Quarterly Market Commentary

October 2020

There is plenty of uncertainty for investors to worry about in the short-term including the U.S. election, the delay of the next U.S. fiscal package, and the likelihood of continued rising case counts as cooler weather brings people indoors in the weeks and months ahead. Stocks don't like uncertainty so we have had a correction in September, and may well have another one as we get closer to the U.S. election. The uncertainty associated with the last two elections helped lead to corrections that bottomed in November 2012 and November 2016, so maybe this one will too.

It might seem appropriate to approach this volatility with a defensive stance, but it has been our long-standing view that corrections often present opportunities to be taken advantage of rather than a time for caution. There are typically 2 to 3 corrections of at least 5% every year, and each one presents an opportunity to 'buy the dip'. Stocks are forward looking and what we can say almost for certain about next year is that the election will be behind us, the U.S. will probably have a fiscal package, and a vaccine will hopefully become broadly available. The stock market will likely 'look through the valley' of the current uncertainty and set new highs based on the prospect of rising economic and earnings growth in 2021.

Could we have another economy-wide lockdown? While cases are rising, mortality is a fraction of what it was in March and April primarily because of the younger demographic of those who contracted the disease in recent months, but also because therapy has become much more effective. Businesses with social interaction such as bars, restaurants, banquet halls, etc. have all seen restrictions re-imposed and private social gatherings have also seen renewed restrictions. These targeted restrictions are highly prudent but represent a much smaller part of the economy than the broad lockdowns earlier in the year.

The economy is expected to slow sharply in the fourth quarter and economists are revising those forecasts lower. Is the economy at risk? The partial reopening of the economy means the third quarter GDP is going to be very strong when compared to the extreme low of the second quarter lockdown, with a consensus forecast of 24.7% U.S. GDP growth qtr/qtr at annualized rates.[i] As high as the third quarter consensus appears, economic data continues to positively surprise and the Atlanta Fed's GDPNow projection, revised with each major data release, is now at 34.6% for the quarter suggesting the potential for another huge positive surprise when the initial GDP estimate is released in late October.[ii] Growth will most likely slow from that extreme pace. Economists have been revising 4th quarter GDP estimates lower, largely because some of the 4th quarter growth they were expecting got pulled forward into Q3 and partly because the fiscal package has been delayed. The third quarter has been revised higher much more than the fourth quarter has been revised lower: the outlook for the full year 2020 continues to be upwardly revised. And consistent with the improved outlook, analysts have been revising earnings forecasts higher since the spring.

The stock market is near record highs and yet the economy is not expected to fully recover until late next year. Why the disconnect? This apparent disconnect is seen in almost every economic recovery and is mainly due to the forward-looking nature of stocks. Stocks tend to begin to recover before the recession ends and will typically rise faster than current earnings as investors anticipate rapid earnings growth in the year ahead. The equity move is magnified by Fed easing which helps boost the earnings outlook while lowering bond yields, and therefore increasing the multiples applied to the improved earnings outlook. In our opinion, the best valuation metric is not the Price-To-Earnings multiple, but the equity risk premium which inverts the Price-To-Earnings multiple into the earnings yield and compares that to bond yields.

Our expectation for a continued economic and earnings recovery suggests the cyclical case for stocks remains strong.

We remained very active during the past quarter and we are very comfortable with our current positioning. Some of the names that we continue to hold and favour include:

AECON GROUP INC.

Management at Aecon believes that the company is well-positioned to benefit from an anticipated increase in federal and provincial government infrastructure spending as part of a broader economic stimulus package. Aecon noted that it has already seen increased demand for its road-building services (namely in Alberta and Ontario), while larger-scale projects are expected to have a longer procurement timeline.

Backlog totaled a record $7.3bln, +4.3% quarter over quarter and +7.4% year over year. Encouragingly, backlog expected to be executed over the next 12 months was up ~19% year over year.[iii] Notably, no projects in Aecon's backlog have been cancelled. Aecon has witnessed some project bidding delays, although its management sees such delays as temporary.

Aecon's diverse end-market exposure, record backlog, and new-award prospects support our positive view on the company.

ALGONQUIN POWER & UTILITIES CORP.

We believe that Algonquin Power & Utilities Corp. offers a compelling valuation in the context of an extensive growth pipeline that includes development activity, potential acquisitions, utility rate base investments, and potential international investments. As the company has diverse investment opportunities, a conservative payout ratio, and manageable leverage, we believe that management's 10% annual dividend growth target through 2021 is realistic.

