Equities

Global Portfolio Advisory Group

Canadian & U.S. Morning Comments

September 19, 2017

Scotiabank GBM DailyEdge Summary by Warren Hastings and Sunny Singh

Telecom & Cable – Converging Networks: Network Test Results Caught Our Attention

- It has been a while since we have done a deep dive into network quality. Although network quality and test results do not necessarily affect near-term results, we believe network quality is one the most important leading indicators for medium- to long-term wireless subscriber share, average revenue per user (ARPU), margins, and capex. In late August, we took a snapshot of the Canadian wireless networks using Open Signal's app. Last week, *PCMag* published its annual network tests. The results were similar. In this edition of Converging Networks, we highlight some of our results and the implications for capex and potential for network sharing in Canada.

Global Fertilizers – Fert Rally Lacks Sustainable Support

- ***Fert stocks were up sharply, with the performance rank of CF/OCI > YAR > other ferts, suggesting a nitrogen-led rally.*** And of course, the market is correct to show more interest in nitrogen (N, soaring) than phosphate plus potash (P+K, ebbs/flows). Urea has just hit $258/st NOLA, up from $225 last week, and $160 in July. The current price would suggest urea is demand-driven. While there may be temporary pockets of regional/seasonal tightness, we all know urea is not even close to a demand-driven commodity.
- ***It's too early to assess whether the first part of the trade (CF chasing the fall urea rally) is now behind us.*** However, where we do have conviction is that, at current prices, what goes up should come down. Therefore, the next part of the trade is to short CF. We're too scared to do it yet, as we want to see how tight this market could become. With this momentum, why is $300/st NOLA any more wacky than $258/st?
- ***Higher urea is supported by mostly temporary factors:*** (1) Northern hemisphere restocking; (2) urea trader short-covering; (3) higher coal prices in China and increases in Chinese urea pricing; (4) Indian/Egyptian tenders indicating strong international benchmark pricing; and (5) uncertainty about the commissioning of

Koch's Enid expansion (900K st urea). With the recent rise in anthracite coal and the RMB strengthening, we now see marginal cost support for urea at $240/st, but ONLY during the high demand season.

- ***What does the N-rally mean for Nutrien, now trading at an implied $48/sh?*** Using spot fertilizer prices and $350M of synergies (70% realized), we see Nutrien generating ~$4/sh of FCFE, worth $50 to $57/sh, using a 7% to 8% FCF yield. This means upside is winding down for us, given a sub-20% ROR on the high end, and our view that nitrogen has run a little too far and potash has more downside than upside. While we'll take the ~20% rally over the past few months, some of it has likely been for the wrong reasons (i.e., soaring N rather than more confidence in the strategy/outlook).

Summary of target price / rating changes:

- **Agellan Commercial REIT (ACR.UN, $11.81, SP, $12.25)** – Target price increased from $11.50

In terms of companies reporting results:

- **None to report**

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

- **Inter Pipeline Ltd. (IPL)** – Raised to Outperform from Market Perform at BMO Capital Markets
- **Keyera Corp. (KEY)** – Raised to Outperform from Market Perform at BMO Capital Markets
- **Cascades Inc. (CAS)** – Raised to Outperform from Sector Perform at RBC Capital Markets
- **Africa Oil Corp. (AOI)** – Cut to Neutral from Outperform at Credit Suisse

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

Credit Suisse Research:

Time Warner Inc. (TWX, NEUTRAL, Target Price: US$ 107.50)

Thanks for the memories; DOWNGRADING to NEUTRAL (from Outperform); Raising Estimates

