

Laketon Canadian Growth Equity

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Milos: Hello and thank you to our listeners for tuning in to a continuing series of audio commentaries featuring Laketon Portfolio managers...

My name is Milos Kostich and as VP sales, strategic alliances, it is my pleasure to welcome today Susan Spence, VP and portfolio manager with the Laketon Canadian Equity Fund and Daphne Dodig, VP and portfolio manager, also with the Laketon Canadian Equity Fund...

Clearly, these have been difficult times in the financial markets. No one can predict exactly what lies ahead in the very near future, and given the uncertainty in the capital markets, we know that it is important for investors to be informed and aware of what is happening in the economy as well as their specific investment holdings.

Daphne, several months ago on our last call we discussed the state of the US banking system and the effects that it was having on the Canadian banks....Much has happened since then and we are seeing pre - announcements from several Canadian banks as we speak...What has changed since we last spoke and are we going to see further bank write-down in the upcoming quarters?

Daphne: You are correct Milos, much has happened since our last discussion and unfortunately it hasn't been good. With the collapse of Lehman Brothers on September 15th and subsequent concerns of additional institutions failing, we've had unprecedented action by governments and central banks globally. More specifically, we've seen governments invest directly into their banking system so as to prevent systemic failure, in addition to, significant monetary stimulus in an effort to inject liquidity and unclog the financial pipes. Here at home, our government is purchasing \$75B in mortgage assets from the banks in an attempt to increase liquidity and make mortgage loans more affordable and on the capital side, OSFI has increased the allowable limit of preferred shared issuance in the calculation of Tier 1 capital.

Broadly speaking, this financial crisis can be characterized as a four-stage evolution. Stage one was the recognition of massive losses due to the U.S. housing market and the shadow banking system. Stage two turned to capital concerns and adequacy issues –hence the “new partnership” formed with government. And now we're about to enter stage three where banks will realize significant losses due to the damage this crisis has inflicted on the real economy. Stage four will finish with a return to the balance sheet and capital concerns and at that point, more banks will file for Chapter 11, more dividends will be cut and perhaps banks will be fully nationalized and/or governments will fully guarantee loans against losses.

More colour on stage three and this is a direct response to the second part of your question as to whether or not we're going to see further write-down in the up coming quarters: despite the fact that we've seen governments “invest” in banks and central banks cut interest rates, we believe a deep recession in the U.S. is currently in the making because banks are not willing to lend. Banks are squarely focused on maintaining solvency because after years of lax lending and overly stretched balance sheets, the deep recession implies a major rise in future loan losses. Our view is U.S. centric because we believe that if the U.S. slides into a deep recession, it will be difficult for Canada to avoid. Although our banks are structurally on a more solid footing, it will be hard for them to escape losses and write-down and valuations will compress along with their global brethren. Our portfolio is currently underweight the financials.

Milos: Given the current economic slowdown and the effects that it is having on a variety of sectors, can you give the listeners a sense, Susan, of what is happening on the consumer front in Canada and how that is impacting the Canadian retailers?

Susan: There have been signs of weakness on the consumer front in Canada for some time now, although up until the third quarter any slowdown felt by Canadian retailers was generally concentrated in central Canada, Ontario specifically. Strength in other regions, particularly the west and specifically Alberta, more than offset the challenges in Ontario. So overall the environment continued to be quite healthy.

With the release of third quarter results in the past few weeks, however, we have witnessed a bit of a change in tone from retail management teams. The third quarter results in and of themselves were actually quite solid and even included some upside surprises relative to expectations. But there is concern now that things will get worse in Ontario and that conditions in other regions will get more challenging:

- Problems in the manufacturing sector (particularly the auto and auto-related companies, which are at the forefront of the news these days and are concentrated in Ontario) are growing.
- We generally think of declining commodity prices, particularly oil, as being good for the consumer as it means lower prices at the pumps and thus a greater portion of the consumer's wallet freed up for discretionary spending. But consumption in the Prairie provinces is levered to oil and other commodity prices, so if things are getting tougher for the commodity-focused companies the western economy will be feeling the pinch.
- Furthermore, Atlantic Canada has provided a lot of labour for the oil companies and thus there are knock-on effects in the east as well.