BCE INC.

The stability of BCE was on display again in Q2/20. Despite meaningful temporary disruption from COVID-19, BCE delivered balanced results that were not as bad as that of Rogers, but not as good as that of TELUS. It also delivered very strong fiscal cash flow and a reduction in debt leverage (not including $1 billion in data centre proceeds still to come in H2/20), despite the revenue/EBITDA headwinds. These results should support the yield and safety investment thesis that most BCE shareholders covet during times of uncertainty like this. Looking past the pandemic and recession, we believe that BCE is well-positioned for growth in a world with more broadband connectivity and 5G services. We also see opportunities for accretive mergers and acquisitions activity using the company's scale and low cost of capital.

BROOKFIELD BUSINESS PARTNERS

Brookfield Business Partners delivered a very strong Investor Day, focusing on the operational and financial resiliency of its businesses, the value of its underlying portfolio, and near-term upside opportunities.

As a reminder, Brookfield Asset Management continues to own 95 million units (63% of outstanding on a fully diluted basis) with a fair market value of $3 billion, which translates into approximately $1.95 per Brookfield Asset Management share (approximately 6% of its market value). Brookfield Asset Management is entitled to incentive fees based on Brookfield Business Partners' share price performance, but not until Brookfield Business Partners trades through its previous high watermark of $42 per unit (which is approximately 34% above current).

Five key takeaways from the Investor Day, as provided by the company's management, include:

1. Their belief that their portfolio is stronger and more resilient than ever.
2. Their view that the parent and subsidiaries are well-capitalized with ample liquidity to fund growth initiatives.
3. Their updated expected liquidation value of $40 - $44 is well-above current market price
4. Their belief that in-place portfolio supports upside through $60 per unit, led by Westinghouse and Clarios
5. Their expectation that longer-term upside beyond $60 is supported by robust acquisition pipeline and strong financial partnerships

BROOKFIELD PROPERTY PARTNERS

Brookfield Property Partners also recently had an Investor Day and these are some of the key takeaways:

1. Brookfield Property Partners firmly committed to their distribution policy, saying that they believe this down turn is cyclical.
2. The CFO simplified the story from 256 core properties (or 1,100 total properties) into an easier question: how much are just the top 40 worth? The answer was that these properties' equity value, after mortgages owed and all corporate debt, is estimated to cover $10 per unit. So if an investor believes the 40 highest-quality properties at Brookfield Property Partners still have intact values, then they get the remaining 1,060 properties for effectively for free.
3. The CFO laid out why Brookfield is standing behind their office investments with two key points: 1) work from home is not working for many employees and employers, and 2) Brookfield's offices specifically will prosper as tenants demand modernized office space. He also cited anecdotal evidence from Brookfield's own return to work experience which started in June. They have 60% of New York staff in the office and 85% for both Toronto and London. Their on-staff epidemiologist says the office environment they have created is "safer than the grocery store".
4. Brookfield believes Brookfield Property Partners is still a deep value investment, as evidenced by their recent $1 billion Substantial Issuer Bid (of which only $514 million was filled). When you're at the peak of a cycle, an investment provides low opportunity and high risk. When you're at the trough of the cycle, an investment provides low-risk and high opportunity. And I say for all of these reasons, we see tremendous value in Brookfield Property Partners' units today.

CANADIAN IMPERIAL BANK OF COMMERCE

We favour CIBC largely based on relative valuation, potential upside to our target price, and dividend yield. In addition, the bank's lower risk posture, most notably the bank's overweight position in domestic mortgages, continues to support our positive outlook.

CIBC remains well capitalized with a Common Equity Tier (CET) 1 ratio of 11.8% at the end of Q3/20 (in line with the peer group). This represents a very healthy 280bps over the current regulatory minimum. The ratio is expected to rise even further over the coming quarters if OSFI does not lift its restriction on share buybacks and dividend increases. CIBC's dividend yield of 5.9% is above the peer group average of 5.3% and is second only to Bank of Nova Scotia.

We recently moved back to valuing CIBC on a forward Price-To-Earnings multiple basis where the stock now trades at 10.6x and 9.4x our 2020E and 2021E earnings per share, respectively. This compares to 11.4x (2020E) and 10.1x (2021E) for the peer group. CIBC has historically traded at an 11% discount, on average, over the past five years. From March-September, we had been valuing bank stocks on a Price-To-Book multiple basis due to the high degree of uncertainty around earnings estimates. CIBC currently trades at 1.2x Price/Book compared to the peer group average of 1.4x. Historically, CIBC has traded at ~2.0x-2.1x. While we do not expect CIBC to deliver better earnings growth, we expect CIBC to exhibit less earnings and capital volatility than the group generally.