- **Downgrade to Neutral:** We believe the T transaction is close to receiving regulatory approval, with objections from Brazilian regulators likely to be surmountable. We refresh our model and modestly increase our 2017/18 EPS forecasts to $6.09/$6.63 (from $5.95/$6.62), but given limited upside to the value of the deal, we downgrade our rating to Neutral (from Outperform).
- **Transaction with AT&T likely to be approved:** In the US, we believe it would be difficult for the DOJ to block the transaction on antitrust grounds given its vertical nature and the precedent from Comcast's acquisition of NBCU. The main outstanding antitrust barrier is in Brazil, where the regulator (CADE) has highlighted competition concerns about the merger - however, we note that in the worst case T could divest Sky Brasil to alleviate these concerns.
- **$83-$87 "break price" range:** Time Warner's guidance of "high single-digit" growth in adjusted operating income in 2017 suggests the company is still benefiting from strong organic operating trends, notably in its core Turner cable networks division where the most recent affiliate renewal cycle continues to drive strong revenue growth despite softening subscriber trends. Absent a merger proposal, we argue TWX would likely trade in the 9.3-9.6x 2018 EV/EBITDA range today, based on 8.5-9x for Turner, 11x for HBO and 9.5x for Warner Bros., suggesting fair value if AT&T were to walk away or the deal is blocked of $83-87. If the deal were to break, we believe the stock would likely trade above fair value given the quality and scarcity value of TWX's assets and their attractiveness to other potential merger partners.
- **Valuation:** TWX trades at a 5% discount to the current value of the AT&T offer, and at implied multiples of 11.3x 2018 EV/EBITDA, 16.2x P/E, vs peers on 8.5x and 10.9x respectively. The main risks to our thesis are regulatory concerns regarding the merger with AT&T.

The Gap, Inc. (GPS, NEUTRAL, Target Price: US$ 30)

Proprietary Analysis Highlights Attractive Real Estate Positioning; UPGRADING to NEUTRAL (from Underperform); Raising Ests and TP to $30 (from $23)

- We upgrade shares of GPS to Neutral from Underperform given: 1) the surprising top 10 score in our proprietary brick-and-mortar real estate analysis; 2) the recent announcement of an additional ~200 low quality store closures; 3) improvements in the supply chain at the Gap brand starting to materialize across pricing structure, resulting in lower markdown intensity; and 4) an attractive valuation. We adjust our estimates and raise our Target Price to $30 from $23.
- CS Brick-And-Mortar Analysis Indicates GPS Is Better Positioned Than We Thought. The biggest surprise in our analysis was The Gap Inc.'s top 10 score. GPS scored 57.1% versus the group average of 50%, and well above other mall-based specialty retail companies (LB 50%, ANF 50%, and KORS 44%). GPS pulled ahead by scoring higher in the mall exposure and mall quality categories.
- GPS Focused On Further Fleet Rationalization. We are encouraged by GPS's recent announcement to shutter ~200 low quality Gap brand and Banana Republic locations, and focus on Old Navy and Athleta concepts. We believe the move to a healthier fleet and an increased focus on digital is prudent as sales continue to shift online.
- Adjusting Estimates. We adjust our FY17 comp, revenue and EPS estimates to 1.1%, $15,517M, and $2.06 from 0.9%, $15,512M, and $2.02. Our FY18 estimates go to 1.6%, $15,912M, and $2.27 from 0.8%, $15,765M, and $2.15. We upgrade our rating to Neutral and raise our Target Price to $30 from $23, reflecting an equal weighted average of:

1) comparable multiples ($32); 2) DCF ($35); and 3) a long-term growth model ($23). Risks include a deteriorating traffic environment and continued consumer shift to lower margin eCommerce sales.

Rating Changes:

CVS (CVS) — Analysts at RBC initiated both CVS and WBA with "outperform" ratings. For Walgreens, RBC said the company is primed for accelerating earnings growth as it "appears ready to harvest the rewards" of its efforts from the past two years. For CVS, RBC said the company is "at an inflection point in its corporate life cycle, as well as in the life cycle of the industry."

Tesla (TSLA) — Analysts at Jefferies initiated coverage of the stock with an "underperform" rating and a price target of $280 per share. That target represents a 27.3 percent downside potential from Monday's close of $385. Jefferies said in a note it expects losses to continue until 2020, adding Tesla still faces challenges in scaling its business.

Michael Kors (KORS) — Oppenheimer upgraded the stock to "outperform" and raised its price target $55 from $45 a share. "Margins seem to be finding the bottom, while sentiment is extremely negative," it said in a note.

