



Equity Analyst Panel Discussion Transcript | Odlum Brown's 28th Annual Address

Moderated by Murray Leith, BComm, CFA, Executive Vice President & Director, Investment Research

I'd now like to invite our team of Equity Analysts into the conversation to talk about what it all means from a "bottom up" perspective and how we, as investors, are building more resilient portfolios.

Just so you are not looking at tiny pictures on your screen, I'm going to split the team into two groups, starting with Trevor Chang, Fai Lee and Cory O'Krainetz. Welcome gentleman.

Trevor is our resident expert on REITS, Real Estate Investment Trusts. He also covers other wonderful companies including, Dollarama, Charter Communications and TransDigm, a major manufacturer of aftermarket aviation parts. Fai is our resource analyst, covering traditional energy companies, as well as other commodity businesses. He has also opportunistically recommended businesses outside his usual areas, including GM, United Healthcare and CAE, the world's largest manufacturer of flight simulators. Cory is responsible for the Odlum Brown Yield Portfolio, and covers many of the great dividend-paying companies including Utilities, Pipelines and Telcos. He's also responsible for the Forest Products sector.

Let's start with you, Trevor. The global supply chain has been disrupted by the pandemic and that's causing prices to increase. January Consumer Price Inflation in the U.S. was a staggering 7.5%.

In their last quarterly call, Costco noted that approximately 80% of their containers are late by an average of 51 days. Companies are rethinking their just-in-time inventory systems. What can businesses do to make their supply chains more resilient?

Great question, Murray. From what we've seen, companies are increasingly adopting a just-in-case inventory system. So rather than matching the supply of goods with consumer demand, companies want to hold onto more inventory. Today, inventory levels are 10% below what they were pre-pandemic. Not only do companies need to restock this shortfall, but they also need to build up safety stock. Things like medical supplies will also likely be on-shored, meaning we will manufacture it locally, which will also increase the need for more storage.

When do you think the supply chain issues will be fixed?

Inventory issues are already being fixed, at the margin. Some of the companies we follow are reporting improved product availability, so things are getting better. But, there are still ships backed up at ports and it's a slog to get through it all. Current projections expect supply chain issues to be fixed by the end of 2023.

That sounds like a long time, but I'm sure improvements along the way will make a big difference. With companies strengthening their supply chains, what investments do you recommend to take advantage of that increased resiliency?

We recommend an industrial REIT called Granite. They own massive warehouses, which they rent out. There are three major reasons to like industrial real estate:

1. Demand will grow because companies are expected to hold more inventory, as mentioned earlier.
2. We believe the overall consumption of goods will continue to grow.
3. People enjoy shopping online. Online shopping is convenient and reliable, and for it work well, online retailers will need more industrial storage. In fact, Amazon is Granite's second-largest customer!

Supply chain issues are affecting more than just durable goods, they're also affecting food, particularly meat and other perishables. Tell us more about what's happening there.

The food supply chain has really gotten hurt by the pandemic. Meats are a great example. With the pandemic and various mandates in place, food producers are having a hard time. They are having to draw down on inventories in order to meet their commitments to customers. That's hurting a stock we recommend called Americold. Americold specializes in cold-food storage. It makes money when food is stored and delivered from its facilities. As you can imagine, if there's less food being stored, Americold makes less money. But, we are moving out of the pandemic and mandates are being lifted. That should bode well for food producers and inventory levels at Americold should recover.

That should have a very positive impact on the stock price too. Thanks Trevor.

Let talk about Energy. Fai, does Oil & Gas have a place in client portfolios?

Absolutely, yes. When I look at the oil and gas sector today, I see the stocks offering great value.

This year, oil and gas stocks are forecast to generate free cash flow yields in the range of about 15%, which is really high. What I am basically saying is that oil and gas companies are going to be making a lot of money and this is not being fully reflected in their share prices.

Here's the kicker, the 15% yield is assuming an oil price of about US\$70 per barrel. However, as you know, oil prices today are actually a lot higher, so there could be even more upside if oil stays flat or increases.