The stock has been a strong performer as compared to its peers, up 26% in the last six months and second only to National Bank (another one of our holdings). The bank outperformed the group average of 11%.

COGECO INC.

Cogeco is facing a hostile takeover bid from a New York firm called Altice USA that is offering in excess of $10.3 billion USD. Altice USA, a large U.S. cable operator, included a side arrangement that would see Rogers Communication acquire Cogeco's Canadian assets for $4.9 billion.

Notwithstanding our view that it will be an uphill climb to convince the Audet family to relinquish control of Cogeco at this time (we still believe that things could change in three-five years if/when pressures on the business have escalated from Fibre To The Home and 5G competition, including fixed-wireless broadband overbuild using 5G), we do not believe that Altice/Rogers will give up in the near term. We expect a full-court press on the family and the Quebec government, as well as subordinate voting (SV) CCA / CGO shareholders. In addition to threatening increased competition in Cogeco's regions (via fibre and/or fixed-wireless overbuilding), we attach high odds to some sort of higher and/or restructured offer for the company.

CANADIAN TIRE CORPORATION, LTD.

Canadian Tire remains the preferred name in our coverage universe. With all Retail banners now open, including retail sales up for each banner in July, we anticipate a material sequential financial improvement to commence in Q3/20. We believe that Canadian Tire's largest banner, Canadian Tire Retail, should see revenue growth converge with strong retail sales (+20.3% y/y in Q1/20) in H2/20 and into 2021 as dealers replenish inventory. Additionally, we believe Canadian Tire Retail will continue to benefit from the nature of its product offering (living, fixing, playing and auto), compounded by being a benefactor from Canadian discretionary dollars remaining more domestic oriented in 2020. Turning to Financial Services, we reiterate our stable outlook for the segment. We anticipate the decline in Gross Average Credit Card Receivables to level off by year-end with the focus turning to the ageing of the current portfolio in 2021. We forecast the allowance rate and rolling write-off rate to peak in 2020 and show a modest improvement in key metrics in 2021.

In H2/20 we believe the Retail performance should normalize in addition to the impact of the pandemic/accounting on Financial Services starting to dissipate. As investors gain visibility and comfort with this outlook, this should illustrate the punitive valuation applied to Canadian Tire Corporation, the safety of its dividend and lead to a higher applied valuation, in our view.

ENBRIDGE INC.

Enbridge's better-than-expected H1/20 results provided a strong start to the year and management's $300 million identified cost-savings should mitigate the lost revenues from lower Mainline volumes for the balance of the year. In addition to mitigating the impacts of COVID-19 and the depressed commodity environment, Enbridge's priorities include navigating the regulatory processes for L3R and the next phase of the Mainline commercial framework. Over the long term, we expect Enbridge to continue to have a strong competitive incumbency due to its geographic footprint, scale, and diversification, and we believe that this positions it to play a role in North America's hydrocarbon export market.

FIRST CAPITAL REIT

We remain optimistic and confident on the recovery in value of First Capital, despite the impact of COVID-19 on both the economy and shopping behavior.

We believe the continued improvement in rent collections will lead to outperformance in terms of both growth and stability within First Capital's peer group. First Capital collected 75% of rents at Q2/20, 79% in July, and 82% in August (cash rents only). With government support, this would have increased to +90% in August. First Capital's primarily necessity-focused tenant and asset base in high-density locations helped sustain strong leasing activity in Q2/20, with over 400,000sf renewed at a +10% average spread.[iv]

Versus its closest retail peers, First Capital has the highest concentration in tenants deemed 'essential' and those that cater to peoples' everyday needs. Nearly 75% of rents are derived from these tenants, including grocers (17%), medical offices (15%), pharmacies (9%), and banks (8%), among others. This compares to First Capital's closest peers (Smart Centres REIT and RioCan REIT), at 57% and 75%, respectively. First Capital also has virtually no exposure to retail's most challenged areas (e.g. department stores, fashion, theatres).[v]

Compared to the two grocery-anchored retail REITs (Choice Properties and Crombie), First Capital has higher urban-concentration (>90%) and population density (294,000 average 5km-radius population density, +42% since 2016).

