--remain on track to achieve commercial production levels by year-end 2011 and mid-2012, respectively. Most important, management reported that it has been able to successfully address problem areas at Ravensthorpe that it had identified before purchasing the troubled asset from **BHP Billiton (BHP)** for pennies on the dollar in early 2010.

IAMGold's Niobec Expansion Project Could Add Significant Value

IAMGold (IAG) reported mixed third-quarter results, with higher gold production offset by escalating production costs. The firm has made good progress on its Westwood project, which is scheduled to come on line in early 2013, and also gave some updates on the Niobec expansion project, which is still in early stages but has the potential to add significant economic value. IAMGold's attributable gold production during the quarter was 222,000 ounces, a 14% year-over-year increase. Much of the production gains came from the successful ramp-up of gold production at the firm's newest gold mine, Essakane. However, production costs also skyrocketed during the quarter, offsetting some of the benefits of higher gold production and selling prices. IAMGold's cash costs during the quarter averaged $674 per ounce, significantly higher than the $539 achieved in the year-ago quarter. The company's cost inflation significantly outstrips the production cost increases we have seen for most of the gold miners we cover. This cost inflation partly stemmed from processing lower-grade ore, as well as higher energy, labor, and royalty expenses. However, many of IAMGold's peers outside South Africa have seen only moderate cost increases in the current quarter, and we think management must do a better job of keeping a tight rein on cash costs.

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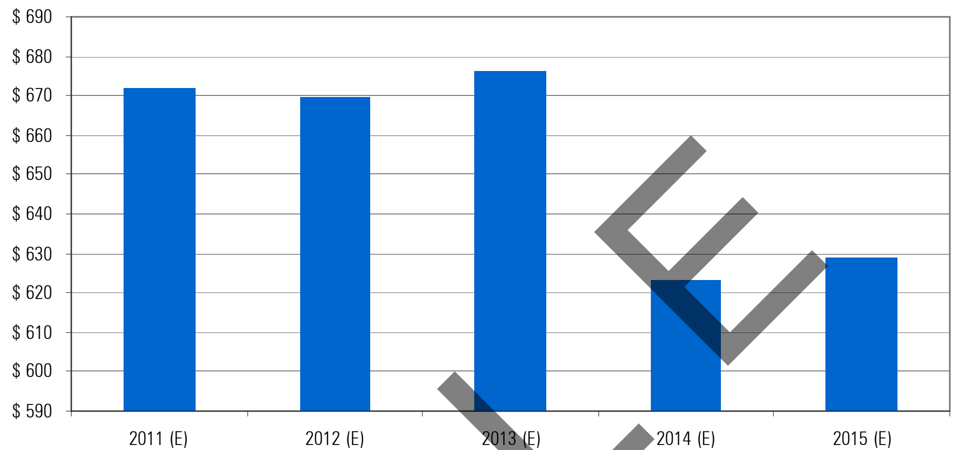
Total Cash Costs



Source: Morningstar estimates

As for future growth, IAMGold is making good progress on its next major greenfield project, the Westwood gold mine in Quebec. Westwood is still slated to come on line in early 2013 and is expected to produce an average of 200,000 gold ounces once it ramps up to full capacity. The firm also gave further details on the exciting Niobec expansion project. IAMGold completed a scoping study on the expansion project during the second quarter, which contemplates a potential tripling of niobium production from current levels to roughly 15 million kilograms of niobium per year. Given that niobium is a high-margin metal that is benefiting from secular growth trends, we think a successful expansion at Niobec could add significant economic value for IAMGold. Nevertheless, this project is still in its early days and we are not yet incorporating its financial implications in our fair value estimate.

Refining Our Long-Term Potash Price Forecast

After re-evaluating our expectations for potash industry dynamics, future supply and demand, and the marginal utility of potash, we are settling on a long-term potash price forecast of $375 per metric ton at the typical plant gate in Saskatchewan. Our new price projection results in marginally higher fair value estimates for several of the potash producers we cover, while fair value estimates for other potash makers remain unchanged. Differences in valuation changes arise depending on a company's plant locations, split of international versus domestic shipments, mix of various potash products, and incorporation of recent results and cash flows.

Producers of potash benefit from an industry oligopoly, which we think will allow potash prices to remain well above marginal costs of production over the long term. Potash production is a concentrated business, with the top six producers accounting for more than 80% of capacity, by our estimates. This oligopoly (and resulting reluctance to compete on prices) has allowed the price of potash to rise well above the marginal cost of production.

The prospects for new entrants to materially penetrate the market (and break up the happy oligopoly) are fairly low, with BHP Billiton as the most notable possibility. If this mining giant is able to bring meaningful production to market or acquire a large incumbent, the company could put downward pressure on potash prices by operating at full capacity without regard to market

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conditions. That said, acquisition targets are few and major greenfield development projects still have hurdles to cross, with large projects currently scheduled for the back half of the decade.

In addition to the industry's oligopolistic nature, the marginal utility of potash for farmers should provide support to potash prices above production costs. However, we don't think potash prices will run north forever; we actually predict a contraction, as potash supply growth (bolstered by brownfield and greenfield projects) outpaces demand growth. Further, we think crop prices will come down, and farmers will be less willing to accept elevated potash prices. despite potash utility.

CONSUMER

Inflation Turns Loblaw's Comps Positive; Shares Are Fairly Valued

Same-store sales, helped by inflation, turned positive at **Loblaw (L)** in the third quarter, and results were essentially in line with our expectations. However, it appears that the competitive environment is intensifying, as **Target (TGT)** is poised to open 200 stores in Canada over the next 12-24 months. **Wal-Mart (WMT)** is also expanding its Canadian presence. At some point, Loblaw will need to drive comparable-store sales at least in line with inflation to protect market share.

Overall sales, which include Loblaw's retail and finance segment, increased 2% to CAD 9.727 billion. Loblaw reported consolidated earnings per share of $0.84, up 18% from the year-ago quarter. At the retail segment, same-store sales came in at positive 1.3% against a negative 0.4% year-ago comparison. However, the comps increase was mainly driven by food and fuel inflation. Food tonnage decreased, despite only moderate internal food inflation. Retail EBIT margins improved 40 basis points to 4.2% versus 3.8% last year. Through various cost controls, Loblaw once again managed to deliver enough expense leverage off a weak comp to offset the 30 basis points of gross margin contraction. According to management, the gross margin decline was nearly all attributed to increased lower-margin fuel sales. If that's the case, then gross margin rates in food were at least flat, which contradicts trends on that line item at U.S. food retailers. The financial services segment added about another 20 basis points to consolidated EBIT margins, which increased to 6.6% from 6.1% last year. The trends at Loblaw's credit receivables are similar to the ones we are seeing at Target. This should help to mitigate some but not all of the margin pressure at retail that we expect from accelerating square footage from Target and Wal-Mart over the next two years.

Profits Sour at Saputo Because of Competitive Pressures, Higher Costs; Shares Still Look Rich

Saputo's (SAP) second-quarter results supported our thesis that the Canadian dairy processor is not immune to higher milk costs and margin pressure, given that its pricing and cost structure are extremely sensitive to dairy prices, which have ticked up. In addition, consumers tend to make purchase decisions in Saputo's categories based on price rather than brand, which could limit the company's ability to raise prices as it tries to offset these higher costs. We continue to believe that the market is extrapolating recent momentum over the longer term. We have to assume mid-single-digit annual revenue growth during the next 10 years and that the firm is able to maintain peak operating margins of more than 11% through 2020 to get to the current share price--an unlikely outcome, from our perspective.

Second-quarter sales grew 15% year over year, but the bulk of this growth reflects the acquisition of Fairmount Cheese Holdings (the parent company of DCI Cheese) earlier this spring. As a result, we doubt this level of growth is sustainable. Persistent cost inflation, combined with unfavorable foreign currency movements, offset the savings generated from the firm's efficiency initiatives, as the

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reported operating margin fell 140 basis points to 10.5%. The U.S. dairy business was particularly challenged in the quarter, as operating margins contracted 310 basis points to just 8.8%. According to management, this situation is unlikely to abate over the near term, as a result of a recent regulatory change whereby the whey factor used in determining milk pricing is no longer fixed. We've been saying for quite some time that Saputo maintains significant exposure to erratic changes in commodity costs and possesses a limited ability to differentiate most of its product lines, and this thesis is playing out. From our perspective, material margin expansion over the longer term will be limited, and we forecast operating margins of 11.5% in fiscal 2012 (about 10 basis points above the operating margin generated in fiscal 2011).

