“The stage is now set for a shallow glide in interest rates, a resumption in business spending, and for global growth to benefit Canadian equities.”
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Foreword

Last year, “A Look to the Future” predicted that 2014, not 2013, would herald the return to growth in many areas, with some potential to surprise to the upside. That view played out in terms of economic growth, which was moderate in many parts of the world. The world’s governments took advantage of the relative calm to repair foundations, particularly in Europe. The stability that ensued allowed the US to socialize the idea of reducing its stimulus in the form of quantitative easing activity. It also allowed many equity markets to surprise to the upside.

This year’s report examines the extension of that stabilization process and evaluates our previous expectations for 2014. On a macro level, our chief economist examines how the stage is now set for a shallow glide in interest rates, a resumption in business spending, and for how growth in the rest of the world will benefit Canada. We also provide our assessment of the state of North American housing markets and how they will impact our economies as well as central bank actions.

This year we have focused our outlook through the three lenses of energy, mining and infrastructure. These three sectors are the pillars of the Canadian economy, and are also the cornerstones of our expertise at CIBC. All three are in the early phases of super-cycles that will offer very meaningful returns in the near, medium and long terms. Along with our longer term views, we offer granular insight into some of the less well-known mechanics that will play out between energy and infrastructure, and within the mining and metals complex. We also examine the impact of US monetary policy on emerging markets in Asia and Latin America, and how domestic policies there impact our three core sectors.

We believe that next year will be marked by steady economic performance and governmental action. It will offer a number of opportunities to participate in a renaissance in Canadian energy and in global mining. Next year will also continue to offer the chance to get in on the ground floor of a global infrastructure boom. We continue to have a very constructive outlook for 2014.

Sincerely,

Quentin Broad
Equity Research

Eric Métivier
Capital Markets Trading

Joanna Zapior
Macro Strategy
Ten for fourteen: the economy in the year ahead

Avery Shenfeld, Economics

In this publication in 2012, we cautioned that investors would have to wait until next, next year (2014) for stronger economic growth, but argued that asset markets would begin to anticipate that move in the latter half of 2013. We’ve had that response, with the climb in bond yields and equity prices consistent with a typical cyclical turn towards better times.

But the proof of the pudding is in the eating, and 2014 will have to meet or beat those expectations to drive equities still higher. Even if, as we expect, Canada’s economy merely matches consensus forecasts, upside surprises in global growth (Figure 1) should deliver that fuel. Our Top 10 looks at the economic developments likely to be key in shaping investor returns in 2014.

1. Lighter US fiscal drag

Whatever your view on the urgency of deficit reduction, government belt tightening has been a significant negative for growth. That was particularly the case in Europe in 2012, and in the US in 2013—years that appear to have marked their near-term peak for fiscal contraction.

That albatross hanging over the global economy won’t vanish in 2014, but will be substantially lighter (Figure 2). Washington has no political appetite for another shutdown in a mid-term election year. Look for Congress to reach a less-than-grand budget deal and call a temporary truce, just ahead of the mid-January deadline. Even the Republican-proposed spending levels under the current contingency resolution entail less of a new drag on growth than what we saw in 2013.

It’s unclear if that fiscal trend extends to Canada. While governments were generally ahead of plan in fiscal 2012–13, soft nominal GDP in the past year could leave some provinces seeking new budget cuts or revenue hikes in 2014. If so, the fiscal swing

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Figure 1

Real GDP growth rates (see last page)

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<td>3.8</td>
<td>3.5</td>
<td>4.3</td>
<td>4.5</td>
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</table>

* at Purchasing Power Parity.

Source: CIBC.
will initially mean more for export-oriented sectors than those targeting Canada’s domestic markets. Canada’s advantage lies later in the decade, when Ottawa will have some elbow room while Washington could be returning to restraint.

2. Restored momentum in EM

Market chatter about a slowing pace to the developing world’s growth reached a peak when Fed tapering talk heated up. But these economies will be emerging, not submerging in 2014, with a little help from their friends in the developed world.

The emerging markets slowdown dates back two years. No doubt, some of it reflects self-inflicted wounds from policy decisions made in the likes of China, India and Brazil. But these economies were made more fragile by the slowing pace in their exports to the developed world. A return to growth in Europe, and an acceleration in the US, should go a long way to restoring export momentum in emerging markets. In this case, a rising tide will lift most of the boats in the EM world. For its part, China already looks to be on a much firmer path in the second half of 2013, judging by an acceleration in its raw materials imports, the most critical indicator for Canada (Figure 3).

3. Shallow glide for US rates

Bond traders don’t like to feel manipulated, so expect a lot of yellin’ about Yellen in the coming year, as the Fed attempts to steer both ends of the yield curve. The short end, of course, is guided by the funds rate, and tame inflation will have her team sticking near zero until 2015.

The Fed will also use even unrealistically dovish guidance about future short rate policies, and an opaque tapering plan, to hold long rates at acceptable levels. Judging by the last two policy statements, anything much above 3% on 10-years will be resisted. When the Fed announces its first tapering, it will cushion bond market impacts by warning that it could ramp up purchases if rates soar, and lowering the jobless rate at which it will raise the funds rate. Expect 10-years to end 2014 not much above 3% as a result, with Canadian 10-years on a similarly shallow glide-path (Interest and Exchange Rate Forecast).

4. Don’t expect BoC hikes until ’15

In contrast to the Fed, forward guidance has become less forward at the Bank of Canada. Governor Poloz is more forthright than Mark Carney in acknowledging the imprecision of such longer term forecasts. In dropping the warning of a rate

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**Figure 2**

*Japan aside, fiscal tightening eases up*

<table>
<thead>
<tr>
<th>Fiscal Drag (%-pts)</th>
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<tbody>
<tr>
<td>2013</td>
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<tr>
<td>US</td>
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<tr>
<td>UK</td>
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<tr>
<td>EZ</td>
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<td>Jp</td>
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Source: IMF, CIBC.

**Figure 3**

*China: re-enter the dragon*

<table>
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<tr>
<th>Auto Sales (Sept)</th>
<th>Housing Starts (Q3)</th>
<th>Electricity Use (Sept)</th>
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<tbody>
<tr>
<td>Aug/12</td>
<td>Dec/12</td>
<td>Apr/13</td>
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<tr>
<td>Copper</td>
<td>Crude Oil</td>
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</table>

Source: NBS, Bloomberg.
hike to come, he hasn’t really turned neutral. The Bank’s base case clearly still has the next move as a hike, but it’s too far out to mention.

We don’t expect the Bank to hike rates until early 2015. Unlike the last two cycles, today’s 6.9% jobless rate (Figure 4) doesn’t mark full employment, as confirmed by tame core CPI and wage inflation. Not only are more than 900,000 Canadians involuntarily working part-time, but frictional unemployment is less of a problem with fewer new young workers entering the job market, EI benefits less available, and immigrants more likely coming with jobs in hand. Look for inflation to stay at or below the 2% target even as the jobless rate drops to 6.2% by early 2015.

5. Asymmetric monetary policies

Even with the overnight rate stable at 1%, Canadian fixed income markets, and the C$ for that matter, will be pricing in just how quickly short rates will be raised after 2014. Asymmetries in monetary policy impacts will mean the likely answer is: not very quickly. Canadians have heavily dipped into credit for past consumption and housing purchases. The lack of pent-up demand, and the existing stock of debt, will have the economy less sensitive to the continuation of low rates as a growth driver.

In contrast, the larger stock of debt implies a much greater than historical sensitivity in consumption and housing when interest rates do climb. Because a little will mean a lot in terms of cooling demand, Canada could be at only a 2% overnight rate (a zero real rate) even with the output gap closed at the end of 2015. Still, that will remain a full point above the US rate, and even further from the ECB, which due to banking fragility, will have to be even later and gentler, a reason we see the C$ gaining on the euro and range-bound vs the greenback.

6. Growth lifts industrial demand

These haven’t been the best of times for much of the commodities world. From oil, to natural gas, to base metals, there’s been much attention paid to surging supply from technology changes or new production facilities. Mining equities have also struggled in the face of cost overruns.

But demand counts too. Softer growth in emerging markets, a recession in Europe that only recently ended, and subpar US growth, weren’t a rosy backdrop for materials stocks. Firmer global growth will be critical in brightening the demand side of the ledger in 2014 and beyond. Even if there are secular trends in global supply that are working to contain prices, industrial materials equities will be a happier place if demand tops expectations.

7. Growth helps Canadian earnings

It’s been a reasonable year for the TSX, but the Toronto market was left in the dust as New York soared to record highs. That was very much about fundamentals; the US earnings recovery has to this point far outpaced Canada’s. In 2013, bottom-up forecasts for double-digit earnings growth for the TSX composite were far too rosy.

But stronger global growth ahead is the sauce for a catch-up in earnings performance. Our top-down model, which had anticipated low single-
digit earnings growth for 2013, now sees 12% earnings gains in 2014 (Figure 5). If so, valuations for TSX equities don’t look particularly rich when benchmarked against historical norms for year-ahead PEs. Overall, equities linked to global growth will fare better than those tied to domestic spending, or conservative stocks previously in favour as mere substitutes for low yielding government bonds.

8. Housing a drag on growth

Largely due to sated demand rather than climbing interest rates, the forest of cranes in Canada’s housing sector will be chopped down to size in 2014. The prospect of higher mortgage rates has brought forward sales activity into the fall of 2013. But developers are less impressed.

In Toronto, for example, condo completions are slated to spike sharply in 2014, running ahead of trend demand. Most of those units are already sold, but risks of excess supply are tempering the pace at which new projects are now being launched.

Nationally, that trend has seen homebuilding flatten out in terms of its contribution to GDP, en route to being a drag on growth as we move further into 2014. The relative paucity of pent-up demand for housing and related durables is a key reason why we see Canada’s growth held to 2.3% even with the US speeding up to a 3% pace. The silver lining is that a pull-back in new supply will help contain the pace of local housing price corrections when interest rates climb more materially in 2015.

9. Business capex upturn

Fortunately, as the housing cranes come down, the oil rigs should be going up, along with a broader climb in business capital spending on machinery and equipment. Capital spending has been weak in Canada, given the heavy tilt towards resources and related infrastructure, and a shaky outlook for global growth that bred caution in corporate plans.

That looks to be turning, not because of firmer spot prices for resources, but because of diminished downside risks to future prices. CIBC’s oil services analyst expects to see a return to growth in Canadian E&P capital budgets, and we have recently seen the green light announced for major oil sands projects. Also on the drawing board are a new facility in the potash sector, a number of electric power projects and, a bit further ahead, pipeline and LNG projects.

Manufacturing capital spending budgets could still be on the lean side, given the challenges posed by a still-firm Canadian dollar. Canada’s manufacturing has not seen the recovery that is underway south of the border. The gap has been particularly wide in capital intensive industries, which have led the rebound stateside. That is part of the backdrop of superior productivity growth stateside, which allows higher wages to be paid out, but also implies that Canadian manufacturing should be less sensitive to rising interest rates than the sector will be in the US.

10. Capture the 65+ market

Capturing the youth market remains the mantra for tech companies trying to reach the trend-setters.
But in terms of the longer term trend, it’s age before beauty, as older cohorts continue to increase their share of the population. From now until 2020, spending by those over 65 is expected to grow at roughly twice the pace as overall Canadian household outlays. Of course, in 2014, we’ll all only be one year older. But those investing for the long term should keep their heads up for sectors that will capitalize on this trend, including wealth management, health care, leisure airlines and the like.

### Interest and exchange rate forecast

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### Exchange Rates

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Source: CIBC.
Canada: regions latch on to the global recovery

Emanuella Enenajor, Economics and Warren Lovely, Macro Strategy

There’s been little reason to cheer Canada’s economy recently, with a weak external sector casting a shadow on growth prospects. But already, with the eurozone exiting recession and signs that US performance in 2014 could get a solid boost from easing government restraint and improving housing, global demand could quickly swing from a headwind to a tailwind for Canada. While that should make for a better performance on the national level, some regions are poised to share in the upturn more robustly than others.

No great rotation in economy yet

The outgoing year has been one of unforeseen shocks for many provinces. Flooding took a notable toll on Alberta’s economy in June, although reconstruction work looks to mitigate any dampening effect to 2013 GDP. For Saskatchewan, the announced break-up of an international cartel weighed on potash prices, hitting profitability and production plans. Such unforeseen challenges have weighed on provincial growth, also making for more challenging arithmetic on the provincial fiscal side.

But at a higher level, things haven’t exactly been going according to the Bank of Canada’s plan either. The hoped-for rotation in growth away from domestic demand and towards exports and business investment has yet to materialize (Figure 1). Indeed, soft global growth has held back exports and weighed on commodity prices. While oil production has increased briskly, reflecting the benefits from earlier years of investment, weaker resource prices and global overcapacity have reduced the incentives for new investment in the metals sector.

As for Ontario, the boom in US auto sales has failed to translate into a pick-up in vehicle production. Recent line closures only add to the ongoing loss of US market share in that key sector (Figure 2), signalling a diminished correlation between US and Ontario
demand. In light of those developments, the long-standing economic performance gap between western and central Canada has shown few signs of fading.

West is best again in 2014

A rising tide of US growth will be a boon to Canada’s economy, particularly the factory sector—but with the legacy of a rising currency and shuttered production capacity, it won’t be enough to see that industry regain its previous might. While housing has showed remarkable buoyancy in mid 2013, a rising profile for borrowing costs suggests the sector could see a renewed slowdown in 2014—a risk that particularly bears watching in Ontario. For central Canada, that means economic performance no better than the national average in 2014 (Figure 3).

In Atlantic Canada, New Brunswick’s economic growth could accelerate on gains in forestry production in light of improvements in US housing, while Nova Scotia enjoys a boost to production from rising natural gas output at Deep Panuke. But for the region as a whole, unfavorable demographics and interprovincial outmigration should continue to weigh on prospects, keeping growth there tracking slower than Canada as a whole.

Western Canada, yet again, will be the biggest winner with rising global growth helping to push commodity prices higher and support resource sector capital spending (Figure 4) in 2014. That alongside ongoing gains in energy production should see Alberta’s economic growth lead the pack.

Sum it all up and, while Canada’s provinces are set to benefit from the rising tide of external growth, not all regions will benefit alike. With Canada’s commodity producers set to steal the spotlight yet again in 2014, persistent regional economic divergences are set to factor prominently in the makeup of domestic growth.
US: more room to run for the housing recovery

Avery Shenfeld and Emanuella Enenajor, Economics

If there’s one thing bond and equity markets are telling us, it’s that better things lie ahead for the US economy. And while many are hanging their 2014 hopes on an easing in government spending cuts and tax hikes, there’s less clarity on the issue of housing. Against a backdrop of rising long-rates as the Fed ends its quantitative easing program in 2014, concerns are mounting that the momentum in that important sector of the economy is fading, and could weigh on growth. But there are clear signs that the US housing market still has a long way to grow—gains that will be important in providing another leg up for the recovery.

Based on housing starts, homebuilding activity eased after a strong start to 2013, due primarily to slowing momentum in multi-family homebuilding. But for property development companies, new multifamily construction still looks attractive. Rental vacancy rates have been steadily declining, pushing up rents in the process (Figure 1). Further supporting continued gains in homebuilding, the excess supply of housing inventories that plagued builders earlier in this economic recovery has all but vanished (Figure 2), depleted by still-low construction volumes and recovering demand.

That in turn has prices on the move, with existing home prices rising well above 10% annual rates. The trend in prices hasn’t been lost on Americans thinking about dipping their toes back into home ownership. Unlike a year ago, a majority of Americans now expect housing prices to climb in the coming year (Figure 3), and also expect higher mortgage rates ahead. The anticipated increase in costs could be a powerful motivation to buy sooner rather than later.

The missing ingredient for single family, owner-occupied homebuilding has been mortgage availability. Rates are still extremely low by historical standards, so the larger issue is improving availability. We may be on the precipice of just such a turn. Mortgage originations for new purchase...
have been heading higher (Figure 4, L). Banks are reporting easing standards on new mortgages (Figure 4, R), largely through smaller down payments.

All told, we look for housing starts to climb from well below 1 million in 2013 to almost 1.2 million in 2014, with headroom for further growth to 1.5 million over the next few years. For Canada’s forestry sector, that could signal more upside in both production and price terms, given the substantial tilt towards US demand (Figure 5). We see lumber prices climbing to $410/k bd ft by mid-2014.