Nike (NKE) — The Dow component fell 1.5 percent before the bell after analysts at Susquehanna lowered their rating to "neutral" from "positive." The analysts cited concerns that Nike's North America and Europe businesses are "decelerating as some key items, especially in the basketball category, have underperformed, leaving excess inventory in the marketplace."

News:

Kohl's (KSS) — Kohl's said Tuesday it is offering free Amazon returns in 82 stores starting in October.

Fixed Income

Morning Comment

BoC Comments Halt Selling

Yields ended lower after BoC commentary sparked bidding. Absent any market-relevant data, Canadian and U.S. yields spent most of the day continuing last week's reflation trade. U.S. yields ended in that position, but it was Canadian yields that reversed course following comments from Bank of Canada Deputy Governor Timothy Lane. In the Q&A session following his speech the Deputy Governor indicated the BoC is watching currency movements "closely" and "taking that into account pretty strongly in making our decisions." His answer took 0.56% off the value of the Canadian dollar (in USD terms) and 4.5bps from the 2-year benchmark yield.

Canadian manufacturing and U.S. housing starts are on the docket this morning. At 8:30am ET, Canadian July m/m manufacturing sales are expected to post a decline for the second month in a row following weak export data. South of the border August housing starts are released at the same time. The result is expected to show only the third m/m increase in 2017 as the beginning of the year marked a break from a multi-year upward trend. However, it is unlikely the U.S. reacts to the data as it waits for news from the FOMC tomorrow.

Disclaimer

™ Trademark of The Bank of Nova Scotia, used under license (where applicable).

Important Disclosures

This material does not include or constitute an investment recommendation, and is not intended to take into account the particular investment objectives, financial conditions, or needs of individual clients. Before acting on this material, you should consider whether it is suitable for your particular circumstances and talk to your investment advisor.

The author(s) of the report own(s) securities of the following companies.
None.

The supervisors of the Portfolio Advisory Group own securities of the following companies.
None.

Scotia Capital Inc. is what is referred to as an "integrated" investment firm since we provide a broad range of corporate finance, investment banking, institutional trading and retail client services and products. As a result we recognize that there are inherent conflicts of interest in our business since we often represent both sides to a transaction, namely the buyer and the seller. While we have policies and procedures in place to manage these conflicts, we also disclose certain conflicts to you so that you are aware of them. The following list provides conflict disclosure of certain relationships that we have, or have had within a specified period of time, with the companies that are discussed in this report:

Scotia Capital (USA) Inc. or its affiliates has managed or co-managed a public offering in the past 12 months. **Agellan Commercial REIT, Inter Pipeline Ltd.**

Scotia Capital (USA) Inc. or its affiliates has received compensation for investment banking services in the past 12 months. **Agellan Commercial REIT, Inter Pipeline Ltd., Keyera Corp.**

Within the last 12 months, Scotia Capital Inc. and/or its affiliates have undertaken an underwriting liability with respect to equity or debt securities of, or have provided advice for a fee with respect to, this issuer. **Agellan Commercial REIT, Inter Pipeline Ltd.**

Scotia Capital Inc. and its affiliates collectively beneficially own in excess of 1% of one or more classes of the issued and outstanding equity securities of this issuer. None.

This issuer and its affiliates collectively beneficially own in excess of 5% of the total issued share capital of The Bank of Nova Scotia. None

The Bank of Nova Scotia and its affiliates collectively have a net long position in excess of 0.5% of the total issued share capital of the issuer. None.

Scotia Capital (USA) Inc. had an investment banking services client relationship during the past 12 months. None.

Scotia Capital (USA) Inc. had a non-investment banking securities-related services client relationship during the past 12 months. None.

Scotia Capital (USA) Inc. or its affiliates expects to receive or intends to seek compensation for investment banking services in the next 3 months. None.

The Head of Equity Research or a Supervisory Analyst owns securities of this issuer in his or her own account or in a related account. None.

The Bank of Nova Scotia is the parent company and a related issuer of Scotia Capital Inc. and ultimate parent company and related issuer of Scotia Capital (USA) Inc. None.