In addition, Saputo announced its intention to repurchase up to 5% of shares over the next year, but because the stock is trading at a premium to our fair value estimate, we don't believe this is a prudent use of capital. We would prefer the dairy processor reinvest in its business or return the excess cash to shareholders in the form of a higher dividend payout.

Tim Hortons' Momentum Carries Into 3Q;
Growth Prospects Abound, but Shares Understate Competition

Despite facing mounting macroeconomic and consumer spending challenges in both core markets, **Tim Hortons (THI)** posted strong third-quarter top-line growth and healthy operating margin growth. Canada segment same-store sales accelerated for the third consecutive quarter to 4.7%, while the U.S. segment posted its third quarter out of four with same-store sales growth above 6% (6.3%). The company remains on track to meet management's full-year same-store sales outlook of 3%-5% growth for both regions (we project 4.0% in Canada and 6.0% in the U.S.). Operating income increased 10% to $151.1 million, after adjusting for one-time items related to the sale of the company's interest in Maidstone Bakeries and the closure of stores in two U.S. markets, and year-to-date adjusted operating margins of about 20% keep the company on pace to meet its full-year earnings per share outlook of $2.30-$2.40 (especially in light of ongoing share-repurchase activity, which reduced the diluted share count 7.9%).

In our view, Tim Hortons' wide economic moat in Canada remains intact, and we believe the company still has room to grow in less penetrated Canadian markets; we forecast 4,200 restaurants and kiosks in Canada over the next decade. The firm is also well equipped to profitably expand in the U.S. over the next several years thanks to cobranding strategies, the continued rollout of its cafe/bake shop format, and new menu innovations that are having an additive impact on store traffic growth and the average ticket size. Tim Hortons' growth aspirations outside North America also remain intriguing, including the opening of its first Dubai location this quarter and expectations of 120 locations in the region over the next five years under its master license agreement with Apparel Group. Details are sparse at this point, but increased inroads into the consumer packaged goods category (including the possible launch of single-serve products in the next year and a half) should present channel diversification opportunities over the near future.

Nevertheless, even wide-moat operators can face increased competition, and we harbor concerns that the continued decline in same-store transactions in Canada could be masking increased competition from **Starbucks (SBUX)** (which reported an uptick in Canadian sales trends in its most recent quarter) and **McDonald's (MCD)**. Though we don't view either one as an immediate threat to Tim Hortons' scale and brand in Canada, we do believe competition could become increasingly fierce in the next decade, leading to more frequent price wars. Even though next year's implied price/earnings and enterprise/EBITDA multiples appear reasonable at 15 and 10 times, respectively, we find shares modestly overvalued based on our long-term discounted cash flow assumptions.

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ENERGY

ARC Resources Reports 3Q Results; Announces 2012 Plan

ARC Resources (ARX) delivered a strong third quarter, with year-over-year production growth of 10%. Revenue in the third quarter was slightly lower than our forecast due to natural gas prices, at CAD 351.8 million versus our expectations of CAD 362 million. Average daily production was 85.2 thousand barrels of oil equivalent per day, slightly higher than our forecast of 84.6 mboe/d. The firm benefited from the first full quarter of production from the Phase 2 gas plant at Dawson, which raised the region's production to average 154 million cubic feet equivalent per day--nearly half of total natural gas production for the entire firm. ARC seems to have built some operational momentum coming into the fourth quarter, and we do not expect the firm will have any difficulty meeting its full-year production goal of 80-85 mboe/d.

The company issued a second news release detailing its 2012 capital spending program, aiming for total production volumes of 90-95 mboe/d. The firm is targeting a budget of CAD 760 million, primarily directed at its oilier acreage in the Ante Creek and Pembina Cardium. Given the favorable economics of liquids over dry gas production, it makes sense that the firm would capitalize on its oil plays. Many North American exploration and production firms are diverting more 2012 capital spending away from dry gas to focus on oil production, and there is the possibility that marginal gas supply could recede enough (at least temporarily) to cause prices to rise. ARC's development strategy has been to build gas production in chunks--as it did with the latest Dawson gas plant. This development method, though cost effective, is less nimble operationally, and could prevent ARC from taking advantage of an uptick in prices. That said, we view ARC's asset and production mix favorably, and think management is doing a capable job.

Baytex Beats Our Production Forecast After an Active 3Q

Baytex Energy (BTE) delivered a strong third quarter and confirmed that its full-year production will be at the upper end of guidance of 50-55 thousand barrels of oil equivalent per day. Production for the quarter averaged 52.6 mboe/d, above our forecast of 51.3 mboe/d. The production mix also shifted toward liquids faster than we anticipated, as spending was concentrated on oil wells to the tune of 90% of third-quarter spending. Liquids volumes grew 11% from the second quarter, while natural declines mostly offset natural gas production, which grew only 2.5% sequentially and is down 12% year over year. Capital spending and operation costs were largely in line with expectations, despite the difficult weather that Baytex and many other Canadian E&Ps faced in the quarter. At Seal, the firm drilled seven net wells and said its most common well design now consists of eight 1,400-meter laterals. Baytex has consistently increased the number of laterals per well and realized incremental gains and improved economics as a result. The company's light oil plays in the Viking, Cardium, and Bakken formations also saw strong activity, with 8.5 net wells drilled in the quarter. For the fourth quarter, the company said additional heavy oil refining capacity (such as the completion of ConocoPhillips' (COP) CORE expansion project at its Wood River refinery) has begun to narrow the WCS/WTI heavy oil spread from normal levels of 18% down to roughly 12%. While we think increasing production will normalize the spread after a few quarters, we expect Baytex (and other heavy oil producers) to realize higher crude selling prices in the interim.

Bonavista Makes Two Acquisitions in 3Q, Motivated by Bargain E&P Equity Prices

Bonavista Energy (BNP) negotiated two acquisitions in the third quarter, keeping with our thesis on the firm as a value-oriented acquirer. The purchases involved private firms for a consideration totaling CAD 180 million. Details regarding the resulting production and reserve additions were not provided, but the firm said the cost of the acquisitions was on par with that of its internal growth

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program. While we are generally dismissive of acquisition activity in itself as a value creator, we view Bonavista's opportunistic timing and selective targeting of entities that will allow it to consolidate acreage positions and increase drilling inventory as an exception to the norm.

Operationally, the quarter was less optimal for the firm. Average daily production was 71.6 thousand barrels of oil equivalent per day, below our forecast of 74.1 mboe/d. The shortfall was the result of wet weather conditions and unexpected turnaround activity. We see this as a nonrecurring event, which many Canadian E&Ps struggled with over the second and third quarters. The company also noted that after the transactions, it is now producing about 75.0 mboe/d. As a result, we are still confident that the firm will meet its 2011 production guidance of 70.5-71.5 mboe/d.

Canadian Natural Bounces Back From Tough First Half; Announces 2012 Production Guidance

Canadian Natural Resources (CNQ) announced earnings that showed the company is on the road to recovery after a tough first half and unveiled 2012 guidance that should help to put the Horizon difficulties in the rearview mirror. Net earnings rose to CAD 836 million from CAD 596 million a year ago, thanks to higher oil prices and the return of Horizon to full production. However, production for the quarter fell to 612,575 barrels of oil equivalent per day from 621,284 boe/d a year earlier as a result of the ramp-up of Horizon during the quarter. Oil and natural gas liquid volumes decreased to 403,900 b/d from 411,585 b/d a year earlier, but improved from 349,915 b/d in the second quarter. Natural gas production fell slightly during the quarter to 1,252 million cubic feet per day from 1,258 mmcf/d a year ago. The performance during the quarter demonstrates that Canadian Natural is back on track, in our opinion. While the company has been plagued by operational issues, primarily with Horizon, the North Sea, and West Africa, it still has a sound asset base that we believe should deliver strong future oil growth.

To that point, the company announced 2012 production guidance that included estimated growth of 17% with anticipated liquids growth of 24%. While North Sea and West African output is expected to fall slightly in 2012, the difference should be more than made up by high-return heavy oil growth of 16%, thermal in situ growth of 10%, and North American light oil and NGL growth of 17%. The midpoint of the full-year estimated production range of 675,000-726,000 boe/d is above our previous estimate. We continue to view Canadian Natural as undervalued and believe the newly announced guidance could awaken investors to its long-term growth story. Execution will still be key, however, given the company's recent operational stumbles.