Oil prices have been depressed for a number years. Why are they so high now?

I'm sure Russia comes to mind, so I'll address that first. Last week, the West Texas Intermediate oil price benchmark was around US\$92 per barrel, which is relatively high, but, if you had asked me about Russia's invasion of Ukraine, I would have said we weren't seeing much impact on oil prices. In the last three days though, the price has moved up by 20% to US\$111 per barrel, so you can appreciate that the situation is fairly fluid.

However, Russia's invasion of Ukraine doesn't fully explain what's going on with oil prices today. When it comes to commodities, there's a saying that "the cure for low prices is low prices" and that's exactly what happened here. Let me explain. Oil companies have been cutting back capital spending for years due to low prices. At the same time, oil demand has fully recovered after falling sharply during the start of the COVID pandemic. Low investment and strong demand have created a tight oil market and that's why oil prices are high today.

In past cycles, we would have seen energy companies use their free cash flow to ramp up production and this would eventually lead to lower oil prices. That's not what we are seeing now though. Companies are more focused on maintaining capital discipline and returning cash to shareholders. They have been under investor pressure to do this because of the industry's poor capital allocation track record and climate change concerns.

Fai, you also recommend some stocks that will benefit from the transition to clean energy. How do you reconcile that with your Oil & Gas coverage?

I want to be clear that I believe addressing climate change is very important and necessary. Sometimes though, I get the impression that investors don't fully appreciate that the transition away from oil and gas will take a long time, likely decades. Also, the transition could be messy and disruptive, as we are seeing now with some European countries that are facing sky high energy prices.

That being said, I see a long growth runway for clean energy and I am always on the lookout for new attractive investments. It hasn't been easy given they can be quite pricey, so I've been fairly selective. Currently, I cover Albemarle, a leading lithium producer; Cameco, a major uranium producer; and General Motors, which is moving towards producing only electric vehicles. All of these companies will benefit from a global transition to clean energy.

Cory, what happens to the pipeline companies, as we transition away from oil?

We recommend two of the largest names in the sector, TC Energy and Enbridge. They own critical infrastructure that we simply can't live without. So, they will be the last ones operating.

We also think it is important to differentiate between oil and natural gas. Natural gas is the cleaner option, and will play an important role as we move away from fossil fuels. It heats our homes, supports our industries, and it keeps the lights on.

And, with the world reassessing its energy security, we think there will be more interest in natural gas from politically stable countries like Canada.

For Enbridge, natural gas represents about half of earnings. For TC, it's more than 75%.

Now having said all that, management understands that times are changing. And there is a wonderful opportunity to invest in renewables or even develop completely new businesses, like hydrogen distribution. So we think they will be part of the solution.

Finally, the stocks provide a hefty 6% dividend yield.

How does the world make the transition to a greener future?

Well Murray, in a word, electrification. We're going to use more electricity to meet our energy needs. The obvious example is electric cars. As anyone in Vancouver knows, this trend is well underway.

But the trend is bigger than just EVs. Data centres are another great example. Even pipeline companies plan to use renewables for their energy needs. So, we think electrification is the way forward, if we use renewables.

Can we realistically meet our needs with renewable power?

This a great question. It is a monumental task to shift the world to renewables and it is going cost up to \$3 trillion per year.

The first step is to reduce our dependence on coal in our power grids. It is the most harmful fossil fuel and failing to move away from it would severely limit the environmental benefits of electrification. Thankfully, this is happening at a remarkable pace. The United States plans to reduce their coal mix from almost 50%, to less than 5% by 2030. We expect all governments to eventually do the same.

Wind and solar will be coal's replacement. They are the cleanest and cheapest options, in most places. And, better technology will only improve their competitive advantage.

The biggest issues for wind and solar are intermittency and location. Electricity is only generated when the wind blows and the sun shines, and the best locations are often far away. So there are limitations. Batteries will allow us to store some of that electricity, but natural gas will still be needed to fill in the gaps, at least over the medium term. Finally, we need larger and more complex transmission networks. So there is a lot that needs to happen.