For the Fed, the housing sector represents a key source of upside to economic growth in 2014. As a result, the Federal Open Market Committee (FOMC) will likely lean against a too-rapid climb in bond yields that threatens housing. Look for 10-year rates to be on an only-gradual climb higher through 2014.
European strategy: edging away from the cliff

Jeremy Stretch, Macro Strategy

After two years of contraction, the outlook for the eurozone looks somewhat brighter in the upcoming year. This is in part by virtue of reduced fiscal drag, with improving financing conditions and stronger domestic demand pointing towards a modest expansion, not yet fast enough to ease the external debt burden. Economic competitiveness across the periphery has benefitted from the painful process of internal devaluation. Additionally we have seen narrowing current account imbalances, even if eurozone critics would argue that this is a function of internal devaluation crushing domestic demand. Reduction in underlying risks has led to a substantial compression in long-end spreads, alleviating financing pressures and helping to underpin our view of above-consensus expansion in 2014.

Crisis mentality easing

The crisis mentality that had prevailed since the first leg of the Greek crisis in 2010 has dissipated, helped by the resumption of eurozone growth—activity turned positive in Q2/2013 after six straight quarters of contraction (even if the gain owed much to German seasonal influences). A strong resolve to avoid another summer of political uncertainty ahead of the German election also served to boost sentiment. Political stability and a return to growth have together helped to ease previously-elevated euro break-up risks. Such positive influences have been added to presumptions of the European Central Bank (ECB) being prepared to support peripheral bonds, if necessary, while the maintenance of elevated levels of global liquidity provided positive conditions for peripheral bonds. This supportive combination has helped to lower funding costs, narrowing spreads and underpinning recovery hopes (Figure 1).

Need for painful internal devaluation

Two of the primary risks of the single currency regime, which have been writ large during the crisis proved to be significant current account imbalances, and a lack of peripheral competitiveness. Recall how a reduction in borrowing costs post the euro’s arrival opened the way for peripheral consumers to aggressively increase consumption. This extended current deficits to excessive levels and boosted the German surplus in the process. In effect, the eurozone acted as a microcosm of global imbalances. Indeed, the combination of unsustainable current account positions and rapidly rising unit labour costs in a number of peripheral economies created an untenable situation.

Figure 1

Spreads narrowed from crisis highs

Source: CIBC.
Hence the need for the painful process of internal devaluation; via lower wages and cuts in government spending, which—when accompanied by rising levels of taxation—take an aggressive bite out of living standards. Conducting such measures against a weak external environment was always going to be painful as the rest of the eurozone belatedly followed Germany’s HartzIV reforms from 2003. However, we are now seeing some success from the process as improved macro-economic competitiveness led to a narrowing of the gaps in unit wage costs.

We have also seen current account imbalances diminish with, Greece aside, the bulk of the improvement coming via rising exports, rather than merely a collapse in imports (Figure 2). Critics of the eurozone project argue that to further alleviate sizeable imbalances would require Germany to further lower its current account surplus. This would have to come via stronger domestic demand, perhaps as a function of looser fiscal policy or perhaps a weaker currency to boost peripheral competitiveness, or perhaps a combination of both. With Germany implacably opposed to tolerating higher inflation, via domestic wages or looser fiscal policy, current account distortions are not likely to disappear.

### Structural reform requires patience

Structural reforms, with tightening fiscal policy offset by a loose monetary policy stance, always require a degree of patience. While there is a greater degree of macro-economic optimism than has been the case for the last couple of years, the eurozone remains a slow burning scenario, which underlines that while default and exit risks have been minimized they are not negligible.

Despite some improvements in competitiveness, the continued advance in unit labour costs in countries like Italy, when combined with ongoing political instability, underline the lurking risks (Figure 3). While the growth dynamics are more encouraging, the advance will not be sufficient to arrest rising unemployment, in particular youth unemployment (Figure 4). The resulting pressure on consumer finances will add to potential deflationary tendencies.

### Wary of deflationary risks

While the ECB argues that deflationary risks are modest, and we do not see aggregate consumer prices trending towards deflationary tendencies, downside price pressures across the periphery remain considerable (Figure 5). Such influences add to concerns relating to the advance in the ratio of...
government debt to GDP, falling prices being set against static nominal government debt values. Markets are for now happy to pick up peripheral debt for a comparatively low risk premium over German bunds. As a result, the periphery benefits from lower financing costs. But, without an advance in underlying growth, ongoing deflationary tendencies may eventually remind market participants that over the long term debt burdens could eventually prove unsustainable.

In this context, we cannot ignore the impact of the currency. We regard a “fair value” level of EUR USD to be around 1.24, moderately above the value at the start of the process in 1999. Although recent highs have barely taken us 10% above fair value, we would regard the EUR as a headwind to growth. Germany can easily withstand currency strength, but it mitigates peripheral recovery hopes and adds to deflationary tendencies. Our bias towards an above-consensus economic performance in 2014 is at least partly predicated upon the single currency providing stimulus.

While a modest EUR depreciation will help alleviate deflationary concerns and sustain hopes for above-consensus growth expectations, the pressure on the ECB to maintain an exceptionally lax stance will remain considerable, albeit at the expense of further splintering the consensus within the ECB.

Looking towards the AQR

Ahead of the ECB taking on the role of banking supervisor, 128 banks across the zone, 85% of institutions, have to face up to the Asset Quality Review (AQR). Unlike the two previous rounds of stress tests, which were rightly derided due to the subsequent banking collapses, the ECB cannot be seen as overly lenient this time around and has set an 8% capital to assets ratio. We can expect relatively harsh treatment of any balance-sheet shortfalls, with the unintended by-product of banks reining in lending in an attempt to meet the requirements. Capital requirements may prove to be a catalyst for the ECB dipping into the unconventional policy tool bag once more via an additional Long-term Refinancing Operations (LTRO), this as the lack of progress on European banking reform, notably single resolution mechanism, remains a potential structural flaw.

Structural flows aside, the improved financial conditions, easy monetary policy, improved competitiveness and reduced break-up fears portray a eurozone that has edged a little further away from the edge of the cliff.
Asian strategy: still emerging strongly

Patrick Bennett, Macro Strategy

The coming year shapes up for Asia as one where a key influence is going to be investor attitudes toward the management of global quantitative easing programs—whether continuation or curtailment. Attention will be on how those processes impact regional asset markets and, in turn, influence local policy making decisions.

The shape of Asian growth will also owe a tremendous amount to the path of growth in China. The world will be watching how the Chinese leadership progresses with ongoing efforts to rotate growth away from an investment-heavy model to one of a greater influence of consumption.

Watch impact of tapering

So long as fears surrounding the tapering can be contained, 2014 will be a year during which divergent economic performances are better-reflected in relative currency performances than has been the case in the last few years. This has hitherto not been the case due to the predominance of the so-called risk-on and risk-off moves, where many assets in the same class are simply dealt with in the same indiscriminate manner.

Our expectation of markets where fundamental strength is rewarded and flaws exposed is in fact driven in part by this type of trade developing during the last months. Without doubt, there is a general fear around the prospects of the Fed tapering its asset purchases. While this has been discussed elsewhere in this publication, it is useful to remind readers of the Asian case.

Asian financial markets have been considered the beneficial recipients of global easing programs with stock markets and asset prices driven by the flow. The thinking thus goes that as soon as the liquidity tap is turned off (if even only a “quarter turn” or less), money will flow out of Asia, currencies will be put under pressure and regional central banks will be forced to defend against the outflows by raising rates. Messages in that vein have certainly been heard in Asia during the last months.

However, we take some issue with such a simple characterization of why Asian markets have been buoyant—if in fact they have—and of the belief in the response function simply being that money will stream from the region and put assets and economies, via monetary policy responses, under threat.

But don’t dismiss the strong fundamentals

Emerging markets globally are set to post GDP growth in 2013 of around 5%. In Asia the figure is closer to 6%, in no small manner underpinned by

Figure 4

Asia current account surpluses stabilized in 2013

Source: CIBC.
China posting growth somewhere around 7.5%. Of the Asian growth, a growing proportion can be traced to resilience in external demand, itself a result of greater inter-regional trade, which has compensated for still-soft demand from developed economies.

More Asian trade now goes to other Asian economies than to developed markets. China is Taiwan and South Korea’s largest trade partner. Where China goes so too do these economies. Looking at the numbers, Asia’s current account surpluses have stabilized in 2013 (Figure 1) and, on assumption of moderate global growth in 2014, can improve.

There are of course economies in Asia that are burdened by trade and/or current account deficits, some also with fiscal deficits. The occurrence of tapering, at whatever pace, certainly exposes these weaknesses. Indeed there was notable withdrawal of portfolio flows and currency weakness in select economies May through August as prospects for tightening were priced. The underperforming markets were predominantly those of Indonesia and India, less so but still impacted were the Philippines and Malaysia.

**Portfolio flow and pressure valves**

We note, however, that portfolio flow stabilized, and in some cases started to return to these markets even before the FOMC passed on the opportunity to begin tapering in September (Figure 2 & 3). We infer that investors have rightly already taken stock of the likely impact of tapering—and the fear that is whipped up around the talk of it beginning looks overplayed.

The pressure valve for economies facing deficits is a weaker currency and we should be encouraged that the process is working. These are not the bad-old days of 1997 when fixed or near-fixed exchange rates and inflexible policies devastated the region.

Asia faced 1997 and emerged chastened and ultimately in better shape, and the same happened during and after the tech-bubble burst of 2000–01. When the financial crisis of 2007 and beyond unfolded, Asian economies neither had the previously-high leverage that the developed economies now do, nor were they reliant on foreign flows to fund deficits.

Solid economic fundamentals in the fashion of moderate growth, (mostly) low inflation, currencies that are by and large on the cheap side of fair value, and policymakers willing and ready to respond to...
shocks, put the Asian region in good stead for 2014. Add in China having avoided a hard landing in 2013, and in our opinion tracing a more sustainable path, and the prospects for the coming year are bright.

**China**

The outlook for China itself is of steady growth, overseen by reform-minded leaders. It is worthwhile to once again reacquaint ourselves with the 12th 5-year plan in China (through to 2015), from which all other policy initiatives flow. China’s shift in emphasis from quantity to quality of growth was enshrined in that plan. Likewise was the determination to steer the economy from an over-dominance of investment and infrastructure as platforms of growth, to a greater emphasis on consumption. Consumption as a share of GDP was 36% in 2012. That is nowhere near ideal, but real consumption growth during 2008–12 averaged 9%, according to World Bank and EIU data. China is a huge economy and change necessarily takes time. What we should not doubt is the commitment of policymakers to the task.

The third plenary session of the 18th Chinese Communist Party recently concluded in Beijing. The key points to come were the reiteration of steady growth, adjusting structures and deepening reform. Further, the plenum stated that the market should play an increasing role in economic reform and in improvement of the modern market system, with the state nevertheless remaining dominant. These initiatives will form the framework of the 13th 5-year plan.

Once again reform and restructuring have been emphasized, and if the price of that is modestly lower growth then that will be accepted. Expectation is that China is very likely to target 7% growth in 2014 against a 7.5% target in 2013. Few, regardless, would have ever believed China could continue at the breakneck pace of the last 10 years. Neither did China.

It is noteworthy that, as we head into 2014, the state of the Chinese economy is probably not one of the first two or three areas of concern that investors are focusing on. Certainly it won’t be far away, but we must be encouraged by policymakers staying on course, and by the diminished fears of a Chinese hard landing or of a credit market crash.

**Asia is well positioned for 2014**

Check the equity market performance during the last three to four years and you will find that the broad MSCI Asia ex-Japan index has done no more than track sideways (Figure 4). To suggest that there is a threat to all markets as the Fed tapers because prices have already been driven to unreasonable heights just doesn’t stack up.

With generally positive fundamentals and asset markets that have not been excessively inflated by global easing, the Asian region is well-positioned to post solid growth and returns in 2014. Periods of doubt over the impact of liquidity withdrawal will ultimately provide better entry to investment opportunities in the stronger economies of the region.
LATAM and the Caribbean: good policy matters

John H. Welch, Macro Strategy

In Latin America, 2013 marked a year when good and bad economic and market performance were determined by good and bad policy. This separation resulted partially from global stability. There was no large trend upward or downward in commodities prices. The US, Japanese and European economies continued on a path of slow recovery, although at different paces, and China’s economy stabilized at a lower but still high growth rate. Hence, the environment was ripe for a delineation of performance according to types of policies. The prospects for 2014 will fall along the same lines, especially in the face of less monetary accommodation in the United States. Those countries that have pursued responsible policies will weather the increase in interest rates much more robustly than those countries that have not.

Unfortunately, much policy debate since the 2008–09 crisis has centered on ideological mudslinging between the so-called developmentalists and neoliberals. When faced with deteriorating economic performance, policymakers in Argentina, Brazil, Bolivia, Ecuador and Venezuela continued to double down on the very policies that have led to poor performance, such as increased government intervention, loose fiscal policy, protectionism, and loose monetary policy. We have now added Brazil to this group of countries as the policies that the government has pursued since 2008 virtually assure a one-notch ratings downgrade and have made a two-notch downgrade, to below investment-grade, significantly more likely.

Contrast that performance with the countries that have pursued responsible fiscal, monetary and trade policies such as Chile, Colombia, Mexico and Peru. Despite most having or will have center left governments, they have stuck to the fiscal straight and narrow, along with continued reform. Good economic performance has followed with approximately 4.5% (unweighted) average growth. These countries are well positioned for even better economic performance in 2014 and market performance should follow.

The overall asset performance in Latin America in the second-half of 2013 became hostage to the fears of the US Federal Reserve “tapering” its asset purchases. The first (over) reaction occurred mid-year when Fed Chairman Ben Bernanke suggested the possibility of reducing these asset purchases. Images were conjured up of the selloff and blowups in Growth Markets following the Fed tightening of 1994–95. Those started with Orange County defaulting in Q2/1994, and became explosive with the Mexican devaluation and float in December of the same year. In June 2013, Growth Markets, following their 1994 lead, sold off and the US$...
strengthened dramatically. As the market became more accustomed to the idea, selloffs close to FOMC meetings became less intense. Then the Fed decided not to taper despite the fact that the market was ready. The strong rally in Growth Markets that followed means that we will likely go through the same process all over again. Now that the market has started to discount a December tapering, value has once again returned to Growth Markets, credit and currencies.

As in 2013, the relative performance of Latin America’s asset markets in 2014 should reflect these policy differences. In the group of LATAM countries in our focus—Brazil, Chile, Colombia, Mexico, and Peru—Brazil was the largest underperformer both in credit and in rates as we had anticipated in our 2013 publication.

Growth slows but remains robust

The performance of LATAM assets has followed economic performance. Figure 1 shows that Latin American real GDP growth is slowing and that Brazil is a major underperformer. From a market standpoint, Figure 2 shows that Brazil has underperformed the other low-beta countries—Peru, Colombia, Chile and Mexico—as measured by 5-year CDS spreads. Figure 3 shows that high-beta Argentina and Venezuela have underperformed all, including their European counterparts. The continued radicalization of economic policy in Argentina, in addition to the ruling by the New York courts, has made a technical default a high probability event. Meanwhile in Venezuela, economic policies have deepened the country’s challenges.

After feigning a change in direction on policy, the Rousseff administration has met poor growth and higher inflation with mostly the same policies that it has pursued over the last three years. Despite clear signs that higher protectionism, government intervention, and loosening fiscal policies have hurt growth, the Brazilian government continues to provide demand-side stimulus. One good sign is that the central bank is tightening monetary policy but loose fiscal and public sector credit policies make the central bank’s task all that much harder. Fiscal looseness has helped erode external accounts and has put Brazil on a collision course with at least one downgrade in 2014 and a possible second downgrade if policies do not change significantly. Unfortunately, the World Cup in June and July and presidential elections in October reduce the possibility of policy change substantially.

Mexico, Peru, Colombia and Chile, in contrast, have continued to pursue prudent monetary, fiscal and
trade policies. Peru and Chile are running virtually on autopilot as their openness, nominal fiscal surpluses, and good growth rates do not require major reform efforts. Colombia has implemented a number of reforms including tax reforms but further efforts should wait until after the 2014 presidential election. The new Peña Nieto administration in Mexico has passed a number of important initiatives including education, labor, and media. At the time of writing, we expect the Mexican congress to pass a major constitutional reform opening up energy—that is, oil and electricity—to foreign investment for the first time in more than 80 years. We remain strongly constructive on Mexico’s asset markets for 2014.

The prospects for the region for 2014 and 2015 follow directly from the policies put in place in the last few years. And poor performance, at some point, should force a change in policies in those countries that have strayed from the responsible path. That keeps us constructive on the region in the medium to long term.

The Caribbean struggles

Partially because of policies and partially because of the double-barreled nature of the 2008–09 crisis, most Caribbean countries have found themselves in serious economic and fiscal shape. Their economic difficulties continue to increase as the moderate recoveries in G3 countries have yet to translate into increased tourism or financial services growth. Other than the lucky few that are primary goods exporters, most countries in the region rely almost exclusively on tourism and financial services. Figure 4 shows the level and growth rates of tourism for the English-speaking Caribbean. After peaking in 2012, the recovery in tourist arrivals has seemingly stalled, perhaps waiting for more sustainable growth in the US and UK, recovery in Europe, and more robust growth in Japan.

