

# The 2007 Canadian Federal Budget

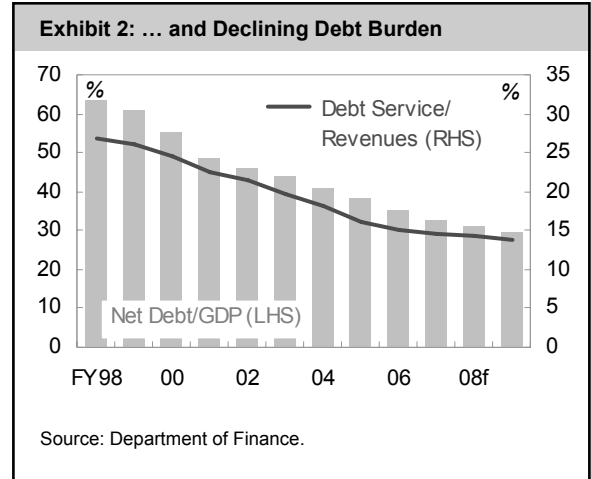
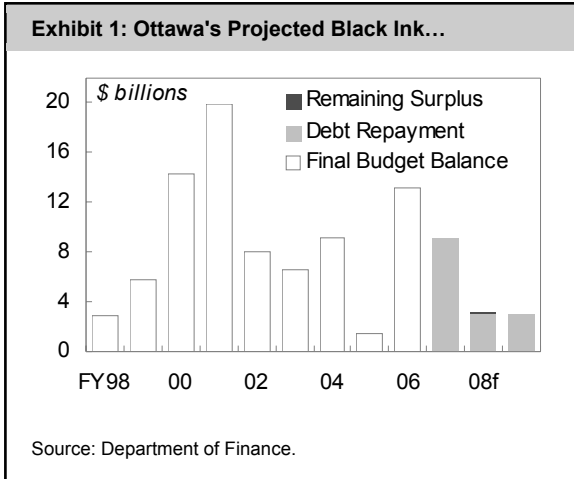
## Economics

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### The 2007 Canadian Federal Budget... A Very Broad Agenda

#### HIGHLIGHTS

- **Federal fiscal stimulus continues** with spending initiatives and tax cuts since the 2006 *Budget* totalling \$5.8 billion in fiscal 2006-07 (FY07) and \$9.0 billion in each of FY08 and FY09. Of this \$23.9 billion total, spending measures approach a 60% share.
- **The revised *Budget* forecast indicates a hefty \$9.2 billion surplus for FY07**, up substantially from the \$3.6 billion *Budget* estimate. With the \$13.2 billion surplus in FY06, debt retirement of \$22.4 billion over the two years is expected to lower the net debt relative to GDP by 5.5 percentage points to 32.8% by March 2007. This raises the possibility of accomplishing the 25% debt-to-GDP target before the scheduled FY13.
- **Budgeting for the future is tighter.** For FY08 and FY09, the underlying surplus covers the \$3 billion annual debt repayment commitment, but a remaining surplus exists only for FY08 and is just \$0.3 billion. However, Ottawa remains committed to strictly monitoring its fiscal performance to keep it on track and accomplish debt reduction of at least \$3 billion annually. With its debt retirement promise, Canada will retain fiscal leadership among its G7 partners. Reinforcing this leadership is the aggregate provincial surplus, now projected to be \$10 billion in FY07.
- **The debt service continues to contrast** with historically low interest rates and the debt reduction accomplished to date. In FY08, interest charges are expected to absorb just 14.3¢ of every revenue dollar, down from 18¢ just four years ago. Moreover, the government's Tax Back Guarantee, that directs savings in the debt service to personal income tax (PIT) reduction will contribute \$1.1 billion in FY08 to the proposed PIT relief and \$1.3 billion in FY09.
- **Personal income tax relief for FY08, including the Working Income Tax Benefit and new Child Tax Credit, totals \$2.7 billion.** Corporate tax relief totals just \$0.3 billion next year, but picks up to \$0.9 billion by FY09 as firms take advantage of the enhanced two-year write-off allowed for manufacturing machinery and equipment over the next two years, as well as more generous Capital Cost Allowances (CCAs) for specific assets such as computers and an accelerated CCA for clean-energy generation.
- **Program spending climbs almost 14% over FY07 and FY08, or 7.6% on a real per capita basis. Relative to GDP, however, program spending at 13.3% of GDP in FY08, is still less than the recent 13.7% peak in FY05.** Key to the expenditure surge in FY08 is a \$6.1 billion increase in total payments to the Provinces and Territories, the first stage of a seven-year plan representing the government's answer to Canada's fiscal imbalance.