How do we participate in renewables? What are your recommendations in this space?

We have five names on our list that will participate in these trends.

The AES Corporation is a global developer of renewable power and is one of the most innovative companies we cover.

Algonquin owns high-quality water and electric utilities, and has a growing portfolio of wind and solar projects.

American Electric Power is a large U.S. electric utility. They were once the poster child for coal, but are now a leading developer of renewables. Plus, they own highly valuable transmission networks, which will be needed to connect renewables to major cities.

Fortis also has top-tier transmission assets, and owns electric and gas utilities on both sides of the border.

However, our favourite is Brookfield Renewable. They own incredible renewable power assets including wind, solar and hydro. They also have the best growth profile in the sector.

Can you tell us a bit more about Brookfield Renewable? What makes it stand out, relative to other names in the sector.

I would love to. The business is run by some of the smartest people in the industry. They think long term, are opportunistic and have deep pockets, so they can make better deals than anyone else.

The business is also well protected by inflation-linked contracts, so they will be fine if costs rise.

Currently about 50% of their power mix is Hydro. Hydro is great. It requires very little maintenance and can last up to 100 years.

Best of all, many of their agreements are contracted to sell power below market prices. Which means, as contracts come due in the next few years, there will be a big jump in earnings.

Despite these attributes, the stock has sold off and is attractively priced. A year ago there was rampant speculation for anything green and we think those stocks just got too pricey. But today, we see a great opportunity to buy the highest-quality name in the sector.

Fai, you recently initiated coverage on UnitedHealth Group. Can you tell us a little bit more about it?

Of course, I'd be happy to. Yes, UnitedHealth is a bit different than the other companies I cover but it's such a great company that I just had to recommend it to our clients.

As you know, Canadians have access to universal health care that is funded by our taxes. In the U.S. though, the majority of people rely on private health insurance plans that are often provided by their employers.

UnitedHealth is one of the leading private health insurance providers in the U.S. with about 45 million members. The company also operates a health care network that offers a wide range of services like primary care with a family doctor or specialty care with a cardiologist.

Given its size, UnitedHealth has a competitive cost advantage. The company has an outstanding track record, great growth prospects and an attractive valuation. It also has defensive characteristics because people are generally reluctant to reduce spending on health care and Americans don't want to face the risk of not having health insurance. The bottom line is that I'm really excited about UnitedHealth's future outlook.

Thank you Trevor, Fai and Cory. I'd like to invite the other half of our team to the conversation. Steven Zicherman is our Technology and Health Care analyst, he also recommends Warren Buffett's Berkshire Hathaway. Ben Sinclair covers Financial Services, including Canadian banks and insurance companies, alternative asset managers, stock exchange companies and discount brokers. Steve Boland's specialty is Consumer and Industrial companies, including Consumer Packaged Goods companies Nestlé and Procter & Gamble, Starbucks, Tim Horton's operator Restaurant Brands, the railroads and a number of other great companies.

Steven, we have owned many of the so-called FAANG stocks – Facebook, Apple, Amazon, Netflix, Google and Microsoft for many years and they have performed wonderfully. I know some clients are concerned about a bubble in the technology space, and I know we have talked about it as well. A lot of the smaller, more speculative technology stocks like Zoom have experienced spectacular declines, and leadership has really narrowed into the big FAANG group, a similar pattern to what happened at the turn of the century. Are you worried about a bubble like we had in 1999/2000?

There have long been worries about the FAANG group of stocks and a repeat of the dot-com bubble. In fact, we wrote about some of those concerns in an *Odlum Brown Report* five years ago, in 2017. In that report, we

made the case that growth stocks could outperform for some time, and that turned out to be a pretty good call.

Today, I think we see some similarities to the dot.com boom/bust cycle. Back in 2000, we had highly speculative stocks like Pets.com, an online pets supply company, which was a great idea, but about 20 years too early. Today, we have “meme” stocks like GameStop and AMC, the movie theatre chain. Meme stocks, for those who don’t know, are companies with a cult-like following among certain retail investors thanks to Reddit and other social media outlets.