As fiscal strains in the region have continued to deepen, Jamaica restructured its internal debt on the way to an IMF agreement. The Jamaican government has financing for the next three years but in 2014 the effects of current reforms on growth need to start to kick in for success within that time frame. Barbados has seen a significant deterioration in its fiscal accounts, prompting a strong reaction from the government. Consequently, Barbados has seen its S&P Sovereign credit rating fall from BBB– to BB– since December 2012, and still has a negative outlook. As in all austerity-cum-reform programs, implementation is crucial and will test the Barbadian government in 2014. The Dominican Republic implemented large austerity with reforms at the end of 2012, which should start to pay off in 2014.

Although facing much more difficult challenges than their LATAM counterparts, we remain cautiously optimistic on the Caribbean in light of these recent efforts.

Figure 4

Caribbean: tourist growth indicators

Source: Bloomberg, CIBC.
Energy commodities: North American revolution rolls on

Katherine Spector, Macro Strategy

The market is still coming to terms with massive, rapid growth in US oil and gas production. Our expectation is that North American oil and gas prices will remain severely handicapped relative to broadly supportive global energy fundamentals. The macro-economic, geopolitical and energy market implications of the US boom will remain a major in focus in 2014.

We are looking for Brent crude to average $110/bbl next year, WTI $100/bbl, and Henry Hub natural gas to average $3.70/mmbtu.

Supply still rules global oil balance

While US oil production (including non-crude liquids) has grown by about 2.4 mbbl/d in the past three years, with another 0.6 mbbl/d of growth from Canada, non-OPEC supply growth outside of the two North American producers has netted close to zero. In other words, while oil supply is growing a lot in the US, it’s not growing in too many other places. A combination of general geological decline and a host of unplanned production outages have plagued non-OPEC as a whole, while OPEC producers themselves have certainly been no strangers to bad luck.

Global oil demand growth has plugged along at a slow but steady rate for the past several years, but record levels of cumulative unplanned supply outages globally have required Saudi Arabia (assisted, to some extent, by Kuwait and the UAE) to pump at record levels for months at a time to maintain market balance (Figure 1). In fact, the market’s precarious balance over the past three years begs the question of how prices might have looked without the tremendous growth in US oil production.

Similar to 2013, in 2014 oil supply, rather than demand, will be what really moves the price dial. There are simply too many countries where production could end up looking significantly better or worse than it does now, depending on—often binary—geopolitical outcomes.

Broadly speaking, we continue to see global oil prices tracking the $80–$120/bbl band to which they have been restricted for the past several years. However, we continue to favor the higher end of that range given our pessimistic bias when it comes to recovery in supply-side trouble spots such as Libya, Iran, Iraq and Nigeria. We continue to have more confidence in an $80–$85 oil price floor than we have in the $120/bbl ceiling; relatively high marginal production costs in North America mean that growth there would slow if prices spent any meaningful time at the lows.

Figure 1

Oil production outages keep piling up

Source: EIA, CIBC.
North American crudes

The most interesting moves in the oil market in 2013 were in West Texas Intermediate (WTI) timespreads, and in various grade spreads [e.g. WTI vs Brent, WTI vs Light Louisiana Sweet (LLS), and WTI vs Western Canadian Select (WCS)] (Figure 2).

In 2013, the US Midcontinent was effectively debottlenecked thanks to additional pipeline and rail takeaway capacity. But the fact remains that the US, by law, does not export crude oil. Although volumes are now making their way to the US Gulf and the east and west coasts with greater ease, what was previously a Midcontinent bottleneck is now an overall US bottleneck.

The massive growth in US crude production is, importantly, all light sweet crude oil. Last decade, light sweet crude commanded a massive price premium over heavy sour barrels, and as a result, US refiners (and, for that matter, refiners all over the world) invested significant capital in upgrades that would allow them to run a heavy sour barrel without sacrificing their yield of light end products. Since the tight oil boom, though, US refiners are swimming in light sweet supply.

The US is already well on its way to entirely backing out imports of light sweet crude. In addition, refiniers are making minor adjustments to run a slightly lighter slate of crude.

But at the end of the day, the US is oversupplied with light sweet barrels. Now that a Midcontinent crude, like WTI, competes directly with a US Gulf light such as LLS, those grades are trading closer together; both are trading well under Brent. This is a relationship that we expect to persist, and perhaps even deepen in 2014.

The discount of WCS to WTI has tracked a very wide range for the past two years; recently, the Albertan benchmark has traded as much as $42/bbl under WTI, and as much as $54 under Brent. WCS remains handicapped not only by infrastructure, but by the fact that just six US refiners buy about half of the crude that Canada exports. The WCS discount is widest when one or more of those key refiners are down for maintenance. We would expect WCS to average at least $25 under WTI next year, but expect periods of much weaker pricing during periods of refinery outages.

North American natural gas

It is hard to see much upside for North American natural gas in 2014. For the time being, both US gas supply and demand are very rapidly price elastic. Supply continues to grow even at low prices;
infrastructure debottlenecking in the east may even accelerate supply to market next year, and the fact that producers got a good opportunity to hedge forward production at $4+/mmbtu in early 2013 effectively gives them a license to drill for at least another 18 months, even if spot prices deteriorate.

On the demand side, the past two years have provided an excellent blueprint for how utility demand for natural gas—which represents about half of total US gas demand—responds to price. At low gas prices—say, sub-$2.50/mmbtu—burning gas is cheaper than burning even the cheapest type of coal (Powder River Basin) (Figure 3). At that gas price, new gas demand is created, putting a floor under prices. At higher gas prices—around $4.20–$4.30/mmbtu—gas starts to lose market share to pricier, Central Appalachian coal. Gas demand is destroyed and prices are capped.

Again in 2014, we believe it will be difficult for gas to top those levels for any sustained period of time. If by some chance they did, we would expect the supply response to be substantial and that would also limit the sustainability of any upside in the gas price.

Beyond the next two years, as US coal plants are retired and replaced with natural-gas-fired capacity, we would expect the gas competition band to shift to a durably higher range. That structural change is not imminent though. We will get more color on the timetable for coal retirement next year, when the US Environmental Protection Agency releases its rulemaking for how carbon pollution will be regulated at existing coal-fired power plants. Those regulations may accelerate or decelerate the coal retirement schedule.
Exhaustion and renewal in the oil patch

Adam Gill, Arthur Grayfer, Jeremy Kaliel, and Jon Morrison, Equity Research Oil and Gas

Following one of the most revolutionary periods in the North American energy sector, the industry finds itself in a time of pause and reset. In many ways, this is nothing new. Over its existence the Canadian energy sector has been in a perpetual cycle of growth and recoil, driven by commodity price volatility, geologic depletion, technological advancement and new resource discovery and development. Over the past 50 years Canada’s energy sector has experienced a total of 19 industry pullbacks [measured by y/y declines in exploration & production (E&P) capital spending] and, to a large degree, we believe history will largely repeat itself. With that said, as the current cycle resets and Western Canadian Sedimentary Basin (WCSB) activity levels begin to accelerate once again, we believe the magnitude of the pending 2014 upswing is poised to be more pronounced (and have a longer positive momentum) than any previous cycles as technological advancements, increased foreign capital and long-term LNG development plans will represent chargers for the WCSB.

Technological change continues

If you review the history of Canada’s oil and gas sector over the past 150 years, you’ll find that the overall technological advancements and pace of change were fairly muted until the turn of the 21st century, when the industry realized more advancements between 2000 and 2010 than the sector experienced in the preceding five decades. In addition to the adoption of horizontal drilling and multi-stage fracturing treatments, a plethora of other advancements such as the development of invert drilling muds and cross-linked completion fluids, advancements in drill bit technology and the application of reservoir modeling and microseismic software have allowed the WCSB to move from a tired conventional basin to an emerging unconventional powerhouse. With continued advancements in oilfield services technologies there is now a plethora of tight reservoirs such as the Bakken,
Montney, Duvernay and Horn River that provide Canada with decades of production growth ahead.

We see four sub-themes for 2014:

1. **Fund flows return to Canada**
   While most of 2013 has been marked by weak international flow of funds into Canada, we believe this situation has already begun (and is to continue) to reverse. If we use ETFs as a proxy for funds flows (Figure 1) investment in the Canadian Energy sector indeed appears to be returning. The three key reasons for these positive flows: (i) the relative underperformance of the Canadian sector vs the US (causing US investors to look north for value); (ii) continued strength in North American oil prices; and (iii) clarity on additions to Canadian Rail capacity (which could add over 700,000 bbl/d of oil takeaway capacity by 2015).

2. **Thirst for yield**
   The growing thirst for yield continues to favor dividend paying energy stocks with near-term dividend sustainability. While dividend sustainability was somewhat strained for E&Ps early in 2013 and remains a focus of investors, we do not believe a wave of dividend cuts is imminent given improved commodity prices (Figure 2). With junior E&Ps continuing to instate dividends, however, we expect the suitability of underlying assets for the long-term sustainability of the dividend model to remain under scrutiny in 2014 like never before.

### Figure 2
**Dividend sustainability reasonable**

![Table](https://example.com/table.png)

While we believe dividend sustainability is somewhat strained for some names, we do not believe that a wave of dividend cuts is imminent for the group. Under current forward strip commodity prices, we believe Bonterra, Crescent Point, TORC, Vermilion, and Whitecap currently have the most sustainable dividends. If commodity prices face a sustained downturn due to a warm winter (gas) and/or punitive differentials (oil), we believe Lightstream, Pengrowth, and Spyglass would likely be the first to show strain under our metrics if commodity prices were to worsen and if we were to ignore proceeds from dispositions.
3. **Expect continued activity on the M&A front**

Due to the application of new technology unlocking large resource potential in Western Canada, we have seen meaningful foreign capital looking to be deployed in the energy sector. The drivers for the investments are many: large resource potential, low geological risk, a stable political environment, and depressed commodity prices due to a lack of infrastructure accessing global markets. This investment has taken the form of outright acquisitions and joint-venture partnerships (JVs).

We believe the trend of foreign capital accessing Canadian resources through JVs will continue. Although over the last number of years, the majority of foreign JVs have taken place between large National Oil Companies and larger producers where there has been substantial resource scale being developed (i.e. oil sands, etc.), recently there has been a number of these partnerships occur on a smaller scale with smaller Canadian E&Ps (Bellatrix for example). The rationale for JV investments (in addition to the reasons mentioned above) is that the JV structure allows foreign entities access to cutting-edge technology being employed in the WCSB by experienced operators, of which many of these foreign investors have limited experience utilizing. In addition, the JV structure is likely more amenable to the Canadian Federal Government (as opposed to outright foreign acquisitions) as it does not result in a majority controlling interest, meaningful influence in the industry, and the sale of large Canadian resources to non-Canadian entities. As such, we believe there is likely to be an increasing number of JVs announced over the near to medium-term (Figure 3).

4. **Production growth always in style**

While true production growth on a per share (PPS) basis may be hard to find, the companies that can achieve it will continue to be rewarded. Companies with the highest PPS growth in 2014E include Tourmaline (45%), Peyto (24%), Paramount (62%), and TORC (32%).

**Top picks**

We remain biased towards higher-quality names with more visible growth prospects, strong balance sheets, and better dividend sustainability (often tolerating premium valuations for these qualities when warranted).

As such, our top picks today among the E&Ps include Paramount (POU-T, SO), Peyto (PEY-T, SO), Tourmaline (TOU-T, SO), Trilogy (TET-T, SO), and Vermilion (VET-T, SO). Our top pick among energy services stocks is Precision Drilling (PD-T, SO).

### Figure 3

**Foreign joint ventures and acquisitions likely to continue**

<table>
<thead>
<tr>
<th>Year</th>
<th>Company</th>
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<tbody>
<tr>
<td>Mar/10</td>
<td>ECA &amp; KoGas</td>
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<td>Apr/10</td>
<td>Sinopec &amp; Syncrude</td>
</tr>
<tr>
<td>May/10</td>
<td>PVST &amp; China Inv. Co.</td>
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<td>Oct/10</td>
<td>TOT &amp; STG</td>
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<td>Nov/10</td>
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<td>Mar/11</td>
<td>PWT &amp; Mitsubishi</td>
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**Source:** Company Reports, CIBC.
Lending to the energy sector

The energy lending market represents roughly 35% of the broader syndicated loan market in Canada. This level has remained relatively stable over quite a number of years given Canada’s significant bias to resource industries in general, and more specifically to energy which includes upstream (conventional production in addition to oil sands enterprises), midstream players (natural gas processing and trading), downstream (refining and marketing/distribution), and pipelines (hydrocarbon transportation).

Generally, the domestic oil and gas lending market can be delineated into three broad categories. Firstly, the junior exploration and production (E&P) lending market is typically served by its banks via a credit facility called a Reserve Based Loan (RBL), which is essentially a secured arrangement where the amount of credit extended is reviewed semi-annually via an exercise called a Borrowing Base Redetermination. This Borrowing Base is derived via a present value calculation, which essentially embeds forecast production (less expected operating costs) at the then current commodity price forecast of each financial institution, resulting in a present value figure using a discount rate of between 7% and 10% depending on the institution. To the extent that a credit facility is syndicated, this exercise is one of consensus building amongst the lenders to arrive at an agreed Borrowing Base level every six months.

Secondly, the intermediate E&P enterprise would normally arrange a financial covenant-based credit facility, which would normally be syndicated given its size ($1.0–$2.0 billion).

The key difference between this type of credit facility and the RBL noted above is that it is governed by a set of financial covenants (versus a Borrowing Base that is reviewed semi-annually). This type of credit facility may be secured or unsecured; however, it is far more flexible and reflects the inherently larger and more diversified obligor risk profile.

Finally, the most flexible type of unsecured credit facility would generally be conveyed to the highest quality (investment grade) energy obligors with very flexible financial covenant patterns. These borrowers would tend to be large, integrated Canadian energy players. Given the very high capital requirements in the Energy sector (particularly infrastructure and oil sands development), such borrowers tend to maintain some of the largest syndicated credit facilities in Canada and indeed have some of the best senior debt ratings for corporations in Canada (outside of financial institutions). This reflects the very large, long-term investments they require and the inherent volatility of commodity prices over time, both of which cause those borrowers to operate with relatively conservative capital structures.

Very large credit requirements of the energy sector have resulted in a broad and diverse energy bank lending market in Canada. Canadian financial institutions contribute a large component of these requirements, but both foreign and regional banks also play an important role in raising and maintaining adequate credit support for energy firms.
Global banks are all material players in the energy lending market in Canada, including Asian banks which have had a long standing presence in the Canadian energy landscape. Importantly, there has been a fairly steady flow of new entrants into the space over the past several years.

This is all to say that the energy lending market in Canada remains extremely robust and, in fact, one of the most dynamic and competitive lending markets in Canada. Loan losses in the energy sector have historically been extremely low—therefore, it is a very attractive market to deploy credit capital for most banks. The ancillary revenue opportunities in this sector are very compelling, including M&A, commodity and foreign exchange hedging, equity capital markets and debt capital markets. Overall, the energy sector in Canada has developed a global perspective, which explains why global E&P “super majors” in addition to National Oil Companies have all developed or acquired substantive operations and expansion plans in Canada.

Looking ahead to 2014, we expect a relatively stable environment with mostly flat credit spreads, perhaps even with a downward bias, given the competitive landscape and continued modest inflow of new entrants to the energy lending market. All banks will remain focused on returns on capital including ancillary revenue; therefore we expect a reasonable level of price discipline. The demand for energy loans from regional banks with limited capability to deliver ancillary services will likely provide an effective cap on any upward margin pressure. Generally, we can expect the current market to continue to function in a balanced and effective manner and thus serve the needs of the energy sector demand quite efficiently.

That said, we can also expect Canadian banks to continue carrying the majority of lending support for the Canadian energy sector. Indeed, we are seeing Canadian banks looking to expand their energy lending practices to a broader global client set that appears very interested in engaging in this regard.
Fundamental drivers of the mining space

Mining Research Team

“Mining activity” supplies the raw material the world needs and wants in order to prosper. In investment terms this relationship has to be expressed in numbers. To most people, economic growth or improving prosperity is measured in Gross Domestic Product (GDP) growth rates. A good GDP growth rate implies more wealth for each individual in the particular economy and that, in turn, implies that these individuals will be spreading that wealth by acquiring more “things”—from the very basic in terms of clothing and food to houses and ultimately even luxury items that are not needed, but certainly wanted. Historically, this growth in the demand has coincided with, if not precipitated, the growth in metals commodity prices (Figure 1).