Research Analyst Gavin Wylie visited Block 10BB in Kenya, an exploration well, on October 2-4, 2012. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Africa Oil Corp.**

General Disclosures

This report is provided to you for informational purposes only. The report is not intended to provide personal investment advice and does not take into account the specific investment objectives, financial situation or particular needs of any specific person. Investors should seek advice regarding the appropriateness of investing in financial instruments and implementing investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized.

Nothing contained in this report is or should be relied upon as a promise or representation as to the future. The pro forma and estimated financial information contained in this report, if any, is based on certain assumptions and management's analysis of information available at the time that this information was prepared, which assumptions and analysis may or may not be correct. There is no representation, warranty or other assurance that any projections contained in this report will be realized.

Opinions, estimates and projections contained in this report are our own as of the date hereof and are subject to change without notice.

The ScotiaMcLeod Global Portfolio Advisory Group prepared this report by aggregating information from various sources as a resource for ScotiaMcLeod Wealth Advisers and their clients. Information may be obtained from the Equity Research and Fixed Income Research departments of the Global Banking and Markets division of Scotiabank. Information may also be obtained from the Foreign Exchange Research and Scotia Economics departments within Scotiabank. In addition to information obtained from members of the Scotiabank group, information may be obtained from the following third party sources: Standard & Poor's, Valueline, Morningstar, Bloomberg, and FactSet. The information and opinions contained in this report have been compiled or arrived at from sources believed to be reliable, but no representation or warranty, express or implied, is made as to their accuracy or completeness.

While the information provided in this report is believed to be accurate and reliable, neither Scotia Capital Inc., which includes the ScotiaMcLeod Global Portfolio Advisory Group, nor any of its affiliates makes any representations or warranties, express or implied, as to the accuracy or completeness of such information. Neither Scotia Capital Inc. nor its affiliates accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents.

Additional Disclosures

This report is distributed by Scotia Capital Inc., a subsidiary of The Bank of Nova Scotia. Scotia Capital Inc.is a member of the Canadian Investor Protection Fund and the Investment Industry Regulatory Organization of Canada.

® Registered trademark of The Bank of Nova Scotia, used under licence. ™Trademark of The Bank of Nova Scotia, used under licence. Scotia Wealth Management™ consists of a range of financial services provided by The Bank of Nova Scotia (Scotiabank®); The Bank of Nova Scotia Trust Company (Scotiatrust®); Private Investment Counsel, a service of 1832 Asset Management L.P.; 1832 Asset Management U.S. Inc.; Scotia Wealth Insurance Services Inc.; and ScotiaMcLeod®, a division of Scotia Capital Inc. International private banking services are provided in Canada by The Bank of Nova Scotia. International investment advisory services are provided in Canada by Scotia Capital Inc. Scotia Capital Inc. is a member of the Canadian Investor Protection Fund and the Investment Industry Regulatory Organization of Canada.

Scotia Wealth Management consists of a range of financial services provided, in The Bahamas, by Scotiabank (Bahamas) Limited and The Bank of Nova Scotia Trust Company (Bahamas) Limited. International private banking services are provided in The Bahamas by Scotiabank (Bahamas) Limited, an entity registered with The Central Bank of The Bahamas. International investment advisory services are provided in The Bahamas by Scotiabank (Bahamas) Limited, an entity registered with The Securities Commission of The Bahamas. International wealth structuring solutions are provided in The Bahamas by The Bank of Nova Scotia Trust Company (Bahamas) Limited, an entity registered with The Central Bank of The Bahamas.

Scotia Wealth Management consists of international investment advisory services provided, in Barbados, by The Bank of Nova Scotia, Barbados Branch, an entity licensed by the Barbados Financial Services Commission.

Scotia Wealth Management consists of a range of financial services provided, in the Cayman Islands, by Scotiabank & Trust (Cayman) Ltd. International private banking services, international investment advisory services and international wealth structuring solutions are provided in the Cayman Islands by Scotiabank & Trust (Cayman) Ltd., an entity licensed by the Cayman Islands Monetary Authority.

Scotia Wealth Management consists of international private banking services provided, in Peru, by Scotiabank Peru S.A.A, an entity supervised by the Peru Superintendence of Banking and Insurance.