As a result, retailers are quite cautious heading into the fourth quarter (their most significant quarter from a sales and earnings perspective). The fourth quarter is typically a very competitive time for the retailers, with the lead-up to the holiday season. This year it is expected to be even more so, both in terms of aggressive promotions and longer store hours. There is also a cautious tone when it comes to discussing 2009. At this point visibility into next year is, understandably, very low, so retailers are reluctant to comment too much about their prospects that far out.

The good news is that companies have been focusing on controlling costs heading into this downturn, and to the extent that they have made progress in this regard, it will help to offset any slowdown in sales. Certainly the recent decline in commodity prices helps the retailers' energy and transportation costs. In addition to internal efforts, part of this cost control has also involved retailers going back to their suppliers for better pricing, so that the suppliers share in the margin pressure associated with increased promotions.

Interestingly, although not surprisingly, there are also indications emerging of changes in consumer behavior in Canada, as consumers become more value-conscious. The silver lining here is that this can actually help drive sales at retailers that benefit from consumers trading down or drive bottom line results as higher-margin private label penetration increases.

Milos: Susan, with that as a backdrop, do you expect that we are going to see continued earnings revisions, multiple compressions and the like for the retailers as we move into '09?

Susan: As with the broader market, I do think there is still risk of further downside earnings revisions for the retailers in general. However, certain companies are more resilient in terms of their earnings – whether it is due to the nature of their product offering (such as Shoppers Drug Mart where approximately 50% of sales are pharmacy, which grows in all economic conditions) or due to their low average transaction size (such as Tim Horton's). And it is these types of names that we continue to focus on in the portfolio. Furthermore (as we do

across the portfolio), we continue to focus on companies with a clear competitive advantage that are growing market share despite the economic environment (again, I would highlight Shoppers Drug Mart for this reason -- it is gaining share in pharmacy as well as in key front end categories such as beauty as it builds its prestige business, taking share from the department stores).

In terms of multiple compressions, I feel there is less risk overall. The retailers have already experienced to a significant amount of multiple compressions to date and most are trading at or below the low end of historical trading ranges on this measure. At some point, before the economic slowdown has run its course, we do expect multiple expansions as investors begin to look ahead to better times for the retailers. When this occurs, performance will be led by the more discretionary retailers. However, we feel it is still too early to shift into these more cyclical names. For now, as we move into 2009, we believe the more defensive, more staple-oriented retailers will continue to outperform.

Milos: A big part of the news lately has been the privatization of BCE and the potential disintegration of that transaction. Daphne, can you give us your thoughts on the recent developments and could we see a public BCE with a reinstated dividend post Dec 11th?

Daphne: To recap, KPMG notified BCE that it does not expect to deliver a positive solvency opinion by December 11th, the day the deal was expected to close. A positive solvency opinion is a condition of the deal. Our view is that the probability that the private equity deal closes is very remote and as a result we fully expect BCE to remain a public company. Speculation is rife as to what will happen next and here are a couple of examples,

- (1) Telus makes a bid in an effort to resurrect "Belus". We would assign a very low probability of this happening because Telus would face major financing hurdles. Also, we believe the regulator still won't allow Telus Mobility and Bell Mobility to consolidate because of the competition issues that would create.
- (2) With approximately \$2.6B in cash at the end of Q3/08, some expect BCE to announce a significant share repurchase program which would boost earnings by 6%. We would assign less than 50/50 odds of this occurring because in an environment of capital scarcity, this would not be a prudent use of capital. We expect management to keep their powder dry and reinvest the money into their own business to better allow them to compete.

Lastly, we fully expect BCE to reinstate their dividend of \$1.46/share which at today's price of \$23.46 would imply a 6.2% yield.

Milos: Thank you to both Daphne and Susan for your comments today, and we look forward to hearing from you in future audio commentaries. I'd like to remind listeners that the Laketon website at www.Laketon.com is source of varied and quite useful information. These audio commentaries are available at a click of a button, and in addition to quarterly fund commentaries and recent presentation that were made across the country during Fall Manager Road Show. Thanks to all for tuning in today.