The good news, we believe, is that this is clearly understood by the very governments that have forced interest rates to near-zero levels. We are confident that these governments will realize that a sustained recovery, and the corresponding increase in GDP, require confidence that the current stimulative monetary policy will be maintained, in the face of ongoing repair of household, bank and government balance sheets.

So, per the commentary of our economics team elsewhere in this publication, we see the end of low rates, but we see the rising rates profile being exceptionally slow—allowing for a continued and sustained improvement in GDP growth rates. Such a scenario should spell a prolonged environment where mined commodities will see steadily increasing demand. There lies the golden nugget—we believe this could be a long run improvement, delivering an ideal long-term investment. With such growing demand trajectories, we want to invest in mining in general, but need to pinpoint individual markets to find current supply-demand balances that are already indicating shortages first. Following those, we’d be looking for mined commodities where the markets may well get into deficit soon while, for now at least, steering clear of markets that hold little promise of getting into a tight balance any time soon.

Broadly constructive on the economy

CIBC Economics’ view that global GDP growth should top 4% for the first time since the recession’s tail end, combined with an easing in fiscal drag and the lagged effect of monetary stimulus, underlines our broadly constructive view on the global economy and commodity markets in 2014.

In China over the short to medium term, we believe that commodity consumption will be supported by rising household incomes, continued urbanization and...
ongoing national level infrastructure developments (Figure 2). As highlighted by our Asian strategist, the shift from capital formation to domestic consumption should have a positive impact on the metals and in particular we would highlight an increase in steel consumption and thus potentially iron ore (if current oversupply reduces) and metallurgical coal. However, we anticipate that this will be a gradual process over many years and one that may deliver positive surprises along the way. We remain more constructive on the industrial metal complex, as improved domestic consumption will continue to boost demand for copper and PGMs.

The following individual sections will highlight our preferences based on specific metals markets in terms of supply-demand balances and outlooks. From a broader perspective though, Figure 3 illustrates the fact that a run in the S&P usually coincides with a run in commodity prices (both driven by economic growth expectation). The big divergence in the late 90’s saw the bursting of the Tech Bubble but the current run in the S&P could be pointing to commodities being priced too low. Alternatively, commodities, and hence mining shares may well offer a very good investment hedge against a possible pullback in the S&P. This view is further backed by very clear evidence across the mining space of sharp reductions in capital expenditure and aggressive reductions in future output growth.
Metals and mining: don’t skip past a sector in transition

Tom Meyer, Equity Research Metals and Mining

2013 was another volatile and downward trending year for the base metal equities. In fact, the first quarter of 2011 marked the last high for the metal equities and metals. Since then, the erosion of value has been at times gradual and at other times violent, but it was an erosion that resulted in significant value destruction, particularly at the smaller cap end of the spectrum. We believe that, as we close out 2013, the sector developments of the past few weeks and months should generate optimism for a better 2014. The problem is we are not convinced anyone is paying attention to the fact that these companies continue to adjust corporate and operating strategies to manage the difficult market conditions. It takes time to implement needed change due to the reality that the first response to low prices is the tendency to blame the market. As low prices linger for longer than expected, net cash balances erode as does the belief that the time for higher prices will soon be approaching. In due course the need for transformation is forced upon the industry; however, it takes months or a few quarters to fully implement. The point is, companies can and do respond to lower prices, eventually, provided flexibility exists in the asset base to do so. We see the coming year as one of margin improvement mostly driven by improved costs but also price support. For us, the most interesting investment opportunities for 2014 are First Quantum (FM-T, SO) and Teck Resources (TCK.b-T, SO). We think both companies are better-positioned or shall we say, tooled, to harvest strong cash flow in key commodities as well as navigate through and take advantage of the ongoing industry challenges and opportunities outlined below.

Selective commodity support

We believe copper and metallurgical coal are best positioned to outperform in 2014, predicated on reasonable demand driven by emerging Asia and balanced by supply growth—which may disappoint. Other metals such as zinc, lead, nickel and molybdenum have supply dynamics that signal to us that we have a good amount of time before we should expect material price increases.

Schedule- or budget-driven?

Those familiar with the mining space over the past few years now think more deeply about crushing and grinding circuits specifically, and project execution in general, than they did earlier in the cycle. There have been enough project disappointments to cause many investors to steer clear of any company with a significant project pipeline. We see change underway. Over the past few years many companies were more schedule-driven with their projects than budget- or cost-driven, and therefore were willing to overspend to meet time commitments. We sense a shift towards increased focus on cost rather than building as fast possible. For some companies this was always part of their mandate, while others have learned or will be learning a new approach.

Shortages abound – different ones

When commodity prices are high and rising, there is a rush towards brownfield expansions and greenfield projects, which creates immediate
shortages of labour, equipment, power, tires and just about everything needed to produce a tonne of coal, concentrate or metal. When commodity prices retreat, these shortages evaporate but new problems arise. The high prices have attracted higher-cost marginal tonne projects and operating assets from previous cycles; their cost structure leaves little cash left over to sustain the business or cover debt obligations. As a result, a shrinking handful of robust companies that are investable across a broad investor base follows. As such, for the better-quality companies, we anticipate multiples to expand based on the scarcity value of higher-margin operating assets.

My social license – the issuer

Not surprisingly, Corporate Social Responsibility and maintaining or attaining social license is likely to be a feature again in 2014. This theme, evident around the globe, is rooted in the history of local communities having had the final say in allowing a project to proceed, and who independently issued the social licence to operate. Contrast this with the current situation where outside opposition groups can disrupt or materially influence the local permitting process, leaving local communities without an independent voice. In some instances it also results in a world with fewer raw materials needed to improve global living standards. It is becoming apparent that without checks and balances on how outside opponents raise money and disseminate information about specific projects, the mining industry will remain at a disadvantage. Stepping up Corporate Social Responsibility programs helps, but the industry needs to do a better job at educating the public about responsible resource development.

Our take – on tax

The probability of any one of the favoured mining jurisdictions undergoing a review of corporate or mining taxes/royalties in a given 12-month period is very high. As commodity prices go up, so does the risk of detrimental tax changes. At times, the low-tax-rate jurisdictions can sometimes be the riskiest places to invest since the pressure to increase taxes can be higher than the pressure to decrease taxes. Although tied to Corporate Social Responsibility, we feel the industry must do a better job in educating the public and politicians about the true cost structure of the industry. The investors fronting risk dollars for the capital-intensive projects must be duly compensated as should the state and the local communities allowing the exploitation of the resource. Unfortunately, the focus on “cash cost” versus the “all-in sustainable cost” has made the sector easy prey for tax increases. The apparent high margins on a “cash cost” basis are not so high after factoring in the many other costs incurred to sustain the business. Ongoing education of the public and government on this topic is required, and not just during election time or when a government is in transition. In most jurisdictions the bias is still for higher taxes, and we expect a volatile 2014 on this front.

Selling margin when needed most

Observe the paucity of secondary or primary equity financings in 2013 as highlighted by Scott Smith earlier in this document, recall the high-yield issuance frenzy of 2012 and watch the periodic announcement of streaming deals, equipment financing or the rare offtake sale in order to fund project development. These are challenging times for many companies who have been increasingly forced to forego long-term net margin in order to obtain needed capital. 2014 may be too early but at some point the market is going to think through some of these funding deals and wonder if the financing was on as attractive terms as originally thought. Once the optimized mining project has exhausted the higher margin “payback ore” in the early years, the lower margin remaining reserves are still burdened by the gold and/or silver stream commitments. Future price cycle swings may
exacerbate the margin squeeze and therefore the risk profile of the asset in the later years. The discussion on when conventional or traditional financing packages will come back into fashion is on now.

**Step back from the edge**

As mentioned at the outset, the past two years of poor performance from the commodity and equity perspective has, we believe, culminated in a shift in thinking, such that the industry is in the process of enhancing margins and asset values for today’s price environment, rather than maintaining last year’s practices for tomorrow’s higher prices. This forced discipline is positioning the companies for an improved 2014 relative to 2013. As first evidence of this we witnessed a number of surprisingly strong cost improvements in the Q3/13 reporting period. Until now, it has been one thing to simply announce cost reduction plans but it is another thing to be able to demonstrably reduce costs at a faster rate than the commodity prices are declining.

**But about that policy**

Although the foregoing commentary implies we have a constructive view on 2014, there is one topic that gives us pause. The seeming randomness of central bank action is our greatest fear for 2014. The voices are many, the messages are mixed, the acronyms are cryptic and the idioms keep changing. What they do, how they do it and when they do it cannot be known. What we do know is that the stakes are high as are the risks of unintended consequences. To that end, in our view, the hard asset nature of the base metal and minerals industry is ultimately a natural hedge to our current debt-based fiat currency system.
Gold: bringing back the luster

Alec Kodatsky, Equity Research Mining

2013 seems unlikely to be remembered as the year gold posted its first average annual price decline since 2001. But many are likely to recall how the price declined, with bullion roiled by a cascading sell-off in April that saw prices fall by more than $200/oz (or 12%) in only two days. While the mechanics of this sell-off may be debated for years, the root cause can be traced back to shifting investor expectations for rising interest rates (vis-a-vis Fed tapering), a stronger US dollar, and persistent low inflation. This negative dynamic for gold was further enabled by profit taking in the gold ETF that quickly pushed significant supply onto an unwilling market.

2014 looks set to offer its own set of challenges as many of the headwinds for gold appear to be entrenched. However, although data dependent, we can now see an upside argument for gold and believe that a significant amount of “bad news” has already been factored into the price. We currently forecast an average 2014 gold price of $1350/oz, roughly similar to where the commodity trades today.

Absent significantly lower inflation and/or much higher US 10-year yields, at current levels gold appears appropriately priced. Should inflationary pressures begin to emerge, or “safe haven” buying of US treasuries once again pushes yields lower, we see upside potential for gold. Downside risks remain should US yields rise more aggressively than expected or US dollar strength emerges. In the background, we must be cognizant that the holders of the ETF remain an intangible, and important, factor for gold prices.

Long term we remain constructive on gold as deteriorating reserve bases, rising production costs and continued physical demand present a positive fundamental dynamic for prices. And we continue to believe that the unwinding of QE over the coming years offers a probability that unintended consequences caused by these extraordinary policies emerge. Consequently, we continue to believe investors should maintain exposure to the sector.

What’s really driving gold?

To create a view for 2014 we believe insight can be gained from how expectations for 2013 played out. In April 2013, market consensus expected Fed tapering to start by the fall (if not sooner); higher US interest rates would follow and there were no signs of imminent inflation or devaluation of the US$. In the background, European debt concerns were also subsiding for the first time in two years. This began to generate headwinds for gold focused on two points: (i) with US and European economies getting back on their feet there was reduced...
need for “safe haven” investments; and (ii) rising interest rates, and in particular higher real rates, diminished the appeal of non-yielding investments like gold. Standing on the doorstep of 2014, we are still awaiting the start of Fed tapering, the US and European economies have yet to decisively turn the corner, and the US dollar has been relatively stable. Notably, gold prices have not recovered, leading us to believe these issues hold little influence over pricing at the moment.

However, in the US, 10-year yields have risen significantly, breaking sharply higher in May only one month after the breakdown in gold, and inflation readings have remained low, measuring sub-2% throughout 2013. Consequently, US real rates have risen consistently throughout the year, and, as shown in Figure 1, have emerged as one of the better inverse descriptors of gold price behaviour over the past four years. The monetary policy has further support through Central Bank purchases, which continue at a similar pace to the levels observed over the past several years and remain a key support for the physical market responsible for ~9% of gold demand 2013 YTD (Figure 2).

You may have a view on gold after all

Despite some price stability in recent months, investing in gold continues to remain out of favor. Many investors don’t have a particular view on the direction of the commodity and this has emerged as a key hurdle to becoming more active in the space. We would suggest that if you have a view on US 10-year rates and US inflation, you can formulate a view on gold prices.

Except in periods of financial duress (i.e. 2009), gold prices tend to struggle in a rising real rate environment, but can gain positive traction when real rates stabilize or decline. For real rates to continue to move higher, 10-year yields need to rise and/or inflation must decline further. With the latest October inflation reading at 1.2%, we see little room for inflation to fall further without instigating fears of deflation. We also see limited scope for a material rise in 10-year yields, which could present a risk to the US housing market (and balance sheet) and would appear contrary to the stated Fed policy to keep rates low for an extended period of time.
Physical demand remains intact

Although gold may have fallen out of favor with the financial markets, this has not been the case in the physical markets. It is also important to bear in mind that gold pricing tends to be highly centered on US data, while views toward owning physical gold vary widely by region. In the current price environment with most large projects being deferred and existing production bases being stripped of marginal, low profit ounces, we believe it will be unlikely that gold supply can surprise to the upside. We therefore see demand as a long-term driver of higher gold prices.

China has notably emerged as the world’s largest producer and consumer of gold, and we expect both relative positions to be maintained in 2014. The country’s current consumption greatly outstrips domestic production, necessitating the importation of significant quantities of gold. With the ongoing process of reorienting the economy toward increased consumer consumption, we think this should result in sustained improvement in China’s future gold demand (Figure 3).

Look to low-cost producers with growth

Gold companies are moving to respond to the drop in gold price with cost cutting efforts and margin improvement programs taking clear priority over production growth. In this most recent quarter we have been generally encouraged by most companies’ ability to rein in costs, but the process is not yet complete. Although increasingly expected by the market, we anticipate that most year-end reserve and resource updates will offer another period of volatility for the sector as mine plans are adapted to a lower gold price environment. Given these challenges we prefer exposure to lower cost producers that can better weather any further downturn in prices, ideally combined with near-term production growth that can help to offset the impact of lower gold. Within the group of senior and intermediate companies we feel Goldcorp (GG-N, SO), Yamana (AUY-N, SO), Agnico-Eagle (AEM-N, SO), Eldorado (EGO-N, SO), and Randgold Resources (RRS-LSE, SO) best fit this description. Amongst smaller gold producers preferred names would include: B2 Gold (BTO-T, SO); Osisko (OSK-T, SO); Primero (P-T, SO); and Alamos (AGI-T, SP). Finally, in the royalty space we would recommend Franco-Nevada (FNV-T, SO).
Silver: gold’s red-headed sister
Leon Esterhuizen, Equity Research Precious Metals

Silver is often described as the poor man’s gold. This reference is supposed to relate to the fact that it is significantly cheaper and thus easier to buy than gold, but this may well be a reference to how poor silver investors have become of late.

What has been driving this collapse in price is the view that gold has become very vulnerable to a possible improvement in the real interest rate environment in the US. Gold and, thus, silver always perform exceptionally well when real interest rates are declining and particularly if they go into negative territory.

In such an environment, the holding cost for gold turns negative so the investor is literally “paid” to hold it and thus the price goes up. Silver, being almost tied at the hip with gold, tends to react the same in terms of direction, but with some added “gusto.” So silver should really be seen as gold, but with an even more volatile trading character (Figure 1).

Although the long-run ratio between the gold and silver prices varies quite considerably over time, it should be clear that silver really does tend to largely follow gold. In that sense, silver is a bit of a problem metal because it also has large industrial application [like the Platinum Group Metals (PGMs)], and should therefore have a significantly more defensive nature when economic growth accelerates. However, since gold is under constant pressure in these environments, silver still suffers.

Although industrial demand is a crucial part of this market, it is very clear that it is investment demand that currently drives this price. This is also where much of our concern lies. Over the course of the past year and a half, the silver price has declined over 50%—leading the decline in gold that really only got going in a big way in 2013, ending up down over 30% at the time of writing.

The really interesting aspect of these two “crunches” is the fact that much of the gold price collapse can be attributed to the massive reduction in gold ETF holdings (over 700 t or about 35% of the entire gold holding at the start of the year), whereas silver ETF positions seem oblivious to the very low price of silver.

Figures 2 and 3 illustrate the fact that silver ETF investors seem to have a dramatically different view of the future potential of the silver price relative to the gold ETF buyer's view of the future for the gold price.

Herein lies both the key to investing in the silver market and the obvious significant risk of a dramatic capitulation or sell-down in the silver ETF if the silver price drops even lower (potentially being dragged lower as gold declines in an environment of rising...
real interest rates—assuming “tapering” does indeed start taking place in 2014).

The “key” to silver, most silver bugs believe, is the fact that it has an industrial application. So, the argument goes, this will drive the silver price higher. We need to point out, though, that most of silver output is from other mining. Some 60% of all silver comes from gold, zinc and/or lead mining, where it is mined as a by-product.

Primary silver mining represents less than 30% of total mine supply and only 20% of total supply (scrap supply is roughly 25% of total annual supply).