At this time, we do acknowledge added near-term uncertainty with recent spikes in COVID-19 cases. The province of Quebec announced on September 28th that three regions (including Montreal, which represents 14% of First Capital's rents) would be subject to heightened restrictions, including restaurants being limited to takeout only, for 28 days.[vi]

We believe this uncertainty is fully discounted in the current unit price, offering investors an attractive entry-point. First Capital currently trades 37% below our current Net Asset Value (51% below our pre-COVID-19 Net Asset Value estimate of $25.60), versus the historical average of just a 3% discount.

We view First Capital as one of our most attractive plays on the reopening of the economy. First Capital's units outperformed during the two recent sector rallies: +14.7% versus +2.1% for the S&P/TSX Capped REIT index return between July 27 and mid-August, and +35% versus +18% between May 13 and June 8. We believe another catalyst for the unit price will arise when the market re-opens for asset dispositions, enabling First Capital to resume its leverage-reduction strategy.

INTER PIPELINE LTD.

Inter Pipeline Ltd. recently announced that it has entered into an agreement for the sale of a majority of its European bulk liquid storage business for proceeds of £420mm ($715mm).

The timing of this transaction is a bit sooner than we had expected, given the termination of a formal process earlier this spring. We view this pending transaction positively as it is expected to provide a bit more financing flexibility and allow the company to refocus on its core North American franchise. We expect the balance of the storage business to be sold down the road, which would complete the exit from Europe. In the near term, we expect management to be focused on finding a partner for the Heartland Petrochemical Complex project, but sentiment around execution risk could remain an overhang until the company makes substantial progress on Heartland contracting and construction during the pandemic. We note that a significant portion of Inter Pipeline's EBITDA is underpinned by long-term cost-of-service and fee-based contracts, and some exposure to commodity margins could provide upside down the road.

MAPLE LEAF FOODS

Maple Leaf Foods remains one of our top picks. The shares did lead all other staples under our coverage in H1/20 (+10%) but have lost ground in Q3 after news that COVID-19 surfaced in its primary processing plant (creating inefficiencies and causing exports to China to be temporarily suspended).

Valuation continues to look very attractive on a sum-of-the-parts basis. Maple Leaf Foods is trading at 9.1x next 12-months consolidated EBITDA, which might be reasonable if the plant-based protein (PBP) business was not generating negative EBITDA. Even if we attribute zero value to PBP, it would imply that the Meat Protein business is trading at only 8.0x. Using what we consider a more logical sum-of-the-parts approach and assuming the PBP business is trading at 2.5x sales (vs. ~16x for Beyond Meat and the 3.3x that an arguably inferior plant-based business was recently acquired by a SPAC), Maple Leaf's Meat Protein business is trading at only 6.7x EBITDA.[vii] This is well below Hormel (18.5x) and even a slight discount to the more commodity weighted meat processors (Tyson, Pilgrim's Pride, Sanderson Farms). We see the potential for Maple Leaf Foods shares to double over the next 2-3 years as normalizing pork markets, continued mix improvement and cost discipline combine to push Meat Protein EBITDA margins closer to the company's 14% target by 2022 (~16% by 2023), and investors better reflect Maple Leaf Foods's PBP strategy in the valuation. At this point, PBP Selling, General & Administrative Expense spending is expected to remain high in dollar terms, with rapid revenue growth and ~30% normalized gross margins allowing the segment to grow into these spending levels within 3-5 years; this would push segment EBITDA margins back into the double digits. So, depending on the investment horizon, risk tolerance and other factors, we continue to recommend investors to consider taking advantage of what we view as the market's myopia in order to benefit from several strong long-term value creation drivers that we believe should push margins and valuation meaningfully higher over the next 3-5 years.

PARKLAND CORP.

Parkland shares have recovered over 80% from the March 18 bottom, and are now trading at 7.4x our 2021E EBITDA. With the refinery turnaround in the rear-view mirror, cost savings initiatives firmly in place, strong capital management, and the volume outlook improving, we see further upside to Parkland shares. Add to this the potential to apply its $1.6bln of available liquidity for accretive acquisitions over the coming year, and we remain confident.

ROYAL BANK OF CANADA

We believe Royal Bank's structural advantages support a healthy premium in this environment. Specifically, we believe that RY's three large domestic businesses (banking, wealth, and capital markets) will continue to provide the diversification we value at this time. Additionally, the bank's ongoing cost management initiatives, as well as strong capital levels, point to better medium- and long-term performance from Royal Bank, in our view.