Enbridge, Enterprise to Reverse Seaway Pipeline

Enbridge (ENB) announced that it will purchase a 50% interest in the Seaway Pipeline from **ConocoPhillips (COP)** for $1.15 billion; **Enterprise Products Partners (EPD)** owns the other 50%. Together Enterprise and Enbridge will reverse Seaway's flow to move crude oil from oversupplied Cushing, Okla., to the Gulf Coast. The two midstream companies anticipate putting 150,000 barrels a day of capacity in service as early as the second quarter of 2012, with plans to increase capacity to 400,000 barrels a day by early 2013. We see this as both a response to the delay of Keystone XL and a superior alternative to the Wrangler pipeline venture announced earlier this fall by Enterprise and Enbridge. We expect that the Seaway reversal will begin to alleviate some of Cushing's supply glut once it comes on line but will not by itself be a full remedy; however upsizing the line to move 400,000 barrels a day in 2013 will make a material impact and help West Texas Intermediate prices converge closer to world oil prices. This convergence will have the greatest impact on Mid-Continent refiners, which have been enjoying cheap feedstock prices--and therefore attractive refining margins--thanks to relatively depressed WTI pricing.

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Encana Completes Sale of Barnett Acreage

Encana (ECA) announced that it had successfully sold its Barnett Shale assets for $975 million. The sale was slightly below the price range the company was targeting ($1 billion-$2 billion), but looks reasonable based on comparable metrics. The included assets are 50,000 net acres with associated gathering pipelines, producing 125 million cubic feet equivalent per day. The sale price implies a deal metric of $19,500 per acre, above the $17,300 per acre that Range Resources (RRC) sold its Barnett acreage for in March. By completing this sale, Encana has secured sufficient cash flow for its upcoming debt maturities of $1 billion over the next two quarters. Strategically, we think the sale was the best option for the firm, as its focus on growing liquids production would have resulted in limited near-term development activity in the dry-gas play.

Enerplus' 3Q Production Misses Expectations;
Facing Growing Inventory of Wells Awaiting Tie-In

Enerplus (ERF) missed production expectations (both ours and its own) in the third quarter, as logistical challenges and weather limited well tie-ins. Average daily production for the quarter was 73.2 thousand barrels of oil equivalent, below our forecast of 74.8 mboe/d. The shortfall stemmed from tying in wells in the Bakken and Marcellus regions. In the Bakken, flooding earlier in the year and subsequent highway repair work limited drilling activity and construction of gathering systems (and correspondingly increased transportation costs as the firm was forced to truck oil volumes). In the Marcellus, drilling activity continued to outpace completions and tie-ins, at a rate of one well coming on stream for every four wells drilled--the firm now has 214 gross wells (15.5 net) waiting on completion or tie in. The company expects to tie in 24 gross Marcellus wells (2.3 net) in the fourth quarter, and we suspect that it will be late 2012 or 2013 before Enerplus begins to make a serious dent in the backlog of wells. The resulting timing difference between investment (drilling costs and land acquisitions) and payback (production) has drawn our focus to Enerplus' cash flows and the sustainability of its dividend yield. In the third quarter, capital expenditures exceeded cash flow from operations by more than 3 times. As a single event we are not concerned, as we think Enerplus' balance sheet can easily support the additional borrowing for the time being. If the firm is not able to accelerate bringing wells on stream, however, we think the possibility of a dividend cut increases.

Nexen Announces Horn River Joint Venture and 2012 Capital Budget

Nexen (NXY) announced its 2012 capital budget, coupled with the welcome news that it will form a joint venture to develop its Horn River, Cordova, and Liard Basin acreage with INPEX and JGC. The terms of the agreement are for Nexen to give up a 40% working interest (split 82% for INPEX and 18% for JGC) in the region for a total consideration of CAD 700 million, with 50% paid up front and 50% as a carried interest. Nexen expects to fully utilize the carry in 2012. We calculate the deal to imply a price of just above CAD 5,800 per acre, which we believe is favorable given the region's remote location and dry gas production. Of more interest is Nexen's choice of partners. INPEX is Japan's largest exploration and production company, with a specialty in liquid natural gas projects, and JGC is an engineering contractor for oil refining and gas processing. The press release states that the partners are exploring the feasibility of a downstream project, including LNG exports. Since proximity to markets has been a formidable obstacle to ramping up development in the Horn River, we think that the potential for downstream would be a boon for both Nexen and other producers in the region.

Nexen's 2012 capital budget held few surprises. The company expects to spend CAD 2.7 billion-3.2 billion, roughly equal to the firm's expectations for cash flow in 2012. Our current estimate for 2012 development and exploration spending was just under CAD 2.8 billion. As such, we probably will be

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increasing the level of spending in our forecast. Spending primarily will be directed at the North Sea, and specifically the Golden Eagle project, as well as the firm's in situ oil sands project at Long Lake. We note that the company's oil price assumptions for establishing its 2012 budget are higher than other Canadian E&P firms we cover--at $95 per barrel for WTI and $110 per barrel for Brent. Should prices fall considerably, we would expect the firm to first pull back on exploration spending, before adding to debt. The company has earmarked exploration spending for its conventional portfolio of CAD 400 million-475 million and has set aside CAD 100 million-125 million for wells in Poland and Colombia, which we would consider entirely exploration. Should oil prices fall in 2012, we would expect the projects that fall into these two buckets would be deferred.

Penn West's 3Q Meets Expectations, but 2012 Production Outlook Disappoints
Penn West's (PWT) third-quarter results were largely as we expected, especially given the tumultuous first half of the year the firm experienced from fires and flooding. Production was roughly 5,000 barrels of oil equivalent per day above our forecast due to higher-than-expected heavy oil volumes, averaging 161.3 mboe/d. Light oil and natural gas production was very close to our expectations, at 83.3 mboe/d and 352 million cubic feet equivalent per day, versus our forecast of 83.3 mboe/d and 360 mmcfe/d, respectively. Much of the quarter's activity was focused on recovering production levels after this spring's fires and floods, but we anticipate that the firm has fully recovered and expect to see a strong uptick in fourth-quarter production, at roughly 172-173 mboe/d.

Penn West also released its guidance for 2012 spending and production levels. The plan calls for a capital budget of CAD 1.6 billion-1.7 billion, and average daily production for the year of 174-178 mboe/d, before divestitures. At first glance, the production outlook looks to be setting a low bar, as the firm expects to exit 2011 at 174-177 mboe/d. For the sake of comparison, Penn West's initial guidance for 2011 was average daily production of 172-177 mboe/d, and 2010 exit production was 167 mboe/d. As we get closer to 2012, we'll be looking for more specific information from the company on development timing--if spending is proportionally higher in the back half of 2012 it could explain why average production for the year seems mediocre, and could point to a strong 2013.

Peyto Continues Impressive Production Growth; No Signs of Slowing in 2012
Peyto Exploration and Development (PEY) continued its run of solid operational and financial performance in the third quarter, reinforcing our low cost/high growth thesis. Production for the quarter averaged 218 million cubic feet equivalent per day, up 5.5% from the second quarter and 52.8% from the third quarter of 2010. Revenue before royalties was on par with our expectations at CAD 107.5 million versus our forecast of CAD 107 million. Peyto's ability to control costs continues to shine, with total cash costs of CAD 1.24 per mcfe. The higher heat and liquids content of the firm's gas pushed the average selling price for the quarter to CAD 5.35 per mcfe, resulting in an outstanding cash netback of CAD 4.11 per mcfe.

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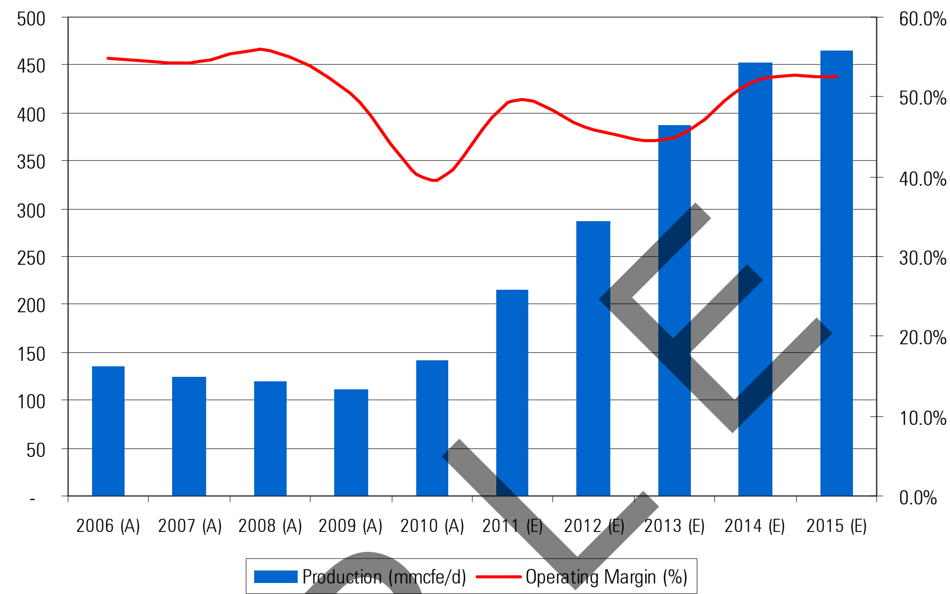

Source: Company filings, Morningstar Estimates

Spending in the quarter included more than CAD 16 million of infrastructure investment. The firm has worked to add compression and refrigeration capacity at the Nosehill and Oldman facilities, bringing total processing capacity to 320 mmcfe/d. This capacity will cover the firm's production growth through 2012. The company also completed the design phase for its liquids recovery project at Oldman, which will increase liquids recovery from 21 barrels per mmcf to 36 b/mmcf. We think the project is time and money well spent, and it exemplifies Peyto's approach of getting the most of the assets it already has, instead of attempting to boost returns by chasing "hot" acreage in unproven reservoirs.