**Fiscal Highlights**

**Before the Budget 2007 measures, the FY07 surplus is now forecast to be \$14.1 billion**, up from the \$7.2 billion estimate in the November *Update*. Ottawa in FY07 continues to be blessed with hefty revenue surprises on the upside. Since November, FY07 revenues have been revised up by \$3.4 billion, doubling projected FY07 revenue growth from the *Budget* estimate of 2.2% to 4.5%. Program expenses for FY07 are now expected to be \$3.0 billion lower than the November *Update* estimate, and the saving on the debt service is now projected to be \$0.5 billion. The underlying revenue strength is particularly notable in light of the major tax relief introduced last year.

**Budget measures will trim \$4.9 billion from the FY07 surplus**, with \$3.1 billion going to other governments, a \$1.3 billion increase in federal programs and \$0.6 billion in tax cuts. Program spending for FY07 thus increases to almost 8%.

**Revenue growth of only 1.9% is forecast for FY08**, reflecting in part the cumulative impact of tax cuts introduced in past *Budgets* and this *Budget*. Tax relief introduced by the government since the 2006 *Budget* totals \$4.0 billion, of which \$1.0 billion is the Age Credit increase and Pension Income Splitting provisions of the *Tax Fairness Plan*, \$2.7 billion is personal income tax (PIT) relief, and \$0.3 billion stems from corporate tax cuts. **For the Tax Fairness Plan**, booked in the November *Update* estimates, legislation will be introduced with the *Budget* legislation.

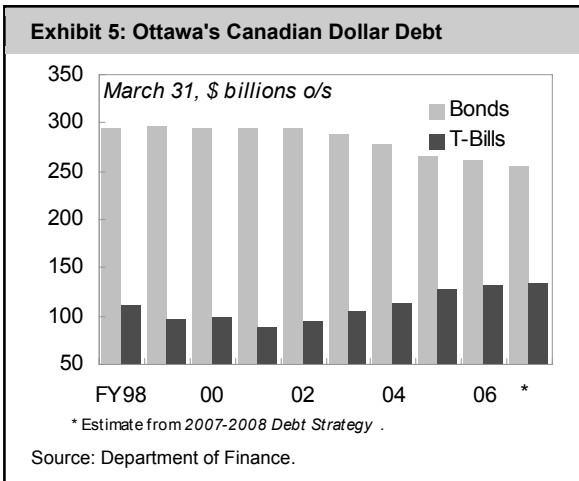
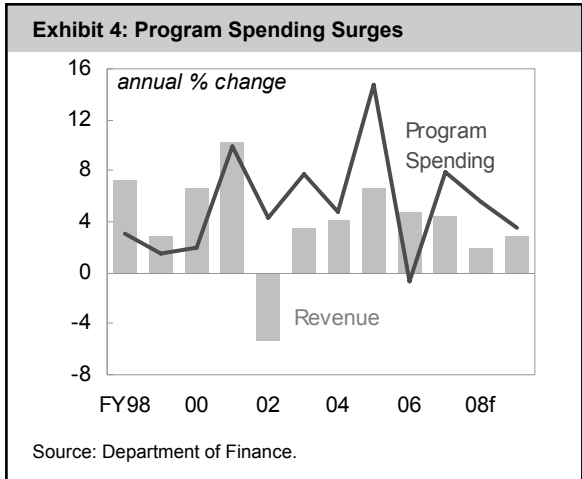
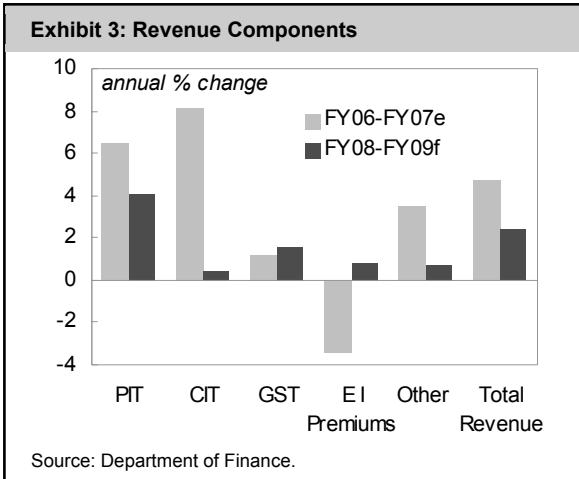
**Central in the PIT relief is the new Child Tax Credit** that provides a \$1.4 billion saving to families in FY08. To help lower-income workers surmount the welfare wall, a Working Income Tax Benefit (WITB) is introduced for 2007, offering a refundable annual tax credit of \$500 for individuals and \$1,000 for families. A supplement is offered to the WITB for disabled workers. For parents of a severely disabled child, a Registered Disability Savings Plan is introduced, to be topped up by Canada Disability Savings Bonds and the Canada Disability Savings Grants. Enhancement of the spousal amount offers a further \$270 million PIT saving for FY08.

