

FP INVESTING

TRADING DESK

SCOTIA CAPITAL NAMES ROGERS PREFERRED STOCK

Scotia Capital says that **Rogers Communications Inc.** is its top telecom pick ahead of the company's earnings announcement set for April 18.

In a note to clients, Scotiabank analysts highlighted a number of advantages it believes the company has, including being able to grow its business with relatively low capital expenditure.

"RCI is our preferred wireless incumbent because of its capex flexibility and more attractive valuation across all metrics," wrote the analysts. "We believe RCI can grow with lower capex dollars and intensity because no fibre-to-the-home investment is required for RCI to remain competitive in broadband."

Lower capex spending means that Rogers can produce more free cash flow than its peers, which should help it boost its dividend in 2017 without affecting its payout ratio — already the lowest among its peers.

Scotia Capital currently rates Rogers stock a sector outperform, with a 12-month price target of \$56. The stock closed Tuesday at \$49.78.

When Rogers announces its earnings later this month, Scotia Capital expects key metrics, including wireless service revenue, to post stable growth. While there may be weakness in the cable segment, the analysts expect that to be offset by strength in Internet. One area where there could be weakness is Rogers' media segment, especially as the poor performance of Canadian hockey teams in the National Hockey League this season hurt viewership.

John Shmuel

FERTILIZER FIRMS DOWNGRADED

Fertilizer prices have weakened significantly in 2016, which has raised red flags at Standard & Poor's. The credit rating agency downgraded three of the sector's global giants on Tuesday, including Canadian firm **Potash Corp. of Saskatchewan Inc.**

S&P analysts said they expect nitrogen, phosphate and potash prices to remain below 2015 levels for the "next several years," with anticipated declines of 10 per cent to 30 per cent between 2016 and 2018. They cited low crop prices, rising supply, overall negative sentiment for commodities and other factors for the grim outlook.

"We therefore forecast lower earnings and higher leverage for the companies than we anticipated before," the analysts said in a note.

In the case of Potash Corp., the S&P analysts reduced the credit rating to triple-B-plus from A-minus. They pointed out that the Saskatoon-based firm is improving its efficiency and has reduced its dividend and capital spending, but they do not think those measures will "fully offset" the deterioration in prices.

In addition to Potash Corp., they downgraded the credit ratings of EuroChem Group AG and K+S AG. OAO Uralkali was not downgraded, but the analysts revised the credit outlook to negative from stable.

Peter Koven

BUY & SELL

BIG-PICTURE VIEWS, CURRENT ISSUES, OUTLOOK AND PICKS



LYLE STAFFORD FOR NATIONAL POST

Larry Sarbit and Tim Skelly at Winnipeg-based Sarbit Advisory Services have shifted their focus to companies where an external or internal activist has already made some type of change. These companies have either decided what to do, or are very clear on what has to happen.

BETTING ON CHANGE

DON'T BUY THE ACTIVIST, BUY THE PLAN, MANAGERS BELIEVE

JONATHAN ROTEM

Activist investors have often been able to generate impressive returns by shaking things up at companies that aren't meeting investors' expectations. They get rid of management, change incentive structures, spin off underperforming or non-core assets, and push for M&A.

The problem is, activists are sometimes wrong. In many cases, they fail to realize that a company's fundamentals, not management, are the problem — and this is something that isn't easily fixed.

Rather than focus on what activists are demanding, the portfolio management team at Sarbit Advisory Services, have shifted their focus to situations where an external or internal activist has already made some type of change.

These companies have either decided what to do, or it is very clear what has to happen.

"Who cares where the change is coming from, as

long as it's positive for the company," said Larry Sarbit, the Winnipeg-based firm's chief investment officer.

"An outside agitator who has taken a stake in the company may be pushing for change, or the inside management may be doing so because they know the company better than anyone else."

General Electric Co.'s chief executive Jeff Immelt is an example of this recent shift in thinking.

In February, his 2015 letter to investors suggested that GE itself has done "a better job of being our own activist," and few companies can match the company's record of meaningful change.

While GE is not a holding in either the IA Clarington Sarbit Activist Opportunities Class or the IA Clarington Sarbit U.S. Equity Fund, which Sarbit Advisory acts as a sub-adviser for, **Microsoft Corp.** is in both.

Portfolio manager Tim Skelly explains that in addition to being the productivity standard for business around the world with the Windows family of operating systems, Microsoft

boasts very high margins. But it was being somewhat misperceived by the market as a play on personal computers.

"At the time we got involved, Steve Ballmer was the CEO and they had a horrible record of capital allocation," Skelly said, highlighting the purchase of Nokia's handset business and Skype.

However, when renowned activist investor ValueAct Capital Management took a stake in Microsoft, they saw a turning point, which quickly led to Ballmer being replaced with Satya Nadella.

"As Nadella was the head of the cloud business, that showed us where the focus of the company was going — a business that is growing very rapidly," Skelly said.

