2017 Top 10 Canadian Equities

January 3, 2017

Warren Hastings / (416) 865-6354
warren.hastings@scotiawealth.com
Sunny Singh / (416) 863-7604
sunny.singh@scotiawealth.com
Shane Jones / (416) 945-5332
shane.jones@scotiawealth.com

2017 Top 10 List Consistent with Procyclical Investment Thesis

Our 2017 Top 10 Canadian Equities list (summarized in Exhibit 1) reflects the cyclicals-over-defensives investment thesis we have espoused for the past several quarters. The list is consistent with a brightening economic backdrop, expected acceleration in global GDP growth in 2017 (per Scotiabank), a constructive outlook for crude oil and select base metal prices, an upward bias in bond yields and muted recession risks. The list is 90% weighted toward cyclical sectors as compared with the S&P/TSX at approximately 77% (the combined weight of the Financials, Energy, Materials, and Industrials sectors). Summary company descriptions and an investment thesis for each constituent of the list follow later in this report, along with a performance analysis of the 2016 Top 10 list.

In brief, our four Financials sector picks reflect our expectation of higher interest rates and ongoing steepness in the yield curve, as well as a strengthening U.S. economy (notably in the case of Royal Bank [RY] and Element Fleet Management [EFN]). Our three Energy sector picks are all high quality oil-weighted producers (one integrated and two senior independent), which we believe stand to benefit from a positive outlook for crude oil prices, supported by strong balance sheets. In the Materials sector, Lundin Mining (LUN) provides exposure to base metals including copper, nickel and zinc with low balance sheet and geopolitical risk. Despite a strong run in the shares following the recent acquisition of Innovia Group, CCL Industries (CCL.b) still offers respectable share price upside potential and growth driven by organic initiatives. Finally, Brookfield Property Partners (BPY.un) returns to our Top 10 list. While real estate currently is not one of our favoured sectors in view of the prevailing interest rate environment, in BPY.un we continue to see a unique combination of growth, value, and yield complemented by several potential unit price catalysts.

Exhibit 1 - 2017 Top 10 Canadian Equities

Company	Sector	Symbol	Price 30-Dec-16	Dividend	Dividend Yield	Consensus Target	Potential Total Return	FactSet Ratings Buy	FactSet Ratings Hold	FactSet Ratings Sell	Market Cap ($bn)
Royal Bank of Canada	Financials	RY-CA	$90.87	$3.32	3.7%	$91.38	4%	7	6	3	$135
Bank of Nova Scotia	Financials	BNS-CA	$74.76	$2.96	4.0%	$79.59	10%	9	8	0	$90
Manulife Financial Corporation	Financials	MFC-CA	$23.91	$0.74	3.1%	$24.63	6%	13	6	0	$47
Element Fleet Management Corporation	Financials	EFN-CA	$12.46	$0.10	0.8%	$15.92	29%	12	0	0	$5
Suncor Energy Inc.	Energy	SU-CA	$43.90	$1.16	2.6%	$47.86	12%	22	5	0	$73
Canadian Natural Resources Limited	Energy	CNQ-CA	$42.79	$1.00	2.3%	$48.64	16%	20	6	0	$47
Crescent Point Energy Corp.	Energy	CPG-CA	$18.25	$0.36	2.0%	$22.75	27%	13	4	0	$10
CCL Industries Inc. Class B	Materials	CCL.B-CA	$263.80	$2.00	0.8%	$307.86	17%	7	1	0	$9
Lundin Mining Corporation *	Materials	LUN-CA	$6.40	$0.12	1.9%	$7.69	22%	15	5	1	$5
Brookfield Property Partners LP	Real Estate	BPY.UT-CA	$29.33	$1.50	5.1%	$34.61	23%	3	1	0	$8
Average					**2.6%**		**17%**				**$43**

** Inaugural quarterly dividend of $0.03/sh anticipated to be declared with the release of 2016 financial results in Feb/2017, pending approval by LUN's Board of Directors.*
Sources: FactSet, Scotia Wealth Management GPAG, company reports.