**Household savings are encouraged through a couple of measures.** RESP enhancements include raising the annual contribution qualifying for the Canada Education Savings Grant from \$2,000 to \$2,500. Capital gains taxes, eliminated for donations to public charities in May 2006, will be removed for donations to private foundations when appropriate self-dealing rules are developed. The age limit for maturing Registered Pension Plans and RRSPs will be raised from 69 to 71 and the definition of RRSP qualified investments will be broadened to include any debt obligation with an investment grade rating and a minimum \$25 million issuance and any security other than futures contracts listed on a designated stock exchange. Missing was a measure allowing some deferral of capital gains taxes — a 2006 election promise

of the Conservatives that was expected in this *Budget* to take some of the sting out of the planned tax changes for income trusts.

**Corporate tax relief** is focused on reducing the marginal effective tax rate (METR) on new business investment. The longer-term enhancements to CCAs for several classes of assets including computer equipment, buildings used for manufacturing and processing and other non-residential premises, will trim Canada’s METR by 2.5 percentage points by 2011. While clean energy is promoted, the accelerated CCA for oil sands projects — both mining and *in-situ* — will be phased out from 2011 to 2015, with projects begun before March 19, 2007, grandfathered. To further reduce the METR, Ottawa will return to any Province the federal income tax gain stemming from that province’s reduction of its capital tax. Ottawa continues to pursue non-tax measures to make Canada more attractive for small and large businesses. The paperwork burden for small business is to be trimmed by 20% by November 2008, and a renewed effort to streamline regulations is promised this spring, including a Major Projects Management Office to act as the “single window “ for federal regulation. A shift to more principles-based regulations recommended for capital markets with a further call to establish a common securities regulator for Canada.

**International tax changes are proposed to increase the availability of capital to Canadian business and lower its cost.** For instance, assuming that the updated Canada-U.S. Tax Treaty eliminates non-resident withholding tax on interest payments, Ottawa plans to remove the withholding tax from arm’s-length interest payments to other countries.



**Program spending growth of close to 8% in FY07 and a further 5.6% in FY08** significantly exceeds the government’s original intention to hold program spending to roughly the pace of population growth and inflation. Next year’s spending increase is dominated by increased payments to the Provinces and Territories, but a broad range of initiatives are also introduced. Health measures, for example, include \$400 million of new funding for Canada Health Infoway and for post-secondary education, enhanced support for graduate students proposed.