Importantly, the amount of by-product silver is enough to fully cover current total industrial consumption. Investment demand (or specifically ETF demand), therefore, is the key to continued primary production and/or even to expand.

This is not a normal or usual supply-demand equation where marginal cost of supply determines the price—if investment demand declined sharply, by-product producers would not stop supplying the metal, but even low-cost primary supply may have to be shuttered. Some 200 kt of annual investment demand is needed every year to keep the silver price up (in line with primary supply being 20% of total supply, this is in the order of 20% of total demand).

Taken together, we think the risk of the silver price declining sharply in future is very high (again, primarily driven off our more conservative gold price outlook).

**Investment opportunities**

Given the constant need for new silver investment demand, and our more conservative view on gold over the short term, our view on the silver price is negative. We see the silver price dropping to a long-term average level in the order of US$18/oz with the ETF position remaining key. In other words, if these ETF holders were to sell in the same way as we have seen in the gold ETF, the downside in the short term could be substantially higher.

For this reason, our positioning in silver remains biased to low-cost producers, such as Tahoe Resources (THO-T, SO), Fresnillo (FRES-LSE, SP) and a silver royalty plan such as Silver Wheaton (SLW-N, SO). For people with a more positive view on the metal price outlook (people who don’t see the ETF as a risk, but simply a reflection of robust investment demand that will not change), Endeavour Silver (EDR-T, SP) and Fortuna Silver (FVI-T, SP) should offer optimal exposure given aggressive growth projections at lower costs.

![Figure 2](Image)

**Silver ETF vs the silver price**

**Figure 3**

**Gold ETF vs the gold price**

Source: Bloomberg.
Lending to the mining sector

Global lending volumes returned in 2013 to the record levels reached prior to the 2008 financial crisis. Mining companies enjoy very good access to bank lending as they refinance corporate credit facilities used for general corporate purposes. Given the lower level of M&A activity in the mining sector in 2013, acquisition-related bank financing has been light in comparison to previous years.

As we approach 2014, lender interest in the mining sector remains solid, and in fact has increased as certain banks recommitted lending capacity to the sector last year, having worked out some of their liquidity and capital issues brought about by the financial crisis. In the process of committing to corporate credit facilities, lenders are also increasingly seeking to deepen ancillary business with their clients.

Tempering the overall optimism, two areas appear weaker compared to previous years: lending to the precious metals sector and project financing. After 10+ years of improving gold prices, 2013 will mark the first year of material gold price decline. There is a healthy level of skepticism as to the outlook for the gold price. With material increases in overall costs of production, the financial outlook for the gold sector is less certain. This combination of events will likely lead to some pull back by the banks who lent to the sector during the bull market, albeit we expect most banks to continue to take a long-term view towards this cyclical sector that they have historically supported.

Project financing attracts a subset of global mining banks who continue to maintain close relationships with their mining clients and find that longer-term, funded loans provide higher revenues and better returns than unfunded corporate revolvers. However, over the last several years project financing became less attractive to both the corporates and the banks. Increasingly stringent environmental and social due diligence requirements for project loans have created challenges and delays. Many corporates will now entertain project financing only as political-risk mitigation in more challenging jurisdictions, falling back on capital markets to finance projects where political risk is less of a concern. Internal liquidity premiums and higher capital requirements for funded term loans, which increase with the duration of the loan facility, drive lenders to increase pricing for actual drawn loans to reflect the actual cost of doing this type of business. This has resulted in a material shift in the underlying cost of project financing post the financial crisis and has required more price discipline by lenders with increased costs ultimately borne by the mining customers in the form of increased spreads on project finance loans.
Platinum and palladium: precious base metals

Leon Esterhuizen, Equity Research Precious Metals

The world has been in the “drink” for a number of years now with central banks across the globe pumping money into the system to encourage economic growth and to prevent deflation and stagnation. That the picture is still a bit more than just precarious would not seem that obvious given significant equity market rallies—over the past year in particular. If the market view is correct, then the global economy is about to start showing proper signs of life again. Gone are the concerns about no growth or even low growth.

If we assume, for now, that this is indeed the outlook for 2014, then it certainly holds a very decent possibility of higher commodity prices as global economic growth leads to increased commodity demand. The PGMs are precious metals with significant industrial application with at least half of all the production of these metals applied to catalytic converters that go into the exhaust systems of cars and trucks where they strip bad gasses from the exhaust gas stream (Figures 1 and 2).

The important point to note is that no car can be sold without a catalytic converter. For this reason, the actual price of the metal has zero impact on demand—security of supply is the critical issue, not price. So, in simple terms then, if the world grows at a good pace again, the world will most likely also be buying a lot more cars and trucks. As it stands at present, in a relatively low-growth environment, global auto growth is running at a steady 4% to 5% per annum for a total auto market in the order of 80 million vehicles.

The average PGM loading per car across the world has managed to settle at about 4 g/car on a rather consistent basis when one takes account of platinum, palladium and rhodium combined (Figure 3). On the simple basis of 4 g/car and assuming 5% growth per annum in the amount of cars, the new demand for PGMs will be around 1.3 moz of PGMs over the next three years. This does not take account of large trucks and/or any possibility of future demand linked to the advent of the fuel-cell car (in this application, the PGM use per car is expected to be at least six times as much as the current use).

This represents a demand growth forecast of at least 10% in the PGM market over the next three years. Given the average PGM mine has a capacity to deliver some 200 koz per annum, this growth implies the need for at least five new mines over the next three years. Over the next three years, we see production expansion of 900 koz out of South Africa with roughly another 200 koz from North America—almost matching the demand. Offsetting this, there is a very clear possibility many of the older mines closing down or being scaled down as cost increases turn them unprofitable.
Given the palladium market is already trading in a deficit of some 800 koz, this scenario implies a continued tight market potentially getting much tighter as the older mines are shut. In the platinum space, a sharp increase in Chinese and now Indian jewelry buying is also expected to add pressure.

Investment demand, as seen in the investment in ETFs, is a crucial part of the puzzle. In platinum, this investment demand drives or is responsible for a tight market, while in palladium, even if we exclude this demand, the metal should remain in short supply. So, our current metal price forecast is for a significant escalation in the PGM price basket into 2014 and 2015.

**Investment opportunities**

Although the metal price view is very constructive under the assumption that global economic growth will return to much higher levels over the next two to three years, the equity view is far less so. Most of the mining companies active in this space are in South Africa—in fact, South Africa produces some 73% of the world’s platinum and some 40% of the world’s palladium with Norilsk Nickel (GMKN-RU, not rated), a Russian company, responsible for about 45% of the world’s palladium supply. That leaves very few companies operating outside these markets with only two companies active in North America.

Given the known socio-political risks in South Africa, and combining this with generally very high equity valuations (with the market already pricing in significantly better commodity prices for most stocks), investment potential is rather limited. We believe a simple ETF exposure (directly to the metals) or buying into a North American producer like Stillwater Mining (SWC-N, SO) to be probably the safest way to take part.

Still, outside of these obvious possibilities, there are at least three other interesting angles. The first is to buy into very good long-term exposure based on exploration success. Ivanhoe Mines (IVN-T, SO) and Platinum Group Metals (PTM-T, SO) fit this bill very well. PTM, a Canadian junior, also has a significant new low-cost discovery that is still expanding. In both cases, we believe very little of the resource base quality is currently expressed in the share prices.

Secondly, for the more adventurous, Aquarius Platinum (AQP-LSE, SO) represents a junior operator in South Africa that could deliver a significant geared increase in the share price if the metal prices were to increase meaningfully. Finally, Eastern Platinum (ELR-T, SP) is a company with some C$100 million in cash while its operating mine has been mothballed until the metal prices improve—essentially offering a very clean option on the market, particularly since it is trading at less than half the implied cash value in the company.

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Source: Johnson Matthey, CIBC.
The significant drop in metals prices and underperformance of mining equities dampened global mining M&A activity in 2013. Deal activity, as measured by aggregate transaction value, was down significantly from 2012 to levels lower than those during the global financial crisis driven by continued uncertainty over commodity pricing, cost overruns, capex inflation, project delays and geopolitical risk (Figure 1).

The slowdown in mining M&A activity was just as pronounced in Canada, with the aggregate transaction value down approximately 23% over the first three quarters of 2013 compared to a similar period one year ago (Figure 2). This year’s slowdown follows the already steep drop-off in Canadian mining deal activity that occurred in 2012, in which the aggregate transaction value tumbled by approximately 49% from 2011 levels. Although this slowdown is a global phenomenon, its effects have been most pronounced in North America and Europe, where their combined share of global aggregate mining transaction value dropped from an average of approximately 55% in the 2010 to 2012 period, to only approximately 38% YTD.

When considering the root causes for this slump in mining M&A activity, a few key drivers stand out. Foremost among these is the increased volatility exhibited by metals prices in 2013. With the prices of gold and copper falling almost 30% and 20%, respectively, from their highs at the beginning of the year to their lows this summer, the uncertainty of the direction of the commodity prices has led buyers to be cautious about pursuing M&A, despite potential targets trading at much lower valuations. The impact of this decline in the gold price appears readily apparent as the aggregate transaction value in the precious metals space has closely mirrored the recent drop in underlying gold prices (Figure 3).

The level of deal activity in the mining sector has been further constrained by recent cost overruns and capex inflation that have impacted a number of major producers. Barrick’s (ABX-N, SP) Pascua-Lama project in Chile offers a telling example with development costs, initially forecasted at $3 billion, climbing to $8.5 billion and expected to climb further still (the project has been put on hold). The impact of overruns on the operational side has been exacerbated by tight capital markets that remain weak in terms of new equity issuance. With share prices down approximately 30% to 40% from their highs at the beginning of the year to their lows this summer, management and boards across the sector are wary of diluting shareholders at much lower valuations. With producers focused on cost...
containment and right-sizing their asset portfolios, management teams have been much less focused on growth through M&A.

Growing geopolitical challenges have also complicated an already challenging M&A environment in 2013. In October, Mexico’s upper house of Congress approved a new mining tax that is causing alarm among producers. Brazil is also undergoing a tax reform where the government is proposing a higher mining royalty rate. In South Africa, ongoing labour unrest has significantly curtailed production at a number of sites. With governments seeking a larger share of mining revenues and tough new environmental standards and labour unrest in some of the world’s leading mining jurisdictions, the geopolitical context for global mining M&A has become very challenging in 2013.

With the increased level of uncertainty created by volatile metal prices, cost and capital overruns, falling share prices and increased geopolitical risks in 2013, the decline in M&A transactions appears to be an unfortunate confluence of factors in the mining space, even with valuations reaching their lowest levels in many years.

Price stability points to more M&A

Despite the challenging environment for mining M&A activity in 2013, looking forward there are some notable reasons for optimism. While there are no immediate catalysts for a sharp rebound in deal activity, the largest impediment to future transactions has started to subside as metals prices have stabilized, albeit at lower levels. With stability and the potential for some upward movement in prices, companies should have the confidence necessary to go forward and pursue M&A opportunities.

The growing demand for base metals should also begin to positively impact price levels. The Chinese economy, the source of approximately half of the world’s demand for base metals, continues to exhibit high single-digit growth. Although this rate of growth is slower than in previous years, it is on a significantly larger economic base and thus continues to have a disproportionate impact on base metals demand. Concurrently, strong demand from emerging economies, such as India and Brazil, further underpins the positive thesis for base metals recovery. When combined with recent production rationalization efforts, there is a clear foundation for strong base metals prices that should help to fuel future deal activity in this space.

Figure 2
Canadian mining M&A activity
(US$ bln)

Figure 3
Global precious metals M&A activity
(US$ bln)

Source: Bloomberg.

Source: Bloomberg.
Also not to be overlooked is the fact that mining valuations are still relatively low. Companies with strong balance sheets and access to capital are well positioned to take advantage while acquisition costs remain low. Furthermore, margins are still robust among copper producers and for the lower-cost gold producers. As prices stabilize, we expect companies with strong balance sheets and liquidity to pursue opportunistic acquisitions at today’s lower valuations.

There has also been a significant increase in financial capital looking to invest in this space. Private equity players, pension funds and sovereign wealth funds are actively exploring new investment opportunities. Several well-known former CEOs of major mining companies are also looking to put funds together to invest in new opportunities.

Given past challenges, markets will scrutinize each deal more carefully but will continue to be supportive of high quality transactions in our view. There are assets with moderate capital requirements that can now be acquired at fractions of their recent highs. The market is likely to be supportive of strategic acquisitions that offer the acquirer lower cost, lower risk assets. There is also a trend toward acquisitions in mining-friendly jurisdictions, which would help to garner shareholder support and minimize the execution risks post-closing of the transaction.

In the Canadian market, the depressed deal activity in the mining space stands in stark contrast to the more robust levels of recent years. Since 2012, the mining sector has accounted for only 10% of total Canadian M&A activity (Figure 4), approximately half of the 20% market share on average from 2008 to 2011 (Figure 5). A return to historical market share levels would suggest a strong rebound in mining M&A activity in Canada in 2014.

There are also a number of risks to a rebound in mining M&A activity. These include economic weakness in key end markets such as China, a resumption of price volatility that would increase uncertainty around the direction of commodity prices and the potential for continued operational challenges and cost inflation that would jeopardize project economics.

Despite these risk factors, we are cautiously optimistic that we will see the beginning of a rebound in activity in 2014. Strong fundamentals underlie the demand for base metals, uncertainty in underlying commodity price forecasts is beginning to dissipate and, perhaps most importantly, valuations remain at attractive levels for those companies that have access to capital and are willing to take a longer term view.
Balancing peak multiples with growing cash flow

Paul Lechem, Equity Research Pipelines and Utilities
David Noseworthy, Equity Research Energy Infrastructure

Canadian energy infrastructure companies are experiencing an unprecedented growth super-cycle. They made capital expenditures of $20 billion in 2012, over six times higher than the $3 billion 10 years earlier in 2002 (Figure 1). We anticipate the accelerated growth to persist at least to the end of the decade and potentially beyond.

Growth fundamentals are intact

Fundamental growth of the sector is firmly intact. We believe ongoing development of the oil sands, conventional oil, liquids-rich natural gas, and liquid natural gas exports will drive growth at similar accelerated rates as today. In many cases, energy infrastructure (pipelines, gas processing plants, etc.) has not kept pace with the rate of growth in production of the underlying commodities (e.g. crude oil pipeline and rail infrastructure, Figure 2), suggesting several years of ongoing spending in the sector. In particular, we believe energy infrastructure to support development of the oil sands, Duvernay, Montney, and west coast LNG will be in excess of $85 billion over the next decade.

The spectre of higher interest rates

We believe that the sector’s current unprecedented growth is driving sector valuations above long-run averages. As can be seen, dividend growth is highly correlated to dividend yields (Figure 3, L) and EV/EBITDA multiples (Figure 3, R).

However, the energy infrastructure sector valuation is also sensitive to changes in interest rates. Historically, as interest rates rise, energy infrastructure companies have underperformed the broader TSX Composite. Just as falling interest

Figure 1
Sector investment at record levels

Source: CIBC.

Figure 2
Crude oil pipeline and rail Infrastructure

Note: Heavy crude and raw bitumen volumes have been adjusted by 30% to reflect required diluent for transport.

Source: CIBC.
rates have been a relative tailwind for these companies over the past 30 years, we expect rising interest rates to act as a relative headwind going forward (Figure 4). In our view, those companies with the best growth outlooks will likely outpace the valuation compression associated with higher forecasted interest rates.

Near term, we expect the impact of interest rates on energy infrastructure relative valuations to be modest. In keeping with the economics view at the front of this document, we do not expect interest rates to increase materially over the next 6–12 months. Forecasts from the Bank of Canada, Bloomberg consensus and economists at CIBC all indicate a slow economy until the later half of 2014 and possibly until mid-2015. Therefore, we expect only modest changes, at most, in interest rates and bond yields over this period of time. Of course, if economic forecasts prove to be too conservative, higher interest rates will represent a drag on energy infrastructure equity price appreciation.

Demographics and a lack of yield investment alternatives should support Canadian energy infrastructure valuations. Many energy infrastructure companies have yields near or above 4%, a yield that we believe represents a threshold for income-seeking investors. Our analysis suggests that 10-year Government of Canada bonds could recover about 100 bps and still not create significant alternative investment opportunities for the yield-focused investor. We believe the negative valuation impact of a risk-on trade due to rising interest rates will be much more significant once yield investment alternatives become available and the yield-focused investor starts differentiating between yield investments based on risk.

Historical data does not support the conclusion that falling share prices should be expected in a rising interest rate environment. Furthermore, energy infrastructure companies have positive betas. Therefore, when higher interest rates are the result of an improving economy, energy infrastructure share prices should rise with the market as a whole, just at a slower rate. In addition, we would expect energy infrastructure growth rates to improve in a strong North American economy as more hydrocarbons are produced, processed, transported, and consumed.