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Royal Bank of Canada (RY - TSX) **Company Description:** RY is the largest Canadian bank in terms of market capitalization. Domestically, the bank has a dominant retail and wealth management business and a strong investment banking franchise. In 2015, RY expanded its presence in the U.S. with the acquisition of City National (CYN).	**Investment Thesis:** • RY's diversified platform in the U.S. offers investors leverage to a rising yield environment, faster growing U.S. economy (relative to Canada) and a potentially more relaxed U.S. regulatory regime. • Domestically, RY's Wealth Management and Capital Markets platforms provide strong revenue diversification which should prove beneficial given top line headwinds resulting from a slowing Canadian consumer. • RY trades at 12.6x NTM consensus earnings, which is ahead of the peer group average of 12.3x. We expect RY to maintain its premium status versus the peer group in 2017. In addition RY shares yield 3.7%, with the dividend sustainable in our view given an EPS payout ratio of 47% based on F17 consensus estimates.
Bank of Nova Scotia (BNS - TSX) **Company Description:** BNS is the third-largest Canadian bank in terms of assets and market capitalization. BNS is also the most international of all the Canadian banks, with significant operations in the Caribbean, Asia, Mexico, and Central and South America.	**Investment Thesis:** • We have once again included BNS as a Top 10 pick given the bank's strong operating performance in 2016, which we expect to continue in 2017. • BNS has a very balanced earnings mix relative to peers, with its International segment expected to provide a meaningful offset to the slowing domestic landscape. BNS also has the best provisioned energy loan book of the Big 5 banks as well as sector best capital levels. • BNS trades at 11.6x NTM consensus earnings, which is a discount to the peer group average of 12.3x. In our view, BNS deserves to trade at a premium, and we expect the bank to do so in 2017. BNS shares yield 4.0%, with the dividend sustainable in our view given an EPS payout ratio of 48% based on consensus F17 estimates.
Manulife Financial Corporation (MFC - TSX) **Company Description:** MFC is a leading global financial services company, providing financial protection, wealth and asset management products and services to individuals and groups, with principal operations in Canada, the U.S., and Asia.	**Investment Thesis:** • Although MFC shares had a significant run in the back half of 2016, given our cyclical bias and likelihood of higher yields in 2017, we believe MFC has further upside potential in the year ahead. • MFC provides investors with significant leverage to higher yields as well as exposure to U.S. markets, generating about 35% of earnings from the U.S. • MFC shares have also benefited from strong revenue and earnings trends in Asia, which are expected to continue in 2017. Energy related concerns were largely a first half 2016 story for MFC, with the insurer now expected to post further investment gains (as opposed to oil driven investment losses) in 2017. • MFC shares yield 3.1%, and we view the dividend as sustainable given an EPS payout ratio of 39% based on consensus F17 estimates.
Element Fleet Management Corporation (EFN - TSX) **Company Description:** EFN operates as the world's largest publicly traded fleet management company with operations across the U.S., Canada, Mexico, Australia and New Zealand and benefits from its global alliance with BNP-Arval.	**Investment Thesis:** • We expect growth in EFN's commercial leasing business to be driven by stronger equipment demand on the back of the ongoing U.S. recovery. Also, EFN's continued growth of fee-based revenues should support a higher earnings multiple. Further consolidation within the U.S. commercial lending market could serve as an additional share price catalyst. • EFN is expected to increase its dividend in 2017 to a level implying a yield of 2%-2.5%, which could attract a new (income-oriented) set of investors. • EFN shares currently trade at 11.5x NTM consensus earnings, below its closest peers Ryder Systems Inc. and Eclipx Group Ltd. at 12.6x and 14.2x, respectively.