"There is a culture change going on. They won't have a bloated cost structure anymore, and they are returning a lot of cash to shareholders."

Another holding in the U.S. equity fund is **Sirius XM Holdings Inc.**, in part, because it has one of the characteristics the managers

look for: a competitive advantage.

"It's pretty much a monopoly," portfolio manager Jonathan Rotem said. "We think it is a fantastic business given all the great content they offer that you just can't get for free, and it trades at a low valuation."

Meanwhile, the activist fund holds an indirect position in Sirius through **Liberty Media Corp.**, a holding company controlled by media mogul John Malone. Roughly 70 per cent of its net asset value is in Sirius.

Rotem considers it an even cheaper way to buy an already cheap Sirius, noting that the sum of Liberty Media's parts are greater than where the stock is trading.

He highlighted its position in **Live Nation Entertainment Inc.**, which has carved out a near-monopoly position in concerts and other live events, as it continues to snatch up competitors.

"John Malone isn't an empire builder looking to create the largest market-cap company in the U.S.," Rotem said. "He wants to realize value for himself and others, so he's

spinning out the assets within Liberty Media.

"That makes it easier for the market and analysts to understand what the different parts are worth."

Since the portfolio managers target businesses they would be willing to own entirely, along with terrific leadership, and that trade at a price that offers very strong rates of return, there aren't always a lot of companies to choose from.

That was the case at the beginning of 2016, when the cash position in the activist fund was 50 per cent.

However, when a wave of volatility hit in February, the managers jumped at the opportunity and brought that position down to 25 per cent.

"We were happy to take advantage of the market's reaction," Rotem said.

"We were very comfortable that some of these companies going through transitions are going to be significantly bigger and more valuable in three to five years. They have short-term concerns we are happy to ride through and take advantage of the volatility."

Financial Post

Scotiabank urges productivity push

BARBARA SHECTER

Bank of Nova Scotia chief executive Brian Porter says Canada's lagging productivity has become the country's "Achilles heel."

In a speech to shareholders in Calgary on Tuesday, the head of Canada's third-largest bank urged the federal and provincial governments to take steps to fix the productivity lag against global peers, in part by creating conditions for companies to innovate.

"Productivity is the most important determinant of a country's per capita income over the long term," Porter said. "And yet, Canada's labour productivity has lagged behind our peers globally for some time."

Porter said that while governments can create conditions for innovation to thrive, companies need to

"step up" to become the primary drivers.

The second piece of the "productivity puzzle" is skilled labour, he said, and suggested that fixing a "disconnect" between the skill of recent graduates and the needs of employers would address an above-average youth unemployment rate in this country.

Companies across industries and sectors, including banks, are fighting over the same small talent pool of digitally savvy specialists such as programmers, engineers and data scientists, he said.

Porter said Scotiabank has turned attention to developing digital talent by helping to fund labs and centres for analytics and innovation at three universities.

"We are also partnering with a number of innovative 'made-in-Canada' companies to better serve our customers

and increase efficiencies," he said, adding that the bank's commitment to push innovation is evident in a doubling of investment in technology to \$2.4 billion.

One of the firms Scotiabank is partnering with, Toronto-based startup Sensi-bill, was incubated in the Digital Media Zone at Ryerson University.

"Sensi-bill developed a game-changing application to make it easier for our customers to manage their purchase receipts, reconcile their bank statements and file their taxes," Porter said.

Many such "fintech" players are rising up as competitors to banks because they offer traditional financial services such as loans and payments systems online at a faster pace.

Despite the potential competitive threat, Porter said he views the upstarts "primarily as an opportunity" for trad-

itional banks.

"We've already built many strategic partnerships with fintech firms, and are leveraging their creativity and agility to drive business value and help us deliver an even better customer experience," he said.

"We are looking to build even more partnerships with other innovative firms."

Speaking to media after the meeting, Porter said the friendly collaboration doesn't mean Scotia opposes greater regulatory scrutiny or rule-making for fintech lenders and deposit-takers.

"If you're taking deposits or you're making loans, then why would you be different than anybody else?" he said. "So I think that in terms of a degree of consumer protection that there should be a level playing field."

Porter told shareholders Scotiabank is fortunate to have a large "internal dis-

rupter" in Tangerine, an online bank that was known as ING Direct before Scotiabank bought it in 2012.

By 2020, fewer than 10 per cent of financial transactions are expected to take place in branches, Porter said.

"At the same time, we expect sales through digital channels to increase materially — likely in excess of 50 per cent of total products sold."

During a question-and-answer session at the annual meeting, Porter said he believes investors have knocked too much off Scotia's shares in response to concerns about the oil industry and slowing growth in some emerging markets.

He said the biggest problems in emerging markets exist in places where Scotia doesn't have operations.

"Sometimes people throw the baby out with the bathwater," he said. "The premium will come back, we just have to have patience and time."

Financial Post