So let’s go back to 2000, speculative stocks like Pets.com blew up several months before the more established companies, like Cisco and Intel, took a big nose dive. At the time, investors were crowding into what they thought were safer names before those names also suffered a downturn. We think there’s a similar pattern happening today. The meme stocks are well off their highs. SPACs, which are speculative, blank-cheque companies, have had their moment in the sun and are now also well off their highs. So, effectively, it’s the tech companies with no earnings that are down a lot, while the market leadership appears to be narrowing like it did in 2000.

While that might sound scary, we think there are two reasons why it’s justified to own FANG stocks in your portfolios. First is that growth company valuations were sky-high in 2000. FANG multiples today are about half as high as the 60-70x earnings multiples applied to growth stocks 20 years ago. In other words, expectations were ultra-high back then compared to today. The second reason is quality. Today’s group of large cap technology stocks are relatively higher-quality companies. This current batch of technology leaders generate much higher margins thanks to their dominant positions and cash-generative businesses.

I agree with your analysis and it’s certainly something that gets talked about a lot in the market. Thank you for sharing that with us.

Generally speaking, lower interest rates justify higher prices. Do you think current stock prices are sensible assuming interest rates rise as expected.

We think even good companies, at too high a price, can lead to bad investments. One example of this is a long-term price chart of Microsoft. From its peak in the 2000 bubble to 2014, the chart looks like a really elongated U shape. Effectively, it took 14 years for investors who bought in 2000 to break even, despite the fact that the company delivered rising earnings per share along the way.

We loved the FAANG stocks years ago. They weren’t as well embraced and prospective returns looked really attractive. Today, we’d say that stock prices are still attractive but they are elevated. So, rather than love them, we simply like them.

So, if we just “like” them now, should clients be thinking about reducing their position sizes? What are your thoughts around timing?

We recently trimmed a couple of positions in the model, but that’s more tactical. Overall, we would say that market timing is never a good strategy. We prefer to do what we’ve done and that’s be selective.

If economies revert back to a slower-growth world then interest rates should remain low, and that’s really supportive for higher-growth technology stocks. If we have higher rates that linger for longer, high multiple, no earnings, speculative stocks will continue to be punished much like they have been in the past few months.

We’ve always been conservative in our approach, with a focus on cash flows, so we have stayed pretty far away from those frothier parts of the market. We continue to prefer quality companies like those we recommend.

Can you share with us your favourites?

Sure. It’s really very difficult to predict who will be the winners in the short run, but volatility can be your friend if you have a long-term orientation. Companies like Apple and Microsoft generate tons of cash flow, which they return to shareholders through buybacks and dividends.

We also continue to like companies with reinvestment opportunities, like Amazon, with its movie studio and other consumer offerings that increase the value of a Prime membership. We think Netflix is a similar company with its expanding library of television shows and movies. We think both of those companies have strong pricing power than can deliver value to patient shareholders.

Lots to consider, thank very much Steven.

Ben, you cover a lot of industries in the financial sector, such as the banks, but one where you see lots of opportunities is payments, companies like Fiserv and PayPal. What attracts you to that part of the market?

There is a very long growth runway in this space, as payments shift from cash and cheques and towards cards, ecommerce and mobile commerce. Fiserv and PayPal in particular are very well positioned to take advantage of this trend. They both have very entrenched competitive positions and they both have very profitable business models.

Perhaps most importantly, the market still views this space as extremely competitive, and while there is some truth to that, we think that these companies aren’t getting the credit that they deserve, and are thus priced very attractively.

It certainly hasn't been a smooth ride. Banks have performed quite well recently, but payments stocks haven't. Why that is? What's the reason for the bumpy ride?

Well a lot has changed in the past 12 months. Many of these companies were big winners at the onset of the pandemic, as the shift towards digital payments accelerated, and stimulus payments provided an additional boost. But, as those stimulus payments have faded into memory and societies have reopened, ecommerce has slowed more than expected, which has affected many of the companies in this space. On top of that, there has been a broad selloff in high-growth technology stocks, including those in payments. Meanwhile, concerns about competition remain as high as ever.