Suncor Energy Inc. (SU - TSX)	**Investment Thesis:**
Company Description: SU is an integrated energy company with extensive oil sands operations in Fort McMurray, Alberta. Suncor's operations include oil sands development and upgrading, onshore and offshore oil and gas production, petroleum refining, and product marketing under the Petro-Canada brand.	• SU is a premier integrated producer with the best production growth profile amongst its Canadian integrated peers (according to Scotiabank GBM analysis), a strong balance sheet (net debt/CF < 2x through F19) at current commodity prices, and a sustainable dividend, in our view (2.6% yield). • Suncor also continues to make strides on the operating expense front, with 2017 oil sands and Syncrude operating cost guidance coming in better than Scotiabank GBM expectations.
Canadian Natural Resources (CNQ - TSX)	**Investment Thesis:**
Company Description: CNQ is a senior independent crude oil and natural gas exploration and production company with operations in Western Canada, the North Sea, and Offshore Africa.	• In our view, CNQ is amongst the highest quality independent producers in the Canadian energy sector and one of our preferred ways to play an ongoing recovery in crude oil prices. • CNQ’s attractive cash flow profile should support shareholder returns (another dividend increase) and further deleveraging in 2017. • CNQ shares yield 2.3%, and we view the dividend as sustainable given an all-in payout ratio of approximately 74% at current commodity prices based on Scotiabank GBM F17 estimates.
Crescent Point Energy Corp. (CPG - TSX)	**Investment Thesis:**
Company Description: CPG is a senior independent oil and gas exploration and production company focused on light and medium oil production with assets in Western Canada and the United States.	• CPG shares came under pressure following its equity financing in September, despite the beneficial impact on CPG’s balance sheet leverage – particularly at lower oil prices - and neutral effect on the company’s production per share growth profile. The share price weakness was unwarranted, in our view. • We expect CPG to outperform in 2017 given our constructive stance on crude oil prices and CPG’s oil-weighted production profile, attractive valuation (traded at 6.6x F17e EV/DACF versus 8.9x for the peer group in mid-Dec/2016, based on Scotiabank GBM estimates), healthy balance sheet (~2.0x debt/CF at current commodity prices on Scotiabank GBM F17e), and, in our view, sustainable dividend (2.0% yield).

CCL Industries Inc. (CCL.B - TSX) **Company Description:** CCL.B is a specialty packaging company, with its headquarters in Toronto. CCL operates four divisions: CCL Label (the largest global converter of labels), CCL Container (aluminum aerosol cans), Avery (labels, specialty converted media, and office products), and Checkpoint (software and labeling solutions, including RFID). It announced the acquisition of Innovia, a producer of films and surface coatings for labels, packaging and security applications, on 19 Dec/2016.	**Investment Thesis:** • Although CCL's recent acquisition of Innovia Group sent the shares up 16% since the announcement, we expect further growth in 2017. • CCL.B's growth is premised on a combination of organic and strategic initiatives, the latter facilitated by a strong balance sheet and a label market that is both large and fragmented. The company expects to reduce post-acquisition (Innovia) leverage of 2.5x to less than 2.0x by the end of F17, leaving room for further acquisitions. • CCL.B has a 0.8% dividend yield, which is well supported given a 16% EPS payout ratio based on F17 consensus estimates.
Lundin Mining Corporation (LUN - TSX) **Company Description:** Lundin Mining Corporation is a diversified Canadian base metals mining company with operations in Chile, the U.S., and Europe, primarily producing copper, nickel and zinc.	**Investment Thesis:** • Our favourable view on LUN shares is predicated on the company's low risk profile (both balance sheet and geopolitical) and leverage to base metals, which dovetails with our portfolios' cyclical positioning. • LUN's near-to-medium term production, cost and capex guidance update in December/2016 was quite positive, and further supports our favourable view of the company. The recent introduction of a dividend policy will likely also place LUN on the radar screens of a new (income-oriented) set of investors.
Brookfield Property Partners LP (BPY.un - TSX) **Company Description:** BPY is a global commercial property company that owns, operates and invests in office, retail, multifamily, industrial, and hotel assets. Approximately 72% of BPY's assets are located in the U.S. BPY also has assets in Canada, Brazil, Europe and Australia.	**Investment Thesis:** • BPY returns to our Top 10 list this year, for many of the same reasons as last year. BPY units offer a rare combination of below-average valuation (20% NAV discount versus the peer group average discount of 4%, according to a 12 Dec/2016 Scotiabank GBM report) and above-average growth (13% AFFOPU CAGR F16E-F18E versus the peer group average at 5%), which should help to partially insulate the shares from further potential steepening of the yield curve. • Potential unit price catalysts include: capital recycling, debt reduction, solid per unit growth and a potential REIT conversion. BPY targets annual distribution per unit growth of 5%-8% and the units currently yield 5.1%. We believe the distribution is sustainable in view of BPY's FFOPU growth target of 8%-11% per annum.