Disclaimer

™ Trademark of The Bank of Nova Scotia, used under license (where applicable).

™ Marca de The Bank of Nova Scotia utilizada bajo licencia (donde corresponda).

Costa Rica — Este es un resumen preparado por la Unidad Portfolio Advisory Group (PAG) de Wealth Management de Scotiabank de Costa Rica, S.A. para nuestros corredores, ejecutivos y clientes, cuyo fin único y exclusivo es mantenerlos informados sobre diferentes aspectos generales del acontecer económico local e internacional. Este resumen es elaborado a partir de información proveniente de diferentes fuentes, que en el medio bursátil nacional e internacional, son consideradas confiables, sin embargo, en ninguna forma se garantiza la bondad, exactitud o veracidad de la información aquí contenida. Los comentarios u opiniones de las fuentes consultadas, son de su exclusiva responsabilidad y no representan el parecer o criterio de ninguna de las empresas del Grupo Scotiabank local o internacional. Los precios, datos y demás información contenida en este documento pueden variar en cualquier momento y sin previo aviso, por lo que deben ser comprendidos y analizados única y exclusivamente como elementos de referencia e informativos. Este informe no constituye de manera alguna, propuesta, recomendación u oferta para comprar, vender valores, o realizar cualquier tipo de transacción en los mercados bursátiles organizados en instrumentos financieros en general, locales o internacionales. Se prohíbe la reproducción total o parcial de este documento sin el consentimiento expreso y previo del autor.