Peyto outlined its 2012 preliminary budget, setting its capital program at CAD 400 million-450 million for the year. The plan calls for six horizontal rigs to run in Peyto's main development areas, with 80% of spending budgeted toward drilling, completion, equipment, and pipelines. The company provided a high-level forecast for 2012 production, targeting an exit rate of 306-330 mmcfe/d, or year-over-year growth of 20%-30%. We expect that 2012 production will land at the high end or even exceed the range provided by management. The company has ample running room in terms of drilling inventory (in our estimation), and there are minimal signs of cost inflation for drilling rigs or completion crews. As long as these two factors are favorable for the firm, we expect development activity to continue at its current pace or accelerate, and we do not view gas prices (at their current level) to be a hindrance for Peyto in the way that they have been for many of its peers.

Suncor Sees Earnings Rise on Higher Oil Prices, Strong Refining Performance

Suncor (SU) reported third-quarter net earnings of CAD 1.287 billion compared with CAD 1.224 billion a year ago, which benefited from gains-on-asset sales. Operating earnings, excluding significant nonoperating items, improved demonstrably, surging to CAD 1.789 billion from CAD 617 million last year thanks to higher realizations and downstream margins and increased oil sands production. Total oil sands volumes increased to 363.5 thousand barrels per day from 338.3 mb/d a year earlier as a result of improved reliability and less maintenance downtime. Exploration and production segment production for the quarter fell to 183.5 thousand barrels of oil equivalent per

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day from 297.2 mboe/d a year earlier as a result of shut-in production on Terra Nova in East Coast Canada, downtime on Buzzard in the North Sea, and lost Libyan volumes.

Given the mixed third-quarter production, Suncor revised its overall full-year outlook to 530-560 mboe/d from 520-570 mboe/d. The company narrowed its guidance range for oil sands while raising guidance for East Coast Canada and lowering international guidance. The company also announced 2012 capital spending plans of CAD 7.5 billion, slightly below what we expected. We believe Suncor's long-term growth story remains intact and see the shares as undervalued. On that note, the company's next major expansion, Firebag Stage 3, is almost completed and currently producing oil, which has driven companywide in situ production past 100 mb/d. In situ production should exit 2011 at 110 mb/d.

As in the first half of the year, the refining and marketing segment turned in another strong performance during the quarter. Earnings rose to CAD 479 million from CAD 159 million a year ago thanks to continued strength in West Texas Intermediate indexed margins. While we have doubts about the long-term viability of refining, Suncor's integration is currently paying dividends as it is allowing the company to capture the wide discount on Mid-Continent crudes. Though that discount has narrowed in the beginning of the fourth quarter, it remains at levels that should continue to lead to strong downstream profits for Suncor.

Talisman Energy's 3Q Results Show Activity Ramping Up

Talisman Energy's (TLM) third-quarter earnings release included indications of progress on a number of fronts. Production for the quarter, net of royalties, averaged 324 thousand barrels of oil equivalent per day, versus our estimate of 339 mboe/d. The miss was primarily related to lower oil production in the United Kingdom due to maintenance and safety-related shutdowns. Despite the lower-than-expected production, continued price strength in Brent crude and Southeast Asia natural gas resulted in revenue of $1.96 billion versus our forecast of $1.88 billion.

In North America, the company's portfolio is making clear signs of a transition. Total volumes of the firm's combined conventional and unconventional portfolio have been roughly flat for the past three quarters, as unconventional production growth offsets conventional declines. However, liquids production is up 14% this year. Furthermore, we expect unconventional growth to drive down operating costs. Using U.S. production as proxy for unconventional volumes and Canadian production for conventional production (Talisman's North American production is reasonably segregated along these lines), we see that Talisman's operating costs for unconventional gas production are roughly half conventional production. As the company continues to drill new wells in Canada's Montney and Duvernay regions, we expect North American operating costs to trend lower.

In Southeast Asia, production was 3.8% higher than in the second quarter, after turnaround and optimization activity increased gas production in Malaysia and Indonesia. Additionally, the firm started up production at the Kitan project in October, providing an additional 10 mboe/d net to Talisman. The firm continues to progress in its international exploration portfolio, drilling a number of appraisal wells in Colombia and Peru and spudding its initial shale well in Poland. We continue to see promise in the exploration portfolio--especially in Colombia--and believe it provides the firm with opportunity for growth and investors with a cheap call option at Talisman's current share price.

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U.S. State Department Puts Brakes on TransCanada's Keystone XL Pipeline
We were somewhat but not overly surprised to learn that the State Department has punted on its long-anticipated decision of whether to approve **TransCanada's (TRP)** CAD 7 billion Keystone XL pipeline. The given rationale, "to undertake an in-depth assessment of potential alternative routes in Nebraska," could push back the approval decision until at least the first quarter of 2013--about the time TransCanada had planned to place the pipeline in service. This comes on the heels of vociferous protests against the pipeline in Nebraska and Washington, D.C., following a final environmental impact statement from the State Department concluding there would be no significant environmental impact from the pipeline. The proposed pipeline route was one of 14 potential routes.

At this point, we are not adjusting our fair value estimate for TransCanada, as we still expect the pipeline will ultimately be approved, even if after the 2012 presidential election. To date, TransCanada has spent CAD 1.9 billion on the pipeline, a large chunk of which has gone toward steel and other raw materials for the pipeline and its facilities. Some of the remaining development costs are truly sunk costs, but we expect that TransCanada could recover a fairly significant amount of its investment to date if push came to shove, by selling or finding alternate uses for the raw materials. Even if TransCanada lost its entire investment to date, which we consider very unlikely, it would amount to only CAD 2.70 per share. On its own, Keystone XL doesn't have particularly compelling project economics; TransCanada expects a 7%-9% unleveraged internal rate of return. What would hurt most, in our view, if the pipeline were not approved would be lost future opportunities to expand capacity very economically via pumping stations and to build storage facilities that leverage the pipeline's footprint. It could be difficult to allocate this amount of capital as efficiently in North American natural gas pipeline infrastructure. We'll keep our ears peeled, as TransCanada remains committed to the project and is working with the State Department to determine the next steps.

TransAlta Eyeing Australian and US Power; Alberta Still Highly Attractive
At the Edison Electric Institute's Financial Forum, we met with **TransAlta's (TAC)** senior management to talk about North American power markets and TransAlta's growth strategy. We also discussed TransAlta's Australian power presence. TransAlta's most vital market in Alberta remains fundamentally appealing, with high prices today reflecting ongoing strong economic activity driven by oil sands development and some large coal outages, highlighting the region's potentially tight reserve margins if supply goes offline or demand continues to grow. At a 2% annual growth clip, TransAlta management estimates reserve margins could drop to less than 15% by 2014, supporting continued strong pricing. The company's long-term opportunity remains intact, though it requires great patience, with fixed-price power purchase agreements covering most of its output until 2021.

Regarding the U.S., management reiterated the company's focus on renewables, both greenfield and acquisitions. The company is currently bidding into requests for proposal for new units at its Blackrock geothermal site. We also learned in a roundabout fashion that the company had taken a hard look at **Ormat Technologies (ORA)**, the technology leader in organic-rankine cycle geothermal, but found the valuation too rich. If not for Ormat's current ownership imbroglio at Israeli parent Ormat Industries, we suspect Ormat would be a more appealing target for TransAlta today at its much lower--undeserved in our opinion--multiple.