While low interest rates are an enabler, they are not the primary driver of sector growth. While high growth and low interest rates both benefit sector valuations, we do not believe that the high sector growth rate is a direct consequence of low interest rates. We see growth primarily as a function of broad sector themes—i.e. new or growing oil sands/unconventional oil/liquids-rich gas production and the need to gather/process/transport this production to market—rather than driven merely by access to cheaper capital.

Pausing to assess current valuations

Canadian pipelines, utilities, and midstream shares have provided a total return of 16.1% y/y on a market-weighted average basis (Figure 5) and next-12-month (NTM) EV/EBITDA multiples have expanded by 1.1x.

Current valuations reflect a view that high growth and low interest rates persist through 2015, or
We anticipate valuations will likely revert toward the historical norm if and when the growth or interest rate outlook changes. Given the stock market attempts to price in changes (growth or interest rates) typically to 12 months in advance of them actually occurring, we would expect any signal of a significant increase in interest rates (>100 bps) to trigger a revaluation of energy infrastructure valuations. Likewise, if and when sector growth starts to abate, we expect valuations to come under pressure. Current investment plans suggest strong sector growth through to the end of the decade. Reversion-to-the-mean valuation likely represents a headwind, not a loss of capital. While an instantaneous reversion-to-the-mean valuation multiple would imply up to 15% lower stock prices based on next-12-month estimates (on average, excluding power producers), we do not expect this outcome. We anticipate a more gradual multi-year reversion-to-the-mean valuation to result in a headwind to total share price returns, but not an outright loss of capital, as we see earnings and dividend growth outpacing multiple compression for those companies with the best growth outlook.

For those companies with forecast growth greater than that implied by the current price, we believe there is further upside appreciation even if multiples compress to historical averages.

Prolonging the period of above-normal growth could provide significant upside appreciation. Based on our valuation framework (a two-stage dividend discount model, which captures the current above normal growth), we see support for current share prices, and even further upside if above-normal growth persists for longer than is currently modeled. We believe those names with the greatest growth, such as AltaGas (ALA-T, SO), Enbridge (ENB-T, SO), Inter Pipeline (IPL-T, SO), Keyera (KEY-T, SO), Pembina (PPL-T, SO) and TransCanada (TRP-T, SO), have the potential for the greatest upside appreciation.

\[
y = -0.0017x + 0.0043 \\
R^2 = 0.3408
\]

Source: CIBC.

### Figure 4
10-year government bond yields and equity

#### Figure 5
Market cap weighted y/y price and total return (%)
There’s certainly a lot to talk about when it comes to Liquefied Natural Gas (LNG) and what it could mean for the energy industry in western Canada and for infrastructure development in Canada generally. The emphasis, however, is still very much on the “could.”

There has been understandable enthusiasm among political and business leaders—and plenty of projections for what a thriving LNG industry would mean in terms of jobs, profits and increased government revenues.

But given the scope of the opportunity, and given the speed with which other countries around the world are rushing to get into the game and fill LNG demand, we in Canada need to push ahead with a much greater sense of urgency.

None of this is to suggest that optimism about the potential of liquefied natural gas is misplaced. A world-leading LNG export industry in Canada means jobs and growth.

It means a stronger and more competitive energy industry. It represents an important long-term economic advantage. It means significant investments in infrastructure pipelines and tidewater terminals.

But even as we consider the benefits of a successful LNG export industry, we must acknowledge that we are not there yet. The logic exists to support major investment in pipelines and export terminals. But anyone with a connection to the energy business knows that the pace of activity is far from frenetic.

In 2011, mergers and acquisitions in LNG-related transactions in Canada were valued at close to $2 billion. Last year, M&A activity hit $8.7 billion.

But so far in 2013 there has only been one LNG-related shale gas transaction (Petronas’ recent $1.5 billion purchase of Talisman’s B.C. Montney) to report and a number of opportunities haven’t managed to make it over the finish line.

More broadly in the energy sector, we are seeing evidence of the same changes in the marketplace. Year to date, Canadian Energy M&A is substantially below historical levels—just $13.3 billion, compared to $59 billion last year and $33 billion in 2011.

A couple of reasons include foreign investment in Canadian energy projects falling off significantly and equity issuance well below the norm—just over $4 billion so far in 2013, compared to almost $11 billion in each of the preceding three years.

The potential of liquefied natural gas is not eternal. The success of LNG in Canada is not assured. There is a window of opportunity, and it is closing. If Canada is ultimately to win in LNG, we need to pull together and seize that opportunity before it passes us by. And time is critical—in part because our major and only real customer for our hydrocarbons is now becoming our major competitor.

Less than a decade ago, LNG facilities were being constructed to import natural gas to the United States. Today, many of those facilities are being repurposed for export. As a result of technology and other factors, the United States can now
extract what by some estimates is a century’s worth of gas in the ground. And that brings opportunity for the US to enter the export game.

The former secretary of environmental protection in Pennsylvania put it plainly: “We literally have the Saudi Arabia of natural gas under our feet.”

With the US on the road to success as a natural gas exporter, we in Canada have entered a critical period. We need to open new markets and we face the imperative to match up our resources with the needs of the Asian marketplace.

Demand from the Asia-Pacific region, specifically Japan, has increased significantly. China is also continuing its integration into global energy markets while seeking to reduce reliance on any single market or supplier.

Canada, therefore, has an opportunity to take advantage of rising demand in the natural gas consuming countries of the Asia-Pacific.

In order to serve the global LNG demands of tomorrow, we need to get on with the necessary investments and the build out of Canadian infrastructure, because there are other nations who are equally determined to get into those markets.

The good news is that Canada has a number of advantages in LNG, beginning with geography. We are well-positioned, in a literal sense, to meet the needs of China, Japan, Indonesia, India, South Korea and beyond.

We benefit from one of the shorter supply routes to the Asian market—competitive with Australia’s. From Canada’s west coast, it takes an average of about 10 days to reach Asian markets, half the time it would take from the Gulf of Mexico.

We also have a substantial resource base, supportive governments at the provincial and federal level, and an open-for-business environment.

Canada also benefits from existing world-class energy infrastructure owned by a host of companies with proven expertise—and the track record to expand this infrastructure and efficiently move natural gas in a safe and cost-competitive manner.

But let’s be clear: in the liquefied natural gas business, the stakes are high and the challenges are formidable. We need to be confident—but we also need to be aggressive, moving with purpose to resolve six key outstanding issues.

First, a royalty regime must be defined—and defined in such a way that it promotes the establishment of an LNG industry in Canada and helps ensure its long-term survival and success. In a highly competitive global industry, it doesn’t take much to marginalize returns to the point that other jurisdictions begin to look more attractive.

Figure 1

Selected export facility projects

Source: CIBC.
Second, we need to make certain we have sufficient skilled labour to build these facilities and pipelines—and to do so under tight timelines.

Third, the federal government needs to adopt a proactive role on coastal management. Ottawa has sole jurisdiction over our territorial waters—so it must take the lead in developing a maritime management regime that will take into account the rewards as well as the environmental risks of increased west coast tanker traffic.

It will be essential—given the importance of these waters to coastal First Nations—for the government to pursue a co-management regime for those waters, together with the province of B.C. and the coastal First Nations.

Fourth, a decision must be made on how LNG facilities in B.C. are to be powered.

Fifth, the contract standoff that’s emerged between project developers here in Canada and potential customers in Asia needs to be resolved. We need to show that not only are we open-for-business, but focused on bringing trade deals with Asia across the finish line.

Finally, and with pricing very much in mind, we need to better understand and move to address the competitive challenge that is being posed by the US. Simply put, the Americans are eager to get into LNG in a big and aggressive way. That could have real implications for our ability to do the same. If we’re hesitant, if we continue to move slowly, we could wake up to discover that our competitive opportunity has vanished.

Four licenses have been approved for American producers to ship LNG to countries with or without a free trade agreement with the US. Another 18 applications are awaiting review—and there is pressure on the Department of Energy to pick up the pace of approvals.

The US is also a nation that historically has been hesitant to part with its energy—a nation whose domestic and foreign policy has for decades been influenced, and at times driven, by the pursuit of energy security. In the current environment, it appears that the administration is amenable to ease those restrictions. However, a number of buyers are uneasy about relying on US exports—and wary of clauses that grant the right to unwind contracts that are included in the export licenses.

But what’s important today from the Canadian perspective is that the competition—the US, East Africa, Australia—particularly Australia—is moving quickly to seize the Asian opportunity, and we need to keep pace. LNG growth is unfolding in real time, all around the world. The lion’s share of investment is up for grabs.

The biggest winners are far from being determined. For Canada, nothing is more urgent right now than getting in the game.

We must move forward with pace and commitment on LNG—understanding that our potential partners overseas have other options to meet their appetite for energy, and that we are not the only game in town.

We must steel ourselves to the fact that this is an industry still in its infancy; that the global market is going to continue to grow and change, with new competitors emerging, supply levels in constant flux and always with an element of unpredictability.

The benefits we offer as a competitor—our energy infrastructure expertise and our stability of supply foremost among them—position us as well as possible to thrive and to lead in the coming decades.
Basic economic and social welfare infrastructure needs account for 3.5% of the GDP spend globally. Even maintaining the status quo requires massive investment and it needs to rise to 4.1% of GDP globally to maintain the historical asset valuation. The numbers are staggering. The global think tanks and economic prognosticators estimate that the world’s economies need to invest between US$57 and US$67 trillion in basic infrastructure by 2030, just to keep pace with global GDP growth. That’s between US$3 and US$3.4 trillion annually, and does not account for spending required to update, repair or improve existing assets. According to McKinsey and Company, the US alone must increase the share of GDP it spends on infrastructure from 2.6% to 3.6%, with emerging economies such as Brazil and Mexico facing the need to double and triple expenditures. Globally, the value of existing infrastructure assets average 71% of GDP; it is as low as 16% in Brazil.

Population growth will increase the demand for energy, food and water—and fuel the growth in transport requirements. As the world population climbs to 8.3 billion by 2030 from 7 billion and becomes increasingly urbanized—it is projected that six out of 10 people will live in cities by 2030—it will require 50% more food and energy and 30% more water. Much of that population growth will occur in areas with little infrastructure backbone today, in South Asia and sub-Saharan Africa. Those countries face the daunting prospects of arid climates, unsustainable agriculture, and challenging age distributions with more than half of the population under 30. Some experts predict that by 2030, as many as 4 billion people will live with water stress, and 1.5 billion will have no access to electricity; 200 million will live on the edge of starvation.

To remedy this in even small measure, the United Nations has estimated that investment of almost 8% of GDP will be needed in the Latin American and Caribbean region just to raise the standard of living to the current level of East Asia, while East Asia needs to increase its spend to 6.9% to raise itself to the standards of Japan.

Failure to invest in the infrastructure needs within these economies and on the global scale required to build the supply chains necessary to augment local resources will compromise development and severely stifle GDP growth and employment. John Beddington, England’s chief scientist, has characterized this scenario as “the perfect storm,” leading as it will to a vast portion of the world’s population leading lives of poverty and despair.

But this is not just an emerging economies issue. The US population is projected to increase by 60 million people; the Canadian population by 4 million. Those economies will require investment not just to support their own population growth, but to service the export of energy, food and chemicals that will be needed to supply the rest of the world. Failure to invest will suppress GDP and job growth, and lead to poorer economic outcomes for the nations as a whole.

Climate change, deferred maintenance and changing growth patterns add to the investment
needs. Much of the existing infrastructure in North America and Europe was built in the heady years following the second world war, as newly prosperous families took to the automobile and moved out of decaying urban centers to brand new suburbs and planned communities, with new roads and highways, water systems and power plants built to expand the metropolis. In the ensuing decades, however, the focus was on more, not better, and very little was invested to maintain much of that infrastructure. In 2010, the US Department of Transportation estimated that the annual spend on road and highway projects in the US needed to be increased by 40%, or more than US$18 billion, just to bring the existing assets to a state of good repair, with no growth or service improvements reflected in that amount. Politicians acknowledge that sound maintenance practices are good investments in and of themselves, but the general system of government funding in most countries decidedly favors new projects and their attendant ribbon-cuttings and photo ops. But that attitude is short-sighted at best. A 1998 study by the United Nations concluded that for every dollar that was spent on road repairs, four dollars of capital expenditure for reconstruction could be avoided—a return of 400%!

The need to spend money to harden infrastructure against natural disasters is becoming increasingly apparent as well. The devastation that superstorm Sandy wrecked on the US east coast last year has prompted policymakers to examine the cost-effectiveness of upfront investments in such things as elevating buildings and electrical components above maximum flood level, providing alternative power sources for pumps, transport and communication centers, and even constructing storm gates. Initial indications are that such investments will not only protect physical infrastructure, but will also save lives and protect economic activity. Given the cost of such catastrophic losses, the argument can certainly be made that prudent investments will return multiples to public and private investors.

Changing patterns of development as well as of climate will drive massive expenditures as well. Eighteenth century water pipes buried under layers of roads and telecommunications cables and steam pipes can barely support current populations, and are almost impossible to repair or replace without large-scale direct costs and even larger prices for economic disruptions. And yet the cities of the world continue to grow. New York will add 1 million people by 2030. China alone is expected to have 221 cities with over 1 million people by 2030, with 8 being so-called megacities over 10 million in population and 23 over 5 million. Cities remain the turbo-charged engines of economic growth, with urban agglomeration acting as a multiplier of GDP—over the last 30 years, 12% of the population living in cities produced 46% of the global GDP.

This inevitable reconfiguration of the landscape from rural and suburban to urban will continue to drive the need for infrastructure spend well beyond the base amount of 3.5% of GDP needed to sustain existing patterns.

Investors see both financial and economic benefits of putting money to work in infrastructure. A number of studies have concluded that infrastructure investments can pay multiple dividends, not only financial and economic but also social and environmental. For example, investing in clean water directly benefits public health, and reduces both the social cost of disease and the very real financial costs of health insurance and hospitalization. Bringing electricity to rural areas reduces the time women spend doing household chores such as cooking and laundry, and allows them to take on employment outside the home, bringing in earnings that not only directly add to GDP but also elevate the overall household status. In India one study
concluded that the availability of electricity even contributed to the literacy rate, a benefit that has multiple run-on effects over generations.

The challenge is, of course, who will pay the costs of these infrastructure improvements. It has historically been the role of government to fund infrastructure investment, using the taxes it collects directly and indirectly from its citizens and revenues from sales of its natural resources. In the last part of the 20th century, governments began to finance infrastructure in the public debt markets, issuing bonds or borrowing from banks to accelerate the pace of development beyond that possible in a pay-as-you-go strategy. In the last decade, private equity investors have stepped in to shoulder some of this infrastructure development investment, relying on either governmental promises to repay or direct revenues from users of the assets for their returns.

As encouraging as this broadened investor base is, it is important to recognize that even if every investor fulfilled its stated intent to commit a determined portion of their portfolio to infrastructure, the total investment would be less than 4% of that required worldwide in the next 16 years.

Without clear sources of revenue and the opportunity for upside growth, the investor universe for infrastructure is likely to remain only a small part of the total need, and be directed primarily to those assets like telecommunications, power and certain transport modes where customers can and will pay a commercial rate. For the so-called social goods like water and sanitation, it is far more difficult to establish the kind of market-based pricing that will produce a commercial return.

Nonetheless, the opportunity for lenders and equity investors to participate in the global infrastructure finance market and to realize a competitive return continues to be a compelling one for many, especially for those pension funds and sovereign wealth funds who follow socially responsible investment strategies.
The global infrastructure funding markets peaked in 2008 with just over US$250 billion in loan volume (Figure 1). Loan volume growth leading up to this peak had been staggering. In 2009, that all stopped. The credit markets and global economy had been hit hard and loan volumes dropped significantly. In 2009, infrastructure lending fell dramatically to US$139.1 billion across all key regions (Figure 2) with the EMEA region being hit hardest.

Despite the noise in credit markets, European banks were aggressively lending and committing to loans with exceedingly long maturities. Coincidently, the European banks filled seven of the top 10 spots in the infrastructure lending league tables that year.

Loan volumes bounced back with fervor in 2010 and volumes climbed to US$208.1 billion, reaching over 80% of the peak, in the face of recovering capital markets, failing banks, weaker sovereigns and no monoline support. Infrastructure lending attracted lenders who liked premium pricing, drawn profiles and strong credit metrics characteristic of infrastructure assets.

From 2011 to 2013, we continued to see a recovery in the credit markets with more active lending banks and competitive terms on pricing and tenor but without any meaningful upward movement in loan volumes.