SUNCOR ENERGY INC.

TD recently hosted Suncor senior management [Mark Little (President & CEO), Trevor Bell (VP, Investor Relations)] for a series of investor calls. Since these calls closely followed its September 7 operations update and 2020 guidance revisions, most discussions revolved around the mid-term outlook for its core assets (primarily Base Plant, Fort Hills, and Firebag) and the balance sheet. We came away feeling directionally more confident on both fronts.

We believe that Suncor Energy is making the most of the Base Plant outage by incorporating activities that contribute to longer-term cost structure/utilization improvements. It retains one of the most defensive business models in the basin and while we see strong potential for a catch-up trade vs. its peers through this recovery, we believe operational consistency will be key looking forward.

It is worth noting that Berkshire Hathaway and the Saudi Arabian Public Investment Fund recently increased their positions in Suncor. Berkshire Hathaway increased its position by 28% as of Q2/20 and now owns 19.2 million shares. Similarly, the Saudi Arabian Public Investment Fund recently purchased increased its position to 51 million shares per its latest filing (up approximately 67% versus its last filing in Q1/20).

TC ENERGY CORP.

TC Energy announced that it has signed a Memorandum of Understanding (MOU) with Natural Law Energy (NLE), for the purpose of NLE taking an equity interest in the Keystone XL (KXL) and potentially other midstream and power related projects.

NLE is a Treaty alliance of Nations from selected traditional territories. Elected leaders of five First Nations, located in Alberta and Saskatchewan, provided support for the MOU. The entering of this MOU marks one of the first such agreements for TC Energy with Indigenous communities. NLE's participation in KXL is anticipated to be finalized in an agreement, which is expected to be completed in Q4/20. We believe that the entering of a MOU of this nature demonstrates TC Energy's ability to work with key stakeholders to ensure a project makes a positive impact on the communities it is in.

TC Energy and NLE will work together with the goal of establishing additional Indigenous ownership in future projects. TC Energy has also said that they will look to apply this model into additional opportunities along the KXL right-of-way in Canada and the U.S., with other Indigenous groups.

If you should have any questions or comments, please do not hesitate to ask.

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TD Wealth

[i] ACTION LIST EQUITY RESEARCH / INVESTMENT STRATEGY / INDUSTRY OVERVIEW OCTOBER 5, 2020
https://tdsresearch.cibg.tdbank.ca/equities/equity/openReportFile.action?reportId=6C33E2DACD9AB547852585F8006364FA

[ii] ACTION LIST EQUITY RESEARCH / INVESTMENT STRATEGY / INDUSTRY OVERVIEW OCTOBER 5, 2020
https://tdsresearch.cibg.tdbank.ca/equities/equity/openReportFile.action?reportId=6C33E2DACD9AB547852585F8006364FA

[iii] ACTION NOTE EQUITY RESEARCH / AECON GROUP JULY 27, 2020
https://tdsresearch.cibg.tdbank.ca/equities/equity/openReportFile.action?reportId=198C78C2928BCCBE852585B2003C78F6

[iv] ACTION LIST EQUITY RESEARCH / INVESTMENT STRATEGY / INDUSTRY OVERVIEW OCTOBER 5, 2020
https://tdsresearch.cibg.tdbank.ca/equities/equity/openReportFile.action?reportId=6C33E2DACD9AB547852585F8006364FA

[v] ACTION LIST EQUITY RESEARCH / INVESTMENT STRATEGY / INDUSTRY OVERVIEW OCTOBER 5, 2020
https://tdsresearch.cibg.tdbank.ca/equities/equity/openReportFile.action?reportId=6C33E2DACD9AB547852585F8006364FA

[vi] ACTION LIST EQUITY RESEARCH / INVESTMENT STRATEGY / INDUSTRY OVERVIEW OCTOBER 5, 2020
https://tdsresearch.cibg.tdbank.ca/equities/equity/openReportFile.action?reportId=6C33E2DACD9AB547852585F8006364FA

[vii] ACTION LIST EQUITY RESEARCH / INVESTMENT STRATEGY / INDUSTRY OVERVIEW OCTOBER 5, 2020
https://tdsresearch.cibg.tdbank.ca/equities/equity/openReportFile.action?reportId=6C33E2DACD9AB547852585F8006364FA