Australia had been a bit of a question mark for us, given its remoteness and lack of apparent fit with the rest of TransAlta's portfolio. Returns have been strong there, and we learned a little more about

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why that was so. TransAlta is focused on Western Australia where there is little by way of a transmission grid and much of the power demand is "behind the fence," meaning off-grid bilateral contracting, largely with mining companies. As such, power garners a significant scarcity premium, as well as a risk premium given a project's close ties to one or two major buyers. With the mining business booming, opportunities are significant, and TransAlta sees potential to build 300-600 megawatts of natural gas capacity to serve the surge in demand, which has been growing at 9% annually.

FINANCIAL SERVICES

Manulife Ahead of Schedule on Long-Tem Risk-Reduction Plans

Manulife (MFC) reported a third-quarter loss of CAD 1.3 billion, primarily attributed to reserve strengthening associated with annual assumption revisions and the substantial declines in equity markets and interest rate levels. Dynamic hedging generated CAD 3.3 billion in aftertax gains, which offset about 70% of the CAD 4.8 billion earnings impact of variable annuity risk and nonvariable annuity equity-related losses. The net loss might seem large at the first glance, but it is strictly a Canadian accounting treatment where reserve impacts are expensed in the quarter in which they occur. If Manulife reported in U.S. GAAP, it would have recorded net income of CAD 2.2 billion.

Despite the sizable loss, we are encouraged by the progress made in terms of lowering earnings sensitivity. Management has exceeded its 2014 goal for interest rate risk reduction and is ahead of its 2012 goal for equity market risk reduction. Additionally, we are pleased with a strong uptick in insurance product sales in Asia, as well as strong growth in wealth product sales across all three regions--the U.S., Asia, and Canada. During the quarter, management made substantial progress in derisking its product mix to improve returns on equity and the company's risk profile. Overall, we think Manulife has achieved what it set out to do in terms of lowering earnings sensitivity and derisking its product mix. We are encouraged by the progress made in this quarter, despite the bad headline number.

Power Corporation Reports 3Q Earnings

Power Corporation of Canada (POW) reported third-quarter operating earnings of CAD 348 million or CAD 0.73 per share, compared with CAD 275 million or CAD 0.58 per share in the corresponding period in 2010. The increase in operating earnings was primarily driven by higher investment income from Power Corporation's interest in the Sagard 1 fund in Europe, partly offset by a decrease in contribution from Power Financial, a subsidiary of Power Corporation, which derives 90% of its operating earnings from its 68% holding in **Great-West Lifeco (GWO)** and its 57% share in **IGM Financial (IGM)**.

Great-West's earnings were fair, given the difficult macro issues the life insurer was facing in the quarter. Earnings quality was a bit soft, in our opinion, as Great-West's Canadian group insurance operations benefited from mortality improvement in liabilities, partly offset by increases in reserves due to lower interest rates. Great-West's third-quarter contribution to Power Financial was CAD 312 million, compared with CAD 323 million in the corresponding period in 2010. Along with earnings results, management reiterated that Great-West only had 3% of invested assets exposed to bonds of government and financial institutions of eurozone countries.

As for IGM Financial, third-quarter earnings were CAD 213 million or CAD 0.82 per share, compared with CAD 181 million or CAD 0.69 per share for the same quarter a year earlier. IGM's contribution to Power Financial was CAD 121 million, compared with CAD 104 million in the corresponding

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period of 2010. Third-quarter results were buoyed by an increase in mutual fund sales and a decrease in redemption in the Investors Group operations.

Overall the latest quarterly results support our view that Great-West is a solid performer in a difficult industry, as it takes a conservative approach to underwriting, and that IGM Financial is a company prone to an economic moat because of its control over distribution. We think Great-West and IGM Financial are qualitatively attractive and Power Corporation should continue to earn attractive returns on capital.

TMX Group Adds to Capabilities While Supporting Maple Proposal
TMX Group (X) reported net income attributable to common shareholders of CAD 67 million, or CAD 0.90 per diluted share, on CAD 167.8 million of revenue for the third quarter of 2011. Revenue was only down 1% sequentially, as strong derivatives trading volume and foreign-exchange-related gains on accounts receivables offset a decline in additional listing fees.

Even though TMX Group has decided to support the Maple Group offer, it continues to add to its stand-alone capabilities. In the third quarter, TMX Group bought capital markets infrastructure provider Atrium Network and launched its alternative trading system, TMX Select. TMX Select has a differentiated approach with its order-matching model that is strictly price/time priority and a fee schedule that charges liquidity makers and takers the same amount. Globally, competition for equities market share is increasing, and we believe TMX Group competing via innovation is better than competing just on price.

While we weren't surprised that derivatives trading was an area of strength in the third quarter, we were surprised that TMX's Boston Options Exchange stake probably contributed more to the sequential revenue growth than the Montreal Exchange. BOX volume increased 68% sequentially versus just 3% growth at the Montreal Exchange. The 68% sequential growth is also impressive compared with about 20% sequential growth for the whole U.S. equity options market. The comparatively strong growth came from increasing market share to about 3.5% from 2.5% in the second quarter. This 3.5% is BOX's highest market share since the third quarter of 2009 and much better than the 1.9% reported in the first quarter of 2010. We don't believe BOX will continue to materially increase market share, but its stabilization at current levels would still be positive.

HEALTH CARE

QLT Has Ambitious Goals for Its Drug Pipeline
QLT (QLTI) reported third-quarter results within our expectations. Despite management's efforts to salvage Visudyne sales in the U.S., sales in the country fell 26.2% from the year-ago period. Sales outside the U.S., however, performed reasonably well, posting 10% growth, probably thanks to greater contributions from China and Japan. Although rising costs led to a steeper quarterly loss from previous quarters, we think management's clinical development efforts are paying off. Management now hopes to have three Phase III clinical trials by 2013, the leber congenital amaurosis and retinitis pigmentosa indications for its QLT091001 compound and a glaucoma study for its punctual plug program. We remain lukewarm on the punctual plug program, but management said it has made a considerable improvement in the upper punctal plug's retention rate through a new product design. We don't plan to change our punctal plug forecast until management can proceed to a Phase III trial. We continue to believe the majority of QLT's value lies in the QLT091001 program. Now that this molecule has been granted fast-track status by the Food and Drug Administration, we think the drug's approval could come sooner than we initially projected.

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Valeant Is Set Up for an Impressive 2012

Valeant's (VRX) strong third-quarter results were in line with our estimates, but the firm's increased fourth-quarter guidance exceeded our expectations. Based on an improved outlook, we are raising our fourth-quarter and full-year estimates. The firm's new earnings guidance for the year is $2.80-$2.95 per share, versus the previous range of $2.70-$3.00; however, prior guidance had included an estimated $0.13 per share milestone payment for the U.S. launch of Potiga, which will now take place in the first quarter of 2012. Excluding the milestone payment, management's previous guidance would have been $2.57-$2.87. With Valeant's strong internal growth, accretive acquisitions, strict cost-containment initiatives, and aggressive share repurchases, we now believe the adjusted EPS could approach $4.00 in 2012 if the firm completes its pending acquisitions on schedule.

The firm will not release 2012 guidance until January, but we have increased our 2012 estimates based on the increased clarity. We expect significant top- and bottom-line growth stemming from a number of factors. We expect dermatology to lead the company with double-digit internal growth in 2012. Volume is up 24% year to date in 2011, and we see this momentum carrying into 2012. The firm has already instituted selective price increases in the fourth quarter, which should help boost revenue throughout 2012. Acquisitions should also provide a material tailwind for the firm next year. The acquisition of Sanitas was completed in late August, and the Afexa acquisition closed recently; both should help boost 2012 results as the company sees a full-year benefit from them. We also still expect Valeant to close the Dermik and Ortho acquisitions by year-end, which would add more than $400 million to its dermatology sales in 2012.

The firm has shown impressive efficiency in increasing revenue with minimal selling, general, and administrative expense growth, largely because of the successful integration of acquisitions. Adjusted SG&A (excluding stock-based compensation) was just 21.7% of sales in the quarter, down significantly from 25.2% in the second quarter. The firm has identified an additional $75 million of cost synergies in Europe and expects to realize them by the end of 2012.

Valeant also announced that the board of directors has authorized a new $1.5 billion securities-repurchase program. The program can be used to acquire common shares, convertible notes, or senior notes. Since shares are currently trading at a sizable discount to our fair value, we think a share repurchase will add value for shareholders; however, we also think it is prudent to use some of the program to reduce the firm's $5.2 billion in debt.