México — Advertencia: Este documento ha sido elaborado por Nick Chamie, Analistas adscritos al Grupo de Asesorías de Portafolios Internacionales, una división de Scotia Capital Inc.. Este documento podrá ser proporcionado a los clientes del Grupo Financiero Scotiabank Inverlat (en adelante el "Grupo Financiero SBI") que viven en México, y no está hecho para ser utilizado por cualquier persona o entidad, ciudadano o residente que esté localizado en cualquier país, estado o jurisdicción, en donde la distribución, publicación, disponibilidad o uso de éste documento vaya en contra de las leyes o regulaciones que obliguen al Grupo Financiero SBI o sus subsidiarias o afiliadas a obtener registros o licencias en dicha jurisdicción. La información, herramientas y material contenidos en este reporte son proporcionados exclusivamente con fines informativos y no deben ser utilizados o considerados como una oferta o propuesta de oferta para comprar, vender, emitir valores o cualquier otro instrumento financiero. La información contenida en este reporte no constituye una asesoría de inversión, legal, contable, fiscal o una declaración de que una inversión o estrategia de inversión es adecuada o apropiada a las circunstancias o características especiales del destinatario del reporte, o constituye de cualquier otra forma una recomendación a las necesidades particulares del destinatario. El inversionista que tenga acceso al presente documento debe ser consciente de que los valores, instrumentos o inversiones aquí referidos pueden no ser adecuados para sus objetivos específicos de inversión, su posición financiera o su perfil de riesgo, ya que no han sido tomados en consideración para la elaboración del presente informe, por lo que debe adoptar sus propias decisiones de inversión teniendo en cuenta dichas circunstancias y procurándose el asesoramiento específico y especializado que pueda ser necesario. El desempeño pasado de valores u otros instrumentos financieros no debe considerarse como un indicador o garantía de su desempeño futuro, y Scotia Casa de Bolsa no realiza expresa o tácitamente ninguna garantía o declaración, respecto al desempeño futuro de los valores u otros instrumentos financieros objeto del reporte. Este reporte está basado o se deriva de información pública proveniente de fuentes consideradas como confiables. Los Analistas y representantes del Grupo de Asesorías de Portafolios Internacionales, una división de Scotia Capital Inc. no hacen declaración alguna respecto de la exactitud o veracidad de la información contenida en el presente reporte. El Grupo Financiero SBI, sus subsidiarias o afiliadas y sus empleados no garantizan rendimiento alguno, ni pueden responsabilizarse de pérdidas en operaciones o decisiones basadas en esta información o cualquier otra. La información y material de este reporte no pretende proporcionar toda la información que un inversionista interesado pudiera desear y, de hecho, solo proporciona una visión limitada de un mercado en particular. Este reporte no debe de ser utilizado en sustitución del ejercicio de juicios independientes. El Grupo Financiero SBI, o cualquiera de sus subsidiarias o afiliadas, pudo haber emitido o puede en el futuro emitir otros reportes que no sean consistentes con, y/o lleguen a conclusiones distintas a la información contenida en este reporte. Aquellos reportes reflejan las diferentes suposiciones, puntos de vista y métodos analíticos de los Analistas que los prepararon. Los Analistas certifican que las opiniones, estimados y proyecciones contenidas en el este reporte reflejan su punto de vista personal, no el de un área de negocio en particular, y pueden variar o ser diferentes o inconsistentes con las observaciones y puntos de vista de otros Analistas de Scotia Casa de Bolsa. Este reporte no es necesariamente una opinión institucional de Grupo Financiero SBI, o cualquiera de sus subsidiarias o afiliadas. Las observaciones y puntos de vista expresados en este reporte pueden ser modificados por los Analistas en cualquier momento sin necesidad de dar aviso y sin responsabilidad alguna. Scotia Casa de Bolsa no tiene la obligación de emitir reportes cuando las opiniones, condiciones o suposiciones con las cuales se elaboró el presente reporte hayan cambiado. Las opiniones y proyecciones expresadas en el presente reporte no deben considerarse o interpretarse como una declaración unilateral de la voluntad, oferta, sugerencia o invitación para comprar, vender, suscribir o emitir cualquier valor o instrumento financiero, o como una oferta, invitación o sugerencia para contratar los servicios de Scotia Inverlat o cualquiera de sus subsidiarias o afiliadas. La remuneración de los Analistas depende, entre otros factores, de la rentabilidad e ingreso generados por todas las áreas del Grupo Financiero SBI, pero no por un área o áreas en particular. Los Analistas no reciben remuneración alguna por parte de los emisores de los valores descritos en este reporte. La Dirección del Grupo de Asesorías de Portafolios Internacionales de la que forman parte los Analistas que elaboran este reporte, es un área independiente de las áreas de negocio, incluyendo el área de Operaciones y de Banca de Inversión y, no recibe remuneración, directriz, o de cualquier forma, presión o influencia alguna por parte de las áreas de negocio que pueda afectar en cualquier sentido la información contenida en este reporte. Al cierre del último trimestre, el Grupo Financiero SBI, sus subsidiarias o afiliadas y sus Analistas pueden mantener inversiones, directa o indirectamente, en valores, instrumentos financieros o instrumentos financieros derivados, cuyos subyacentes sean valores, que representan 10% o más de su cartera de valores o portafolio de inversión en las emisoras o valores mencionados en el presente reporte. En los últimos doce meses, el Grupo Financiero SBI, sus subsidiarias o afiliadas pudiera haber prestado algún servicio participando como líder, colíder o como miembro del sindicato colocador en ofertas públicas de colocación de valores de las emisoras o valores mencionados en el presente reporte. Los consejeros, director general y directivos del Grupo Financiero SBI no fungen con ninguno de estos caracteres en las emisoras de los valores objeto del presente reporte. El Grupo Financiero SBI, sus subsidiarias o afiliadas al momento de emitir el presente reporte, no tienen ningún conflicto de interés, salvo las relaciones de negocio que en su caso, se han señalado en el presente reporte. Este documento no puede fotocopiarse, ser utilizado por cualquier medio electrónico o bien ser reproducido por algún otro medio o método en forma parcial o total; tampoco puede ser citado o divulgado sin la previa autorización de la Dirección del Grupo de Asesorías de Portafolios Internacionales".

Perú — Este informe se proporciona únicamente con fines informativos. Este informe no es, y no debe interpretarse como una oferta de venta, solicitud de compra de valores y/o contrato de futuros o commodities. Los valores mencionados en este informe pueden no ajustarse para todos los inversionistas ni tampoco pueden estar disponibles para la venta en determinadas jurisdicciones, donde se distribuye el informe. La información y opiniones contenidas en este documento se han compilado y llegado a partir de fuentes consideradas confiables, sin