Now at the five-year anniversary of the Global Financial Crisis (GFC), the credit markets are not what they were pre-GFC but they are pretty close. Long-term debt markets have recovered in most geographies and are vibrant in others like the US where US private placement and the 144A bond is often used by foreign borrowers seeking a long-term solution. Banks have retreated to providing shorter-term maturities although long-dated bank facilities are being made available selectively by the Asian banks and some European banks. In Canada, the life insurance companies have provided long maturities for numerous renewable power deals and the bond market continues to be thirsty for public-private partnership (P3) projects. In the US, the B loan market has been especially active and has provided five- to seven-year funding to power deals with non-investment grade profiles. Asian banks now dominate the infrastructure lending league tables with six of the top 10 positions.

Looking ahead to 2014, we expect infrastructure lending to continue growing but with some headwinds. Banks are lending competitively in the

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**Figure 1**

*Global project finance loan market (US$ bln)*

Source: Thomson Reuters.

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short-tenor market, monolines are out but most geographies have some access to the long-tenor markets and this should improve significantly in the next several years. We have seen a number of debt funds established, mostly in Europe, to provide long-term debt alternatives to the numerous refinancings expected in that region.

Canada: slowing down?

Canada continues to be a favourite for financing P3 projects, largely due to its established and transparent procurement processes and the availability of both short- and long-term debt. The pipeline for P3 deals continues to remain robust as infrastructure renewal remains both a necessity and a stimulant. Ontario and Québec have historically been the most attractive markets to most banks given the substantial completion or milestone payment regime, which is conducive to short-term bank debt. Power projects have also generated good deal volumes in the past but have been tempered by lower power load than initially forecasted, resulting in excess electric supply in certain provinces and creating little requirement for incremental greenfield power generation outside of replacing older coal-fired power plants. Canada continues to develop mega projects such as Lower Churchill Hydro, Northern Gateway Pipeline, North West Bitumen Upgrader and Site C Hydro but there have been no signs of large-scale asset privatizations on government agendas.

Infrastructure loan volumes in Canada have hovered in the $3–$5 billion range annually except for 2009 where there was a major retrenchment in lending globally (Figure 3). Although Basel III implementation has reduced the willingness of banks to consider very long tenors (i.e. in excess of 10 years), many Japanese and some European banks are selectively offering long-tenor bank deals in the power sector. Canadian banks and Japanese banks are the most active deploying capital. European banks have reentered the market in Canada and are becoming more active.

Drawn margins in the infrastructure/P3 and power sectors continue to see downward pressure from the intense competition generated by international banks and alternative debt structures. Both drawn margins and standby fees continue to be at a premium to corporate loans.

Most Canadian banks continue to hold the tenor at a maximum of 10 years with many European banks having similar tenor appetite. Some European and many Japanese banks

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**Figure 2**

Global project finance loan market by geography

<table>
<thead>
<tr>
<th>Year</th>
<th>Americas</th>
<th>Asia Pacific</th>
<th>EMEA</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>138.0</td>
<td>70.5</td>
<td>42.1</td>
</tr>
<tr>
<td>2009</td>
<td>62.5</td>
<td>20.0</td>
<td>25.5</td>
</tr>
<tr>
<td>2010</td>
<td>83.9</td>
<td>98.7</td>
<td>25.5</td>
</tr>
<tr>
<td>2011</td>
<td>38.4</td>
<td>91.8</td>
<td>38.4</td>
</tr>
<tr>
<td>2012</td>
<td>67.9</td>
<td>91.5</td>
<td>39.3</td>
</tr>
<tr>
<td>2013*</td>
<td>92.0</td>
<td>68.4</td>
<td>50.8</td>
</tr>
</tbody>
</table>

Source: Thomson Reuters.

---

**Figure 3**

Canadian project finance loan market

<table>
<thead>
<tr>
<th>Year</th>
<th>(US$ bln)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>5</td>
</tr>
<tr>
<td>2009</td>
<td>2</td>
</tr>
<tr>
<td>2010</td>
<td>3</td>
</tr>
<tr>
<td>2011</td>
<td>5</td>
</tr>
<tr>
<td>2012</td>
<td>4</td>
</tr>
<tr>
<td>2013*</td>
<td>6</td>
</tr>
</tbody>
</table>

Source: Thomson Reuters.
are committing to longer tenors albeit more selectively. The private placement and bond markets are happily providing competitive long-term debt solutions although the bond market is being more selective when it comes to greenfield projects.

**United States: enormous potential**

The US continues to provide the market with hope and anticipation of a wave of infrastructure deals. Among P3, power, energy and M&A related opportunities, the US is expected to keep the market enticed. Although we all know there is a significant backlog in infrastructure investment, few transactions, on a relative basis, are financed in the bank market. Opportunities in power may be limited to refinancings or M&A in 2014. Large projects, such as LNG, will require banks to hold large commitments, while smaller deals will require banks to hold higher commitment levels as a percentage of the total financing to be relevant and remain competitive.

Loan volumes were up significantly in 2013, of which a substantial portion was executed in the Term Loan B market. The total volume in the loan market is expected to continue strong as we see the pipeline fill the 2014 calendar.

![Figure 4: US project finance loan market](chart.png)

**US project finance loan market**

<table>
<thead>
<tr>
<th>Year</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013*</th>
</tr>
</thead>
<tbody>
<tr>
<td>(US$ bln)</td>
<td>20</td>
<td>15</td>
<td>10</td>
<td>5</td>
<td>0</td>
<td>30</td>
</tr>
</tbody>
</table>

* annualized based on H1/13 actuals.

Source: Thomson Reuters.

Canadian banks continue to deploy capital selectively in the US. European banks are re-entering the market in lead roles and have been seen to sell down their uncomfortably and relatively large exposures. Regional US banks are entering the market with smaller commitments and Japanese banks continue to dominate the lead positions with large commitments, low pricing, aggressive terms, longer maturities and some with an appetite to underwrite. The Term Loan B market will likely remain a strong alternative for higher-risk financings. Additional and less expensive liquidity is also being made available from TIFIA (the Transportation Infrastructure Finance and Innovation Act program that provides federal credit assistance with fixed rates much lower than the private markets) and PAB’s (Public Activity Bonds, partially tax-exempt bonds issued by or on behalf of local or state governments for the purpose of providing special financing benefits for qualified projects).

Pricing and fees have been under pressure given the liquidity in the market relative to deal flow. TIFIA and PAB’s have provided the much needed liquidity for P3s. B loans have contributed to the reduction of rates and loosening of terms for the power and energy sectors. The sweet spot for most B loan issuance is “BB” and “BB+”, but...
deals have been executed with ratings of “B”, making it a substitute for mezzanine debt in many transactions.

Banks providing longer maturities have been mixed and include Japanese, European and US banks. Tenors have increased to 10 years from seven years, with well-known sponsors obtaining longer maturities. Spreads and fees have been steadily decreasing, despite the longer maturities offered.

**Europe: stay calm and carry on**

Despite what appeared to be a slow year, European infrastructure lending in AAA rated European countries was notably up from 2012 largely from an influx of infrastructure lending opportunities in the UK (Figure 5).

The UK continues to be one of the most mature infrastructure markets in the world. The pipeline of future infrastructure investments by the government is staggering and estimated to be in excess of GBP250 billion, most of which is expected to be financed in the private markets. Lending filled the void caused when the monolines were no longer supporting the bond market in infrastructure post the GFC. There is now a developing market for debt funds for project finance, which is expected to offer the market longer tenors. There is an expectation that the European banks, which once were leaders in longer-tenor deals, will not return to long-term financing of projects. European banks had retrenched to their local markets in 2011–12, but they have stepped out more frequently beyond local markets in 2013, in particular to follow their core clients.

Future regulatory changes, namely Basel III, are expected to put pressure on the supply and cost of credit and willingness of banks to continue to finance longer tenor projects.

**Australia: for lenders only**

Over the past five years Australia has delivered a consistent stream of lending opportunities in privatizations and P3s. Projects continue to be financed through bank lending despite a brief appearance of monoline-wrapped debt in the mid-2000s (and disappearance during the GFC). Given the lack of a deep local debt capital market or long-dated liquidity, financing tends to be by short-dated mini perm style debt lending. With most asset sales and projects in the billions, Australia offers lenders the opportunity to participate with large commitments.

The pipeline of deals forecasted for 2014 is strong, supported by P3 projects in Western Australia, New South Wales, Queensland and Victoria, where the governments are the most active in investing in infrastructure. There is also strong support for infrastructure development from the recently elected federal government. Privatizations have been supported in New South Wales and Queensland, where state governments have used this process as a means of recycling capital into new projects. These privatizations have attracted the largest and most experienced infrastructure funds across the globe, including the Canadian pension funds. We have seen year over-year-increases in

![Australian project finance loan market](Image)

*annualized based on H1/13 actuals.

Source: Thomson Reuters.
infrastructure loan volumes from 2009 (Figure 6), with 2012 peaking due to a very large LNG project (US$20 billion Ichthys LNG debt) and Australia’s first coal seam gas project (US$8.5 billion APLNG).

The four Australian banks are dominant in their region, leading most deals, have the capacity to provide large commitments and to underwrite, and are price makers. The credit market in Australia has enjoyed a slight premium to pricing for the past couple of years, although pricing pressures have increased in recent months due to increased liquidity from international banks. Over 80% of infrastructure lending has come from international banks in the past three years.

European bank cutbacks appear to have stabilized, while Canadian and Asian banks are looking to expand or maintain their activities in the region, leading to strong competition for investment grade and brownfield asset refinancings. Infrastructure debt funds are increasing their presence on the brownfield (and occasionally greenfield) asset lending side, whereas previously they had focused primarily on equity. There is significant appetite from US private placement, 144a and Maple market for refinancing stable investment grade brownfield assets as they offer longer-term debt alternatives and fixed rates.

Pricing levels will continue to be under pressure across all debt tenors with standby fees 40%–50% of drawn spreads, which is on the upper end of the range for project finance transactions. Substantially all of the bank deals get arranged by the borrower/sponsor calling on its relationship banks and active lending banks to circle the aggregate commitment it is seeking.

Tenor on bank deals is generally within the three- to five-year range although we have seen tenors reach seven years. Five- to seven-years appears to be the average tenor for P3 deals. The Japanese and some other banks, mostly European, have supported longer tenors (i.e. > 10 years) in strategic projects involving core client or sovereign sponsors/developers.
Equity issuance

Over the last five years, investors have shown a preference for equity with a yield component. In that time frame, 65% of equity issuance (or $30 billion per year) originated from yield issuers or came in the form of yield instruments such as preferred shares or convertible debentures. Infrastructure-related equity issuers, such as pipelines, utilities, midstream and engineering companies, are a good match for investors preferring yield and long-term stability. Infrastructure equity issuance has averaged $5.5 billion per year, representing, on average, 11.6% of new issue financing every year over the last five years. Issuance in 2012 and so far in 2013 has been almost double historical averages with $9.1 billion in 2012 and $6.6 billion by October 2013, representing 19.0% and 22.6% of total issuance, respectively.

Future infrastructure issuance looks very promising. Announced projects, such as TransCanada’s Energy East pipeline and Keystone XL pipeline, would represent a total of almost $17.4 billion between now and 2018. TransCanada’s total financing plan for that period calls for $38 billion of capital and Enbridge’s capital plan calls for $36 billion till 2017, of which Enbridge forecasts $2.1 billion to be funded with equity.

It is not inconceivable that total infrastructure issuance could be at a “new normal” level of $9+ billion annually for the next several years, rather than the historical average of $5.5 billion.

Oil and Gas

Oil and Gas issuance represented on average just over 20% of issuance over the five years prior to 2013, averaging $9.6 billion annually. 2013 has been a very challenging year for issuance with only $4.3 billion raised, representing 12.9% of total issuance.

While larger issuers have focused on strategic operations and looked at divesting non-core assets, the next generation of dividend/growth issuers is expected to continue to grow operations and acquire increasingly larger portfolios of assets that will transition their equity transaction sizes from the current ~$50 million level to $200+ million per transaction. These factors, combined with the uncertainty surrounding the government’s receptivity for foreign investment in the largest capital projects, lead us to believe that the capital markets will need to be the basis for most major future capital and development spending.

Figure 1

Overall equity issuance

Source: CIBC.
The expectation is that in 2014 issuance should be back to normal levels of approximately $10 billion with a narrowing of pricing differentials, Initial Public Offerings and expected M&A driven financings.

Mining

Mining issuance hit an eight-year low in 2013. Precious metal issuance represented on average 63% of total mining issuance from 1995 to 2013. The strong correlation between equity issuance and volatility in gold prices has become even more acute over the last two years as precious metals issuance has represented 83% of the total issuance.

For the 10-year period ending in 2012, mining issuance averaged $7.7 billion annually or 16.5% of the total. Issuance has dropped to $1.8 billion (excluding the Barrick Gold offering) so far in 2013, representing only 5.3% of total issuance. The 75% drop in issuance in 2013 is the largest drop since 2000 (excluding the Barrick Gold offering), when issuance dropped to $200 million.

The drop in issuance in the late ‘90s was largely driven by two factors: a sustained drop in gold prices and the technology bubble. Stability in gold prices, along with the corporate focus on cost control, could help stabilize issuance at closer to long-term levels.
At C$42.4 billion, 2013 YTD corporate non-financial new issuance in the Canadian debt capital market has surpassed 2012’s record new issue level of C$35.3 billion led by power and utilities. The Canadian bond market continues to grow with the capacity to absorb large transactions. Over the last two years, the average deal size for corporate offerings has grown by 13%. For issuers, significant incentive remains to transact sooner rather than later, in large part because the all-in yield environment remains at historic lows.

CIBC believes the primary market in 2014 will remain robust to match the level of activity in 2013 for a variety of reasons, including expectations of an increase in rates and ~C$2 billion more in corporate maturities in 2014 than in 2013. In terms of market receptivity, many investors still find value in corporates given the meagre yields being offered by governments, and supported by overall decent fundamentals in Canada. At the same time, it is important to note that the market has experienced noticeable price volatility during the past few quarters.

Infrastructure

After two years of relatively limited bond issuance for public private partnerships (P3s), the pipeline for 2014/2015 looks very promising. Key P3 projects are expected to include:

**British Columbia**: John Hart Power Generation Project, North Island Hospitals, Women’s and Children’s Hospital, Okanagan Correctional Center;

**Alberta**: Edmonton LRT, Alberta Schools IV and SW Stoney Trail Highway;

**Saskatchewan**: Regina Bypass, Regina Wastewater, North Battleford Hospital;

**Ontario**: East Rail Maintenance Facility, Waterloo LRT, Peel Memorial Hospital, Vaughn Hospital, Milton Hospital, 407 East Extension Phase 2 and Eglinton LRT; and

**Federal**: Champlain Bridge and possibly Detroit River International Crossing.

Other project bond business is expected to be concentrated in the power generation and midstream energy sectors. Examples include: (i) the much discussed Lower Churchill Project which is expected to be bond financed with the benefit of a Government of Canada guarantee; and (ii) the Lower Mattagami hydroelectric redevelopment project which is expected to

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Figure 1

**Canadian debt issuance by sector 2013 YTD (2012)**

<table>
<thead>
<tr>
<th>Sector</th>
<th>2013 YTD</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Power &amp; Utilities</td>
<td>24%</td>
<td>28%</td>
</tr>
<tr>
<td>Telecom &amp; Media</td>
<td>18%</td>
<td>24%</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>5%</td>
<td>7%</td>
</tr>
<tr>
<td>Retail &amp; Consumer Products</td>
<td>10%</td>
<td>3%</td>
</tr>
<tr>
<td>Auto &amp; Equipment Finance</td>
<td>18%</td>
<td>19%</td>
</tr>
<tr>
<td>Oil &amp; Gas</td>
<td>4% (6%)</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>9% (15%)</td>
<td></td>
</tr>
</tbody>
</table>

Source: CIBC.
require additional bond financing in 2014 with completion scheduled for mid-2015. We also expect additional renewable power projects to make their way into the Canadian bond market.

**Oil and Gas**

Oil and Gas issuance in the Canadian bond market was $1.6 billion in 2013 representing approximately 4% of total corporate issuance, excluding Maple issuance. This year’s volume was comprised of $500 million of investment grade deals and $1.1 billion of high yield debt. Exploration and production (“E&P”) issuance has seen a slowdown in the Canadian market over the last couple of years as some of the larger producers who have traditionally driven market activity have reduced their capital spending and are living within their means. The high yield sector has picked up some of the slack with over $4.4 billion in E&P new issues since 2011. A notable development has been foreign issuers tapping the Canadian market with BP raising $950 million in Canada since February 2011.