INDUSTRIALS

Air Canada Plans Capacity Growth for 2011 and 2012

Air Canada's (AC.B) revenue improved 7% in the third quarter as traffic grew 3% and yields increased 4%. The company reported a record load factor of 85.8%, which allowed fuel surcharges to stick. Total fuel costs increased 29% year over year and were CAD 210 million higher from last year; raw fuel prices increased 47% but Air Canada used active hedges along with the natural hedge they have with the Canadian dollar to reduce the overall change. Cost reduction reached the annualized CAD 530 million target one quarter in advance and helped to drive costs excluding fuel down 0.4% per available seat mile. A large negative foreign currency impact led to negative earnings per share results. Our estimates call for revenue to improve 6% for 2011, which should lead to an improvement in operating margin north of 5%, including the fuel headwind.

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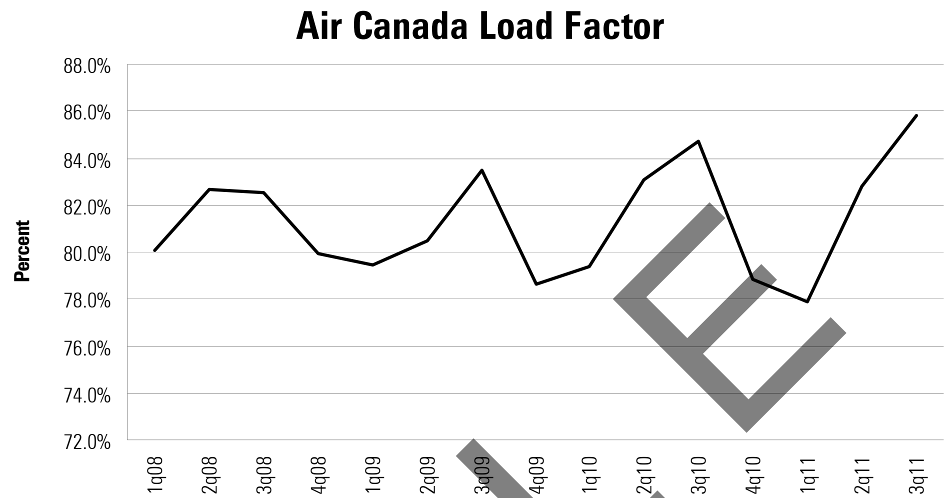

Source: Company filings, Morningstar

Air Canada sees capacity increasing no more than 1.5% for 2012, following a 4%-plus increase for 2011. We are not as optimistic as the firm regarding demand strength 2012, as we are seeing signs of deceleration around the world, especially in the eurozone and the U.S. With competitors reducing capacity because of higher fuel prices and slowing demand, we think Air Canada may need to do the same. Still, results to date have been encouraging, especially those excluding fuel increases.

The balance sheet has cash of CAD 2.2 billion, or 19% of last 12 months' sales. Long-term debt stands at CAD 4.5 billion. However, pension liabilities increased by CAD 500 million to CAD 3.8 billion, resulting from lower discount rates. Labor strains continue and the company is working to resolve them in due course. Discussions continue with multiple unions in order to arrive at a final agreement, but the company sounds hopeful that employees will not strike during the negotiations.

We Are Questioning Ritchie Bros.' Near-Term Prospects After a Less-Than-Stellar 3Q

Ritchie Bros. Auctioneers (RBA) reported third-quarter results that were below our expectations, as it was unable to increase its gross auction proceeds versus last year. We view this revenue decline as worrisome. We believed Ritchie Bros. could expand its meager 4% share of the used-equipment market and grow in almost any economic environment. However, this hasn't held true during the past two years, nor specifically in the most recent quarter. We expect to revisit our assumptions and may reduce our fair value estimate as a result.

Revenue decreased 3% from the year-ago period, driven by a 10% decline in gross auction proceeds. Ritchie Bros. offset this reduction by increasing its auction rate--its percentage take from each sale--by 8%-11.8%. Excluding the $9 million new revenue from changes to the fee structure implemented at the beginning of the third quarter, the auction rate would have been 10.5%, which is above the historical range but below previous lofty levels. The revenue decline, combined with growing fixed costs, caused operating margins to compress 50% to 11%, which is substantially below the firm's 15-year annual trough operating margins of 20%.

When Ritchie Bros. reduced its 2010 guidance in July 2010, we explored the possibility that it might be conceding share to other avenues, as the economic uncertainty forced companies to rent

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equipment rather than purchase, and maybe its business model was in jeopardy. We concluded that it was too early to tell if the firm was losing its competitive advantage and needed to observe if increasing rental volume and decreasing gross auction proceeds would persist.

Today, however, we are beginning to change our positive view on the firm's business model and think the cost associated with convincing new customers of the benefit of the Ritchie Bros. network might be greater than we initially thought. As a result, customers are deciding to sell via a private sale for ease of transaction and Ritchie Bros. is unable to leverage its network. Further, the more Ritchie Bros. strays into selling at-risk equipment, the less compelling and durable its competitive advantage becomes. We think these at-risk sales, which accounted for 30% in the quarter, above the historical range of 20%-25%, make Ritchie Bros.' results more dependent on its ability to assess the directional change in equipment market prices during the coming quarters, rather than simply generating a commission from providing its network. As these two trends continue, we will reconsider our positive economic moat trend rating.

TECHNOLOGY

Preview of CGI Group's 4Q

CGI Group (GIB) is scheduled to report its fiscal 2011 fourth-quarter results on Nov. 10. We expect to see a mixed bag from the company--strong numbers from its commercial business partially offset by a weak showing from its federal government practice. Budgetary constraints have forced several federal government agencies to keep a tight leash on their IT spending, and we expect this to impede CGI growth prospects in the near term. On the other hand, we expect CGI to benefit from continued strong demand for IT services on the commercial side of its business. Solid quarterly results from Accenture (CAN) and Infosys (INFY) indicate that IT services demand continues to remain strong, which should work in CGI's favor.

Negative Net Sales Pose Near-Term Headwinds for Thomson Reuters' Markets Division

Thomson Reuters' (TRI) third-quarter revenue increased 5% on a constant currency basis compared with the year-ago period, with acquisitions accounting for 3 percentage points of the growth. The company's underlying operating margin expanded 80 basis points to 22%. The professional division reported a 10% revenue increase, with acquisitions accounting for half of the growth. All segments within the professional division witnessed strong demand for their offerings. Except for legal, the other segments of the professional division operate in a stable demand environment and we expect this trend to continue. The legal segment faces modest headwinds in its core legal research market in the U.S., but we believe the company's recent expansion into emerging markets in Latin America, including Brazil, should offset the domestic headwinds. During the quarter, the professional division's operating margin expanded 20 basis points to 27.8%.

Thomson Reuters' markets division had another weak quarter, posting 1% year-on-year revenue growth. Enterprise had another strong quarter (8% growth and 16% of segment revenue), followed by sales and trading (2% growth and 50% of segment revenue). However, investment advisory (3% decline and 30% of segment revenue) and media (flat growth and 4% of segment revenue) continued their recent downward trend and dragged the overall performance of the segment. The markets division has been under pressure in recent times as the global financial markets remain unsettled amid the sovereign debt crisis in Europe and slowing growth in the U.S. and other developed economies. In a sign that this segment will remain in choppy waters in the near term, management said net new sales declined during the quarter. In an effort to improve the performance of the markets division, management initiated a series of measures to streamline its

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operations. We don't have much insight into details of the new streamlined structure, and management said it they will provide additional information by the end of the next quarter. On a positive note, the markets division reported a 60-basis-point improvement in operating margin during the quarter (20.3% versus 19.7% last year). This was mostly along the expected lines as integration-related savings started to affect margins positively.