Now with that being the case, we continue to like this industry. Many of these companies continue to grow at a healthy rate, and they have very strong profit margins. Many of them have strong competitive positions that we think can be maintained or even strengthened. So with these stocks having been sold off so much, we think they are that much more attractively priced.

Tell us more about PayPal. After surging in 2020 and the early part of 2021, the stock has basically round-tripped and it is back to where it was at the beginning of the pandemic. That makes some people nervous. Tell our audience why we still like the company.

We have been recommending PayPal for close to four years now, and our thesis on the company is pretty much the same as it was when we first started recommending it. The company is best known for its payment button that you'll see on many ecommerce websites. This button provides convenience and security for shoppers, while driving increased revenue for merchants. So, the appeal of the button has allowed PayPal to grow faster than ecommerce, and we think that will remain the case for many years to come.

Now to your point, it certainly has been a bumpy ride. But PayPal is still growing at an impressive rate, and has also stepped up their new product development, which we think will pay off very handsomely down the road. Again, with the stock having traded off so much over the last 12 months, we think it is very attractively priced.

Fiserv is another company you recommend in the payments space, but it's not a household name. Perhaps you can first explain to us exactly what the company does?

Well among other things, Fiserv allows organizations to accept payments, whether by card or through digital means. So, if you show up to a fast-food restaurant, and you pay for your order with a credit card or with a mobile app, Fiserv would handle that transaction on the back end for a fee.

Fiserv's has underperformed recently as well. Is this a similar story to other payments providers?

There are a lot of parallels. Fiserv has a great business model, healthy profit margins, good growth, and entrenched market position. Yet the market remains very concerned about high levels of competition, even as Fiserv continues to post impressive financial results. While the company doesn't grow as quickly as PayPal, it does trade at a cheaper multiple, which allows the company to buyback lots of its own shares, which we think will pay off quite a bit in the long term.

You mentioned competitive threats, something we think about with all the companies we own. With so much changing in the payments industry, is competition something that keeps you up at night? Will it be an issue for PayPal or Fiserv?

Right, it is something we pay attention to for all the companies we cover.

In this case, both Fiserv and PayPal have faced intense competition throughout their entire existence. The CEO of PayPal even likened it to gravity; always present, always pulling in the same direction, but something they learn to live with.

In PayPal's case, they have enormous advantages over the competition. Think about what it would take to compete with that button. You would have to convince merchants to adopt that payment method before consumers sign up. Or, you would have to convince consumers to sign up before it's available on ecommerce websites. So you can see that PayPal's lead over competitors is self-reinforcing, and that's one of the key attributes of the stock.

Now, in Fiserv's case, they don't have that same relationship or brand recognition with consumers, so they have to fight a little harder. But, if you look at their larger relationships, many go back decades. They are very tight-knit, and that speaks to how difficult it is for competitors to encroach on their turf. As for Fiserv's smaller clients, they have a product called Clover, which is very popular and actually outgrowing many of the competitors that the market is most concerned about.

Well thanks Ben. You know what? I used a clover machine at a gas station on the way into work this morning. So, thank you.

I want to shift gears a bit and talk to Steve Boland about some contrarian investment ideas. The Odlum Brown Model Portfolio has been around for 28 years and the first 10 years were its best 10 years. Back then, we owned a lot of out-of-favour value-type stocks. The strategy required patience and a long-term focus, and it worked extremely well. That strategy hasn't worked over the last 10 years. It's been a ride-your-winners growth-stock-driven market, and we have been fortunate to ride that wave. Those who have tried to think differently and swim against the crowd have really suffered. Many have given up on

contrarian value investing. We think that creates opportunity. Stephen Boland, what does contrarian investing look like from your lens and are you seeing opportunities?