2016 Top 10 List Delivered 12% Average Price Return Despite Defensive Positioning

Exhibit 2 below summarizes performance of the 2016 Top 10 Canadian Equities list. We purposely positioned our list defensively given a challenging outlook when the list was published in early 2016, including a persistent global oversupply situation for crude oil and non-food commodities and low interest rates (problematic for bank and life insurance companies). We noted at the time that if commodity prices were to stage a meaningful recovery in 2016, the 2016 Top 10 list could underperform the S&P/TSX index given the names in the list had little direct exposure to either energy or metal prices. On a risk/reward basis, this was an outcome we were willing to live with.

The list generated a respectable price-only return of 12% versus the broader index's 18% return. As it turned out, commodity prices staged quite a rally in 2016 with WTI crude oil advancing 45% and copper 17% in USD terms. The market brushed aside unexpected outcomes from the Brexit referendum and the U.S. presidential election and instead began pricing in reflation and improved global growth, driving interest rates higher. Not surprisingly the best-performing sectors in the S&P/TSX in 2016 on a price basis were Materials, Energy, Industrials, and Financials – to which last year's Top 10 list was underexposed.

Exhibit 2 - Performance of 2016 Top 10 Canadian Equities

Company	Symbol	Price		Note	Change
		31-Dec-15	30-Dec-16		
Bank of Nova Scotia	BNS-CA	$55.97	$74.76		33.57%
Power Corporation of Canada	POW-CA	$28.94	$30.05		3.84%
Element Financial	EFN-CA	$16.70	$15.76	1	-5.63%
Dollarama Inc.	DOL-CA	$79.94	$98.38		23.07%
Canadian Tire Corporation, Limited Class A	CTC.A-CA	$118.16	$142.00	2	20.18%
Enbridge Inc.	ENB-CA	$46.00	$56.50		22.83%
Chartwell Retirement Residences	CSH.UT-CA	$12.70	$14.65		15.35%
Agrium Inc.	AGU-CA	$123.67	$134.96		9.13%
Brookfield Property Partners LP	BPY.UT-CA	$32.22	$29.33		-8.97%
Brookfield Renewable Partners LP	BEP.UT-CA	$36.27	$39.85		9.87%
Average price-only return for Top 10 list					12.32%
S&P / TSX Composite Index		13009.95	15287.59		17.51%
Outperformance (Underperformance)					*-5.18%*

Notes:
[1] Closing price is the sum of those for Element Fleet Management (EFN) and ECN Capital (ECN).
[2] Closing price on 25 May/2016, when CTC.a shares were downgraded by GPAG.

Sources: FactSet, Scotia Wealth Management GPAG.

Four list constituents managed to outperform the benchmark (S&P/TSX): Bank of Nova Scotia (BNS), our sole Canadian bank pick, Enbridge (ENB), our sole Energy sector pick, and the two Consumer Discretionary names (Dollarama [DOL] and Canadian Tire [CTC.a]). We downgraded CTC.a in late May after a strong run in the shares pushed its valuation multiple to levels well above the ten-year average; the table above shows returns up to that point. Four other names finished the year in positive territory but fell short of the benchmark return. Chartwell (CSH.un) was tops in this group, supported by strong growth, good quarterly results, and demographic tailwinds, which helped it counter an interest rate environment unfriendly to REITs (technically, CSH.un is classified as a Healthcare sector constituent). Brookfield Renewable (BEP.un) and Agrium (AGU), the only Utility and Materials names, respectively, in the list, returned 9%-10%. Agrium's YTD returns began to improve after it announced its merger with Potash Corp. (POT) and analysts warmed to the combination. Power Corp. (POW), despite being exposed to the life insurance sector through an indirect stake in Great-West Lifeco (GWO), did not benefit from rising interest rates in the latter part of 2016 to the same extent as some of GWO's peers, likely because of GWO's relatively lower sensitivity to this macro factor.

Rounding out the bottom of the list are Element Financial - which split in early October/2016 into two separate publicly-traded entities, Element Fleet Management (EFN) and ECN Capital (ECN) – and Brookfield Property Partners (BPY.un). Element benefitted from the split, with the stock rallying in advance as the market began to surface value obscured when the businesses were part of the same corporate entity. However, this was insufficient to overcome the shares' lackluster returns through mid-summer tied to a temporary strategy shift away from acquisitions and a challenging interest rate environment. We see better things ahead for EFN in 2017, which explains its reappearance in this year's Top 10 list. The same could be said for Brookfield Property Partners (BPY.un), which finished 2016 lower by 9% despite its growth, value and yield attributes.

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