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December Events

Monday	Tuesday	Wednesday	Thursday	Friday
28	**29**	**30**	**1** **Earnings:** Bombardier (BBD) Canadian Imperial Bank of Commerce (CM) Gildan Activewear (GIL) The Toronto-Dominion Bank (TD)	**2** **Earnings:** Royal Bank of Canada (RY) Bank of Nova Scotia (BNS)
5	**6** **Earnings:** Bank of Montreal (BMO)	**7** **Guidance Call:** Enbridge (ENB)	**8** **Earnings:** National Bank of Canada (NA)	**9**
12	**13**	**14**	**15**	**16** **Guidance Call:** TELUS Corp (T)
19	**20**	**21**	**22**	**23**
26	**27**	**28**	**29**	**30**
31				

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Key Statistics and Valuations

Industry Group	Star Rating	Ticker	Company	Market Cap	Price	Fair Value	Price/ FV	Consider Buy	Consider Sell	Moat	Uncertainty Rating	2011(E) Diluted EPS	Forward P/E	Forward EV/EBITDA	Forward Dividend Yield
Aerospace & Defense	★★★★★	BBD.B	Bombardier Inc	6,433.7	3.67	7.00	0.52	4.2	10.9	Narrow	High	0.34	7.0x	10.1x	1.6%
Agriculture	★★★★	AGU	Agrium Inc	11,053.5	70.04	90.00	0.78	54.0	139.5	None	High	8.92	7.1x	6.5x	0.1%
Agriculture	★★★★	POT	Potash Corporation of Saskatchewan, Inc.	35,603.8	41.57	57.00	0.73	34.2	88.4	Wide	High	3.98	9.2x	10.3x	0.5%
Airlines	★★★★	AC.B	Air Canada	305.4	1.08	2.00	0.54	1.0	3.5	None	Very High	0.86	3.7x	4.0x	0.0%
Airlines	★★★★	ACE.B	ACE Aviation Holdings, Inc.	337.7	10.40	13.00	0.80	7.8	20.2	None	High	0.86	12.0x	7.0x	0.0%
Application Software	★★★	GIB.A	CGI Group, Inc.	4,904.6	18.72	19.00	0.99	13.3	25.7	None	Medium	1.12	9.7x	n/a	0.0%
Asset Management	★★★	AGF.B	AGF Management Limited	1,487.7	15.63	18.00	0.87	10.8	27.9	Narrow	High	1.36	11.7x	6.1x	6.0%
Asset Management	★★★	CIX	CI Financial Corp	6,009.2	21.08	20.00	1.05	12.0	31.0	Wide	High	1.30	15.2x	11.5x	4.4%
Asset Management	★★★	IGM	IGM Financial Inc.	11,584.8	45.00	48.00	0.94	33.6	64.8	Wide	Medium	3.23	13.7x	10.5x	4.4%
Autos	★★★★	MG	Magna International	8,644.5	36.67	49.00	0.75	29.4	76.0	None	High	4.55	7.8x	5.1x	1.4%
Banks	★★★	BMO	Bank of Montreal	36,205.7	56.66	64.00	0.89	38.4	99.2	Wide	High	5.11	9.9x	n/a	4.4%
Banks	★★★	BNS	Bank of Nova Scotia	53,362.7	48.98	49.00	1.00	34.3	66.2	Wide	Medium	4.44	10.2x	n/a	4.2%
Banks	★★★	CM	Canadian Imperial Bank of Commerce	28,809.3	71.92	76.00	0.95	45.6	117.8	Wide	High	5.87	8.7x	n/a	4.7%
Banks	★★★	NA	National Bank of Canada	10,924.0	68.10	76.00	0.90	45.6	117.8	Narrow	High	6.84	9.4x	n/a	3.3%
Banks	★★★	RY	Royal Bank of Canada	71,154.6	49.47	52.00	0.95	36.4	70.2	Wide	Medium	4.35	9.9x	n/a	4.1%
Banks	★★★	TD	Toronto-Dominion Bank	66,122.5	73.27	77.00	0.95	53.9	104.0	Wide	Medium	6.34	9.4x	n/a	3.6%
Biotechnology	★★★	QLT	QLT, Inc.	339.6	6.88	5.50	1.25	2.8	9.6	None	Very High	(0.33)	n/a	n/a	0.0%
Brokers & Exchanges	★★★	X	TMX Group, Inc.	3,209.3	43.00	50.00	0.86	30.0	77.5	Narrow	High	4.53	11.0x	n/a	n/a
Business Services	★★★★	RBA	Ritchie Bros. Auctioneers, Inc.	2,156.6	20.28	26.00	0.78	18.2	35.1	Wide	Medium	0.80	21.3x	17.4x	1.6%
Business Services	★★★★	TRI	Thomson Reuters Corporation	22,608.2	27.32	36.00	0.76	25.2	48.6	Narrow	Medium	2.20	11.6x	10.5x	2.8%
Chemicals	★★★★	MX	Methanex Corporation	2,204.9	23.65	28.00	0.84	16.8	43.4	None	High	1.81	7.7x	8.6x	2.4%
Communication Equipment	★★	RIM	Research in Motion Ltd	8,784.9	16.76	14.00	1.20	8.4	21.7	None	High	4.17	3.8x	3.1x	0.0%
Communication Services	★★★★	RCI.B	Rogers Communications, Inc.	19,655.3	36.76	45.00	0.82	31.5	60.8	Narrow	Medium	3.00	11.2x	7.2x	2.8%
Communication Services	★★★★	SJR.B	Shaw Communications, Inc.	8,926.6	20.34	25.00	0.81	17.5	33.8	Narrow	Medium	1.55	11.4x	6.4x	3.8%
Communication Services	★★★	BCE	BCE Inc	31,694.0	40.74	37.00	1.10	25.9	50.0	Narrow	Medium	3.06	12.8x	5.6x	4.7%
Communication Services	★★	T	TELUS Corp	17,966.0	55.35	48.00	1.15	33.6	64.8	Narrow	Medium	3.63	13.4x	5.5x	2.9%
Consumer Packaged Goods	★	SAP	Saputo, Inc.	7,708.0	38.41	27.00	1.42	18.9	36.5	None	Medium	2.43	14.3x	7.5x	2.4%
Drug Manufacturers	★★★★	VRX	Valeant Pharmaceuticals International Inc	14,755.2	47.92	58.00	0.83	34.8	89.9	Narrow	High	2.85	12.1x	12.1x	0.0%
Drug Manufacturers	★★★	COM	Cardiome Pharma Corporation	124.7	2.04	2.10	0.97	1.1	3.7	None	Very High	0.08		29.8x	0.0%
Engineering & Construction	★★★	SNC	SNC-Lavalin Group	7,425.1	49.22	50.00	0.98	30.0	77.5	None	High	2.81	14.4x	11.9x	1.7%
Entertainment	★	IMX	Imax Corporation	1,395.7	21.58	12.00	1.80	7.2	18.6	Narrow	High	1.19	19.8x	11.6x	0.0%
Insurance - Life	★★★★	IAG	Indus Alliance Insur and Finan Srvc, Inc.	2,440.0	27.04	33.00	0.82	19.8	51.2	None	High	3.14	9.1x	n/a	n/a
Insurance - Life	★★★★	MFC	Manulife Financial Corporation	20,304.0	11.32	16.00	0.71	9.6	24.8	None	High	1.22	8.1x	n/a	n/a
Insurance - Life	★★★★	POW	Power Corporation Of Canada	9,310.1	22.65	30.00	0.75	18.0	46.5	Narrow	High	2.03	9.2x	n/a	n/a
Insurance - Life	★★★★	SLF	Sun Life Financial Inc	10,707.0	18.32	29.00	0.63	17.4	45.0	None	High	0.64	6.8x	n/a	n/a
Insurance - Life	★★★	GWO	Great-West Lifeco Inc.	19,080.7	20.09	23.00	0.87	13.8	35.7	Narrow	High	2.03	9.3x	n/a	n/a
Insurance - Life	★★★	PWF	Power Financial	17,916.8	25.30	29.00	0.87	17.4	45.0	Narrow	High	2.03	9.8x	n/a	n/a
Insurance - P&C	★★★	FFH	Fairfax Financial Holdings Ltd	8,195.1	402.01	362.00	1.11	217.2	561.1	None	High	13.85	14.3x	n/a	n/a
Insurance - P&C	★★	IFC	Intact Financial Corporation	7,521.9	58.06	51.00	1.14	35.7	68.9	Narrow	Medium	4.77	10.5x	n/a	n/a
Manufacturing	UR	GIL	Gildan Activewear, Inc.	2,359.0	19.43		*Under Review*			None	High	1.90	9.0x	9.5x	0.0%
Medical Diagnostics	★★★	NDN	Nordion, Inc.	573.3	9.19	10.00	0.92	6.0	15.5	None	High	0.29	12.8x	19.5x	0.0%
Metals & Mining	★★★★	CCO	Cameco Corp	7,416.8	18.79	27.00	0.70	13.5	47.3	None	Very High	1.11	14.0x	15.3x	1.5%
Metals & Mining	★★★★	K	Kinross Gold Corporation	15,480.3	13.61	17.00	0.80	10.2	26.4	None	High	1.16	10.7x	5.6x	0.5%
Metals & Mining	★★★★	PAA	Pan American Silver Corporation	2,695.6	24.98	33.00	0.76	16.5	57.8	None	Very High	3.20	7.8x	n/a	n/a
Metals & Mining	★★★★	PDL	North American Palladium, Ltd.	514.6	3.16	4.00	0.79	2.0	7.0	None	Very High	0.18	17.9x	n/a	n/a
Metals & Mining	★★★	ABX	Barrick Gold Corporation	50,705.0	50.70	50.00	1.01	30.0	77.5	None	High	5.39	8.4x	5.4x	0.9%
Metals & Mining	★★★	AEM	Agnico-Eagle Mines	7,506.5	43.98	45.00	0.98	27.0	69.8	None	High	2.77	12.7x	7.8x	1.5%
Metals & Mining	★★★	AUQ	AuRico Gold Inc	2,531.0	8.99	9.50	0.95	4.8	16.6	None	Very High	1.22	7.4x	n/a	n/a
Metals & Mining	★★★	ELD	Eldorado Gold Corp	9,232.3	16.74	16.00	1.05	8.0	28.0	Narrow	Very High	0.75	15.7x	12.5x	0.6%
Metals & Mining	★★★	FM	First Quantum Minerals Ltd.	9,788.0	20.55	17.00	1.21	8.5	29.8	None	Very High	1.61	9.5x	4.2x	0.9%
Metals & Mining	★★★	GSC	Golden Star Resources, Ltd.	540.5	2.09	2.10	1.00	1.1	3.7	None	Very High	0.44	4.8x	n/a	n/a
Metals & Mining	★★★	IMG	IAMGold Corporation	7,352.6	19.56	21.00	0.93	10.5	36.8	None	Very High	1.36	13.1x	6.8x	0.4%
Metals & Mining	★★★	SLW	Silver Wheaton Corporation	11,994.1	33.93	33.00	1.03	19.8	51.2	None	High	2.45	13.8x	n/a	n/a
Metals & Mining	★★★	TCK.B	Teck Resources Ltd	22,404.7	37.92	43.00	0.88	21.5	75.3	None	Very High	4.53	8.1x	4.8x	2.6%
Metals & Mining	★★★	YRI	Yamana Gold, Inc.	12,213.8	16.38	18.00	0.91	10.8	27.9	None	High	1.02	12.3x	8.6x	0.7%
Metals & Mining	★★	G	Goldcorp, Inc.	41,458.2	51.20	43.00	1.19	25.8	66.7	None	High	2.57	16.1x	9.5x	0.5%