An active and still developing story in the Canadian bond market on the energy side is the emergence of the midstream sector. The development of energy processing and transportation assets across North America has increased the capital requirements for midstream companies. Since 2012, the Canadian bond market has seen over $4.6 billion issued in the midstream sector. Several of these issuers are relatively new to the Canadian public markets, migrating from the private placement market just a few years ago. The Canadian investor base has embraced BBB-rated credits, which has provided unparalleled access for midstream companies.

Looking to 2014, we expect increased activity in the midstream sector, spurred by record maturities and capital expenditures. On the E&P front, we expect issuance to be slightly above 2013 levels with issues from domestic and foreign issuers.

**Mining**

The Canadian debt capital market has only seen two investment grade metals & mining issues over the last three years. In the US, mining issuance saw a pullback in 2013 after volumes jumped 81% from 2011 to 2012. Summer saw overall market issuance slow down as expectations of QE tapering caused a move higher in rates, with the mining sector further impacted by increased commodity price volatility. As a result, nearly 74% of mining issuance in 2013 was seen during the first half of the year, while only six deals have been completed since June.

2013 YTD issuance has totaled US$36 billion compared to US$46 billion in all of 2012. With an uncertain rate environment, demand for shorter dated issues and floating rate tranches has increased. Over the past three years, larger transactions have become more prevalent, with five deals of $3 billion or greater in 2013 compared to four in 2012 (three in 2011).

Increased clarity around Fed policy will be the focus in early 2014 as the broader market looks to position itself for any change in the Fed’s accommodative stance. Although recent stabilization in the broader market has provided some relief to mining issuers, current commodity prices have pushed some in the sector to curb development/capital expenditures and begin to de-lever.
In recent years, corporate clients have shown an increasing interest in trade receivables securitization as an attractive alternate source of funding for their growing businesses. Users of securitization (“Sellers”) are found across many sectors including Manufacturing, Energy/Utilities, Telecommunications, Transportation and Diversified Services. In capital-intensive sectors such as Energy, Mining and Infrastructure, securitization offers treasurers the opportunity to complement existing sources of financing and introduces a new tool to the treasurer’s tool belt.

**Background**

CIBC has securitized receivables for its corporate clients since the late 1980s. Funding is typically provided through CIBC’s asset-backed commercial paper issuers, SAFE Trust and SOUND Trust (“ABCP conduits” or “Trusts”).

In a typical ABCP-funded transaction, assets are legally sold by the Seller to the Trust. The Trust funds the purchase by issuing ABCP to investors (Figure 1). The Seller continues to service the assets and its customers as it always has.

Cash flows generated from the collection of receivables are used by the Trust to buy newly-generated trade receivables. The Trust passes back a proportionate share of its variable cost of funding to each Seller.

The Trust issues ABCP with the highest short-term credit ratings, which is accomplished by structuring bankruptcy-remote transactions and adding credit enhancements. In the event of the Seller’s bankruptcy, ABCP investors are entitled to the cash flows of the receivables and are not exposed to the credit risk of the Seller. The Trust overcollateralizes its liabilities with additional trade receivables, which protects ABCP investors against losses on default.

**Attractive funding solution**

Securitization can be an attractive and flexible component of a corporate funding strategy, with many potential benefits:

1. **Diversification**: Provides a new source of liquidity to complement other traditional sources provided by the bank market and capital markets.
2. **Cost effectiveness:** May offer cost advantages versus other committed sources of funding. Ongoing costs to the Seller include the ABCP cost of funding (currently sub-CDOR) plus a program fee for utilization and standby fees for undrawn commitments.

3. **Committed funding:** Commitments are available, similar to revolving bank facilities. Uncommitted facilities may also be offered to reduce fees.

4. **Anonymity:** Sellers using an ABCP conduit are anonymous, which mitigates the name or timing risk that can affect market access under corporate debt programs.

5. **Flexibility:** Revolving funding arrangements allow Sellers to vary their levels of usage.

6. **Ease of execution and ongoing administration:** Deals are typically done bilaterally, which simplifies upfront negotiations and ongoing administration. Legal documentation is largely based on existing templates. Once established, the Seller is responsible for satisfying relatively simple monthly reporting obligations.

**Ideal securitization candidates**

Existing securitization clients and potential candidates share key characteristics, including:

1. **Diversified customer base:** Receivables are broadly diversified with respect to concentrations of business and consumer credit risk, so that the default of any one customer does not have a material adverse impact on the deal. Structural mechanisms are also available to permit a portion of concentrated receivables to be included.

2. **Contractual payment terms:** Eligible receivables are evidenced by a contract and/or an invoice, which outline key payment terms. Preferably, standard form contracts are used for receivables consistency.

3. **Historical data:** A minimum of five years of historical performance is typically required to establish baseline performance expectations and forms the basis of stress testing required for rating agency approval.

4. **Assignability:** Securitization is predicated on the legal true sale of the receivables from the Seller to the Trust.

5. **Servicer risk:** Historically, access to trade receivables securitization has been largely limited to investment-grade Sellers. Under certain conditions, structural mechanisms have been developed that may allow non-investment grade and unrated Sellers to access this market on a case-by-case basis.

**Conclusion**

Innovations over the years have opened the door to securitization funding to a broader universe of clients, allowing them to share in the benefits of a cost-effective facility that is tailored to meet their needs. We expect interest in trade receivables securitizations to continue into 2014 as treasurers look for new, reliable sources of capital to fund their growing businesses.
Disclosures

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Important disclosure footnotes for companies mentioned in this report that are covered by CIBC World Markets Inc.

Stock Prices as of 11/28/2013:

Agnico-Eagle Mines Limited (2g, 7) (AEM-NYSE, US$27.00, Sector Outperformer)
Alamos Gold Inc. (2g) (AGI-TSX, C$13.07, Sector Performer)
AltaGas Ltd. (2a, 2c, 2e, 2g, 7) (ALA-TSX, C$38.20, Sector Outperformer)
Aquarius Platinum Limited (AQP-L, £0.45, Sector Outperformer)
ARC Resources Ltd. (2g, 7) (ARX-TSX, C$28.72, Sector Performer)
Argent Energy Trust (2a, 2c, 2e) (AET.UN-TSX, C$7.89, Sector Outperformer)
ATCO Ltd. (2g, 13) (ACO.X-TSX, C$48.53, Sector Performer)
B2Gold Corporation (2g) (BTU-TSX, C$2.15, Sector Outperformer)
Barrick Gold Corporation (2a, 2b, 2c, 2e, 2g, 7) (ABX-NYSE, US$16.36, Sector Performer)
Baytex Energy Corp. (2g, 7) (BTE-TSX, C$42.61, Sector Outperformer)
Bellatrix Exploration Ltd. (2a, 2c, 2e, 2g) (BXE-TSX, C$7.09, Sector Outperformer)
Bonavista Energy Corporation (2g, 7) (BNP-TSX, C$13.69, Sector Performer)
Bonterra Energy Corp. (2a, 2c, 2e, 2g) (BNE-TSX, C$53.80, Sector Outperformer)
Canadian Imperial Bank of Commerce (2a, 2b, 2c, 2d, 2e, 2g, 3a, 3c, 6a, 7, 9, CD37) (CM-TSX, C$90.97, Not Rated)
Canadian Utilities Ltd. (2a, 2c, 2e, 2g, 13) (CU-TSX, C$36.02, Sector Outperformer)
Capital Power Corporation (2a, 2c, 2e, 2g, 4a, 4b, 7) (CPX-TSX, C$20.87, Sector Outperformer)
Crescent Point Energy Corp. (2a, 2e, 2g, 7) (CPG-TSX, C$39.50, Sector Outperformer)
Eagle Energy Trust (2g) (EGL.UN-TSX, C$7.28, Sector Performer)
Eastern Platinum Limited (2g) (ELR-TSX, C$0.07, Sector Performer)
Eldorado Gold Corporation (2g, 7) (EGO-NYSE, US$5.89, Sector Outperformer)
Emera Inc. (2a, 2c, 2e, 2g, 7) (EMA-TSX, C$29.32, Sector Performer)
Enbridge Inc. (2a, 2c, 2e, 2g, 7) (ENB-TSX, C$43.41, Sector Outperformer)
Enbridge Income Fund Holdings Inc. (2a, 2c, 2e, 2g) (ENF-TSX, C$22.84, Sector Outperformer)
Endeavour Silver Corp. (2g) (EDR-TSX, C$3.95, Sector Performer)
Enerplus Corporation (2g, 7) (ERF-TSX, C$19.36, Sector Outperformer)
First Quantum Minerals Ltd. (2g, 7) (FM-TSX, C$17.92, Sector Outperformer)
Fortis Inc. (2a, 2c, 2e, 2g, 7) (FTS-TSX, C$31.26, Sector Performer)
Fortuna Silver Mines Inc. (2g) (FVI-TSX, C$3.61, Sector Performer)
Franco-Nevada Corporation (2g) (FNV-TSX, C$42.28, Sector Outperformer)
Freehold Royalties Ltd. (2g) (FRU-TSX, C$22.40, Sector Performer)
Fresnillo PLC (2a, 2e, 2g) (FRES-L, £8.33, Sector Performer)
Gibson Energy Inc. (2a, 2e, 2g) (GEI-TSX, C$25.75, Sector Performer)
Goldcorp Inc. (2a, 2b, 2c, 2d, 2e, 2g, 7) (GQ-NYSE, US$22.32, Sector Outperformer)
Inter Pipeline Ltd. (2a, 2c, 2e) (IPL-TSX, C$25.38, Sector Outperformer)
Ivanhoe Mines Ltd. (2g) (IVN-TSX, C$2.01, Sector Outperformer)
Keyera Corporation (7) (KEY-TSX, C$61.06, Sector Outperformer)
Lightstream Resources Ltd. (2g) (LTS-TSX, C$5.50, Sector Performer)
Long Run Exploration Ltd. (2g) (LRE-TSX, C$5.30, Sector Performer)
Osisko Mining Corporation (2g) (OSK-TSX, C$4.29, Sector Outperformer)
Parallel Energy Trust (2g) (PLT.UN-TSX, C$3.81, Sector Performer)
Paramount Resources Ltd. (2a, 2c, 2e, 2g) (POU-TSX, C$36.11, Sector Outperformer)
Pembina Pipeline Corporation (2a, 2c, 2e, 2g, 7) (PPL-TSX, C$33.86, Sector Outperformer)
Pengrowth Energy Corporation (2g) (PGF-TSX, C$6.55, Sector Performer)
Penn West Petroleum Ltd. (2a, 2e, 2g, CD41) (PWT-TSX, C$9.02, Sector Performer)
Peyto Exploration & Development Corp. (2a, 2c, 2g) (PEY-TSX, C$31.80, Sector Outperformer)
Platinum Group Metals Limited (2a, 2c, 2e, 2g) (PTM-TSX, C$1.40, Sector Outperformer)
Precision Drilling Corporation (2g) (PD-TSX, C$9.80, Sector Outperformer)
Primero Mining Corp. (2g) (P-TSX, C$5.49, Sector Outperformer)
Randgold Resources Limited (2g) (RRS-L, £42.61, Sector Outperformer)
Silver Wheaton Corp. (2g, 7) (SLW-NYSE, US$20.72, Sector Outperformer)
Spyglass Resources Corp. (SGL-TSX, C$1.77, Sector Underperformer)
Stillwater Mining Company (2g) (SWC-NYSE, US$11.20, Sector Outperformer)
Surge Energy Inc. (2a, 2c, 2e, 2g, CD40) (SGY-TSX, C$6.29, Sector Outperformer)
Tahoe Resources Inc. (2g) (THO-TSX, C$18.79, Sector Outperformer)
Teck Resources Limited (2a, 2e, 2g, 7, 12) (TCK.B-TSX, C$26.05, Sector Outperformer)
TORC Oil & Gas Ltd. (2a, 2c, 2e, 2g, 7) (TOG-TSX, C$10.28, Sector Outperformer)
Tourmaline Oil Corp. (2a, 2c, 2e, 2g) (TOU-TSX, C$41.95, Sector Outperformer)
TransAlta Corporation (2g, 7, 9) (TA-TSX, C$14.11, Sector Performer)
TransCanada Corp. (2a, 2c, 2e, 2g, 7) (TRP-TSX, C$46.81, Sector Outperformer)
Trilogy Energy Corp. (2a, 2c, 2e, 2g) (TET-TSX, C$26.80, Sector Outperformer)
Twin Butte Energy Ltd. (2a, 2c, 2e, 2g, 7) (TBE-TSX, C$2.16, Restricted)
Veresen Inc. (2a, 2c, 2e, 2g) (VSN-TSX, C$13.69, Sector Performer)
Vermilion Energy Inc. (2g, 7) (VET-TSX, C$58.20, Sector Outperformer)
Whitecap Resources Inc. (2a, 2c, 2e, 2g) (WCP-TSX, C$12.81, Sector Outperformer)
Yamana Gold Inc. (2g, 7) (AUY-NYSE, US$8.82, Sector Outperformer)

Companies mentioned in this report that are not covered by CIBC World Markets Inc.:

Stock Prices as of 11/28/2013:
BP PLC (BP-NYSE, US$46.90, Not Rated)
CNOOC Ltd. (CEO-NYSE, US$202.29, Not Rated)
Daewoo International Corp. (047050-KS, [KRW]38700.00, Not Rated)
Encana Corporation (ECA-NYSE, US$19.11, Not Rated)
ExxonMobil Corporation (XOM-NYSE, US$93.80, Not Rated)
Inpex Corp. (1605-T, ¥1202.00, Not Rated)
Korea Gas Corporation (036460-KS, [KRW]66100.00, Not Rated)
Mitsubishi Corp (8058-T, ¥1989.00, Not Rated)
Norilsk Nickel (GMKN-RT, [RUB]147.98, Not Rated)
Novus Energy Inc. (NVS-V, C$1.15, Not Rated)
PetroChina (PTR-NYSE, US$119.06, Not Rated)
Sasol (SSL-NYSE, US$48.92, Not Rated)
Sinopec Shanghai Petrochemical Co. (SHI-NYSE, US$44.07, Not Rated)
Statoil ASA (STO-NYSE, US$22.55, Not Rated)
Talisman Energy Inc. (TLM-NYSE, US$11.77, Not Rated)
Total S.A. (TOT-NYSE, US$60.61, Not Rated)
Yanchang Petroleum International Ltd. (0346-HK, [HKD]0.39, Not Rated)

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2e. CIBC World Markets Inc. has received compensation for investment banking services from this company in the past 12 months.
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CIBC World Markets Inc. price chart

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CIBC World Markets Inc. stock rating system

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<tr>
<th>Abbreviation</th>
<th>Rating</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>SO</td>
<td>Sector Outperformer</td>
<td>Stock is expected to outperform the sector during the next 12-18 months.</td>
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<tr>
<td>SP</td>
<td>Sector Performer</td>
<td>Stock is expected to perform in line with the sector during the next 12-18 months.</td>
</tr>
<tr>
<td>SU</td>
<td>Sector Underperformer</td>
<td>Stock is expected to underperform the sector during the next 12-18 months.</td>
</tr>
<tr>
<td>NR</td>
<td>Not Rated</td>
<td>CIBC World Markets does not maintain an investment recommendation on the stock.</td>
</tr>
<tr>
<td>R</td>
<td>Restricted</td>
<td>CIBC World Markets is restricted*** from rating the stock.</td>
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**Sector Weightings**

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<th>Rating</th>
<th>Description</th>
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<tr>
<td>O</td>
<td>Overweight</td>
<td>Sector is expected to outperform the broader market averages.</td>
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<tr>
<td>M</td>
<td>Market Weight</td>
<td>Sector is expected to equal the performance of the broader market averages.</td>
</tr>
<tr>
<td>U</td>
<td>Underweight</td>
<td>Sector is expected to underperform the broader market averages.</td>
</tr>
<tr>
<td>NA</td>
<td>None</td>
<td>Sector rating is not applicable.</td>
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“Speculative” indicates that an investment in this security involves a high amount of risk due to volatility and/or liquidity issues.

***Restricted due to a potential conflict of interest.

Ratings distribution*: CIBC World Markets Inc. coverage universe

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<tr>
<th>(as of 28 Nov 2013)</th>
<th>Count</th>
<th>Percent</th>
<th>Investment Banking Relationships</th>
<th>Count</th>
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<tr>
<td>Sector Outperformer (Buy)</td>
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<td>39.6%</td>
<td>Sector Outperformer (Buy)</td>
<td>131</td>
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<td>Sector Performer (Hold/Neutral)</td>
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<td>Sector Performer (Hold/Neutral)</td>
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<tr>
<td>Sector Underperformer (Sell)</td>
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<td>Sector Underperformer (Sell)</td>
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<tr>
<td>Restricted</td>
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<td>2.6%</td>
<td>Restricted</td>
<td>9</td>
<td>100.0%</td>
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