Yes, I am seeing opportunities, Murray. It's about buying a good company that is struggling for some reason. Investors sometimes lose patience when a company has a setback and the stock gets overly depressed. We need to see a credible path to improvement, and if we see that, we're happy to buy low and wait for better days.

Unilever fits that theme. It's a company that is likely familiar to a lot of people. I know I've got a lot of their products at home. Tell us a little about Unilever.

Unilever sells products we all know and use every day. Dove soap, Degree deodorant, Hellmann's mayo, Ben & Jerry's ice cream. A nice thing about Unilever is that they actually get 60% of their revenue from emerging markets. And they have very deep roots in emerging markets. They've been in countries like India and Argentina since the late 1800s. This geographic exposure, I think, gives them above-average growth over the long term.

The stock's sort of been stuck in the mud. It hasn't moved up a lot over the last few years. Why is that? And, more importantly, how does it get better?

Yes, so simply put, the business has underperformed. I think that partly traces back to a few years ago when Kraft Heinz tried to buy them. Unilever said no and instead pursued a strategy to lower costs. I think they got a little too focused on that, and they dropped the ball on sales growth. So, now they're working to rejuvenate sales and I think they'll get there.

There's a lot of pressure on the company to perform better. It's even been reported that Nelson Peltz, he's an activist investor, has taken a stake. We saw Peltz as a Board member at Mondelez and Procter & Gamble. We liked his involvement at those companies and both are performing really well right now.

So Unilever's stock is trading at a big discount to peers. If the business performs better and I think it will, then that valuation gap should close. In the meantime, you collect a nearly 4% dividend yield.

A nice thing about Unilever is it has defensive attributes as well, which I would say is especially important in an uncertain world.

Absolutely. Most of us will keep using soap and deodorant and shampoo no matter what goes on in the economy.

Saputo is another defensive name, and it's also out of favour. Can you tell us about Saputo?

Sure. Saputo sells Dairyland milk and Armstrong cheese. They've got a new plant in Port Coquitlam, you've probably driven by it.

They have a great track record of growth. The company was founded by the Saputo family in Montreal in the 1950s. They started really small, they turned a few containers of milk into cheese every day. They've since grown to become one of the largest dairy processors in the world.

The Saputo family still essentially controls the company. They own about a third of the stock. Lino Saputo Jr. – he's the founder's son – has been running the company for the last 20 years. He's a really good CEO. In fact, a few years ago, he was voted Canada's best CEO.

A real Canadian success story, but that's kind of been forgotten lately because times have been a little bit tough, and people are focused on that. The stock, consequently, is down a whole bunch from its highs, but I think it's going to look a whole lot better in a few years.

Can you expand on that? Why has the company struggled and how is it going to get better?

They've faced a lot of challenges in recent years. Canada is currently performing quite well. But the U.S., which is their largest market, has had very unfavourable dairy prices. So, Saputo buys milk and turns it into cheese, and right now the milk price is quite high, and that's weighing on profits. On top of that, getting labour, like you mentioned earlier, has been a real challenge. Their U.S. profit margin is as low as we've ever seen it.

But, we know that U.S. dairy prices are cyclical. We've seen them move up and down before. We believe in time, it gets better again. And we're also starting to see improvements on the labour side.

That's good to hear. Some of these things are beyond the control of the company, no doubt they will improve in time. But, I'd like to know are they doing anything internally, that they have control over, to improve?

Yes, they are. They're in the early days of a four-year strategic plan to both grow sales and optimize operations. Historically, they've been very good at this. They're building capacity at some plants and consolidating others. They're expanding their best products and dropping less profitable ones. And, they're developing new products, like vegan cheese.

In a few years, I think this all comes together to drive earnings growth a lot higher and from a low stock price, I think shareholders are going to do quite well from here.

Sounds like it, lots of levers there. What I'm hearing is that there are internal drivers at both Saputo and Unilever that should help regardless of what the big picture outlook is for the economy.

Exactly. They're both good companies. They've struggled recently, but we see a path to improve and they have stock prices that just aren't reflecting that.

Thank you, Stephen. And, thanks to the whole Research Team for participating in the conversation today.

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