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Key Statistics and Valuations

Industry Group	Star Rating	Ticker	Company	Market Cap	Price	Fair Value	Price/ FV	Consider Buy	Consider Sell	Moat	Uncertainty Rating	2011(E) Diluted EPS	Forward P/E	Forward EV/EBITDA	Forward Dividend Yield
Oil & Gas - E&P	★★★★★	TLM	Talisman Energy Inc	13,044.9	12.65	23.00	0.55	16.1	31.1	Narrow	Medium	1.17	10.3x	4.8x	1.3%
Oil & Gas - E&P	★★★★	CNQ	Canadian Natural Resources Ltd	41,231.6	37.66	51.00	0.74	35.7	68.9	Narrow	Medium	2.18	11.9x	8.9x	0.7%
Oil & Gas - E&P	★★★★	COS	Canadian Oil Sands Ltd	10,135.8	20.92	30.00	0.70	15.0	52.5	Narrow	Very High	2.43	9.4x	8.4x	11.1%
Oil & Gas - E&P	★★★★	ECA	Encana Corp	14,376.6	19.55	25.00	0.78	17.5	33.8	Narrow	Medium	0.57	26.3x	5.7x	3.2%
Oil & Gas - E&P	★★★★	ERF	Enerplus Corp	4,722.2	26.15	31.00	0.84	18.6	48.1	Narrow	High	1.86	18.1x	9.0x	7.0%
Oil & Gas - E&P	★★★★	NXY	Nexen, Inc.	7,918.4	15.00	21.00	0.71	12.6	32.6	None	High	0.96	7.2x	3.9x	1.1%
Oil & Gas - E&P	★★★★	PEY	Peyto Exploration & Development Corp	3,369.1	25.32	30.00	0.84	18.0	46.5	Narrow	High	1.13	18.9x	11.2x	2.6%
Oil & Gas - E&P	★★★★	PWT	Penn West Petroleum Ltd	9,143.6	19.40	23.00	0.84	13.8	35.7	None	High	1.48	25.8x	7.9x	2.9%
Oil & Gas - E&P	★★★	ARX	ARC Resources Ltd.	7,597.9	26.37	27.00	0.98	16.2	41.9	Narrow	High	1.35	26.2x	9.9x	3.3%
Oil & Gas - E&P	★★★	BNP	Bonavista Energy Corp	3,780.8	26.44	29.00	0.91	17.4	45.0	Narrow	High	1.69	21.0x	9.2x	4.4%
Oil & Gas - E&P	★★★	BTE	Baytex Energy Corp	6,392.7	54.49	49.00	1.11	24.5	85.8	Narrow	Very High	1.27	25.5x	12.6x	3.3%
Oil & Gas - E&P	★★★	MEG	MEG Energy Corp	8,371.3	43.37	45.00	0.96	22.5	78.8	None	Very High	0.38	76.9x	26.7x	0.0%
Oil & Gas - E&P	★★★	VET	Vermilion Energy, Inc.	4,312.6	47.49	52.00	0.91	31.2	80.6	Narrow	High	2.41	16.5x	6.4x	4.4%
Oil & Gas - E&P	*UR*	PGF	Pengrowth Energy Corp	3,966.4	11.03		*Under Review*			None	High	0.66	24.9x	6.0x	7.5%
Oil & Gas - Integrated	★★★★★	SU	Suncor Energy Inc	46,858.2	29.85	50.00	0.60	35.0	67.5	Narrow	Medium	3.15	8.7x	8.4x	0.8%
Oil & Gas - Integrated	★★★★	CVE	Cenovus Energy, Inc.	25,927.4	34.41	42.00	0.82	29.4	56.7	Narrow	Medium	1.80	15.8x	9.4x	1.9%
Oil & Gas - Integrated	★★★★	HSE	Husky Energy, Inc.	23,722.5	25.00	32.00	0.78	22.4	43.2	None	Medium	2.42	12.2x	5.7x	3.7%
Oil & Gas - Integrated	★★★	IMO	Imperial Oil Ltd	37,456.2	44.19	43.00	1.03	30.1	58.1	Narrow	Medium	3.41	12.8x	8.4x	1.0%
Oil & Gas - Midstream	★★★★	TRP	TransCanada Corp	29,788.0	42.36	45.00	0.94	36.0	56.3	Narrow	Low	2.34	17.3x	11.0x	2.9%
Oil & Gas - Midstream	★★	ENB	Enbridge, Inc.	28,581.2	36.68	33.00	1.11	26.4	41.3	Narrow	Low	1.42	22.4x	13.4x	3.0%
Real Estate Services	★★★	BPO	Brookfield Office Properties Inc	7,884.0	15.67	16.00	0.98	8.0	28.0	Narrow	Very High	1.86	8.4x	*n/a*	*n/a*
Restaurants	★★	THI	Tim Hortons, Inc.	8,059.1	50.88	41.00	1.24	28.7	55.4	Narrow	Medium	2.35	18.6x	10.3x	1.4%
Retail - Apparel & Specialty	★★★	CTC.A	Canadian Tire Corp	5,302.0	65.10	67.00	0.97	40.2	103.9	None	High	5.56	10.6x	8.9x	1.3%
Retail - Defensive	★★★	L	Loblaw Companies Limited	10,751.6	38.16	37.00	1.03	25.9	50.0	None	Medium	2.54	12.7x	7.3x	1.1%
Retail - Defensive	★★★	SC	Shoppers Drug Mart	9,236.8	42.99	39.00	1.10	27.3	52.7	None	Medium	2.77	14.2x	8.0x	2.6%
Retail - Defensive	★★★	WN	George Weston Limited	8,832.6	68.43	75.00	0.91	52.5	101.3	None	Medium	4.00	14.5x	5.3x	1.9%
Retail - Defensive	★★	MRU.A	Metro Inc.	5,316.9	52.85	41.00	1.29	28.7	55.4	None	Medium	3.65	11.4x	7.0x	1.6%
Transportation	★★★	CNR	Canadian National Railway Co	35,051.2	78.97	75.00	1.05	45.0	116.3	Narrow	High	4.82	14.7x	10.7x	1.8%
Transportation	★★★	CP	Canadian Pacific Railway Ltd	10,987.0	64.75	63.00	1.03	37.8	97.7	Narrow	High	3.36	15.0x	10.0x	1.8%
Utilities	★★★	TA	TransAlta Corporation	4,671.6	20.89	23.00	0.91	16.1	31.1	None	Medium	1.22	16.6x	8.1x	5.3%
Utilities	★★	FTS	Fortis, Inc.	6,138.7	32.58	27.00	1.21	18.9	36.5	Narrow	Medium	2.09	18.5x	8.7x	4.4%

S A M P L E

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