**Total payments to Provinces and Territories**, including infrastructure and the environment, will climb by \$6.1 billion in FY08 and a plan to FY14 is mapped out. As anticipated, Equalization reform to a formula-driven system broadly follows the O'Brien Panel recommendations, shifting to a 10-Province standard, including 50% of provincial natural resource revenues and introducing a fiscal capacity cap. For the Canada Social Transfer (CST), beyond the \$300 million legislated increase for FY08, \$687 million is added to facilitate the shift to equal per capita cash support across the Provinces. Beginning in FY09, an additional \$800 million annually will be directed to the Provinces for post-secondary education and, in FY10, an automatic 3% escalator for the CST begins. For the Canada Health Transfer (CHT), equal per capita cash across the Provinces is not implemented until FY14 after the current agreement expires. The final result varies sharply across the Provinces with Quebec receiving an additional \$2.3 billion in FY08, Ontario ahead by \$1.1 billion and Alberta gaining \$0.7 billion.

**The government's commitment to predictable infrastructure support**, from FY07 to FY14, starts with the base of the gas tax transfer and the 100% GST rebate for municipal purchases. Expanding on the funding from last year's *Budget*, a Building Fund is added for highway, transit and other major projects, a national fund for gateways and borders and another for public-private partnerships are created and the Asia-Pacific Gateway and Corridor Initiative is enriched. For the important Windsor-Detroit crossing, the federal government will be responsible for the Canadian portion of the new international bridge. The seven-year total for Ottawa's infrastructure program is \$37.1 billion, including a number of funds such as the Strategic Infrastructure Fund that will be sunsetted.

**While we await the revised *Clean Air Act***, further measures are introduced including a performance rebate for energy-efficient car purchases totalling \$160 million over the next two years and a Green Levy on gas guzzler purchases. To encourage renewable fuel production, \$2 billion is allocated over the next seven years. The Conservatives' commitment to secure a prosperous future for Canadian agriculture continues with a \$400 million immediate payment to farmers to address their rising costs and \$600 million to kick start producer savings accounts that will replace the top tier of the current Canadian Agriculture Income Stabilization Program.

**Potential short-term risks include the possibility that the revenue surprises on the upside diminish.** The budget estimates are very sensitive to assume no growth, with the government calculating that a one percentage point shortfall in real GDP growth subtracts \$2.6 billion from the bottom line. However, the government's 2.3% GDP forecast for 2007 appears reasonable, and prudent assumptions are used to translate the economic forecast into revenue projections.

<b>Exhibit 6: Ottawa's Budget Arithmetic</b>				
<i>\$ billions unless otherwise noted</i>				
	<b>FY07</b>		<b>FY08</b>	<b>FY09</b>
	<b>Bud.</b>	<b>Rev.</b>	<b>Bud.</b>	<b>Bud.</b>
Personal Income Tax (PIT)	109.3	111.6	115.2	120.8
Corporate Income Tax (CIT)	35.3	35.0	36.3	35.4
Goods & Services Tax (GST)	29.8	30.5	30.1	31.4
Employment Insurance Premiums	16.1	16.1	16.2	16.4
Other Revenue	36.6	39.0	39.0	39.6
<b>Total Revenue</b>	<b>227.1</b>	<b>232.3</b>	<b>236.7</b>	<b>243.5</b>
Transfers: Persons	56.3	55.8	58.5	60.2
Transfers: Other Cdn Gov'ts*	40.1	41.6	43.5	45.6
Other	92.4	91.5	97.6	100.9
<b>Total Program Spending*</b>	<b>188.8</b>	<b>189.0</b>	<b>199.6</b>	<b>206.8</b>
Debt Service	34.8	34.1	33.8	33.7
<b>Total Expenditure</b>	<b>223.6</b>	<b>223.1</b>	<b>233.4</b>	<b>240.5</b>
<b>Underlying Surplus</b>	<b>3.6</b>	<b>9.2</b>	<b>3.3</b>	<b>3.0</b>
<b>Planned Debt Reduction*</b>	<b>3.0</b>	<b>9.2</b>	<b>3.0</b>	<b>3.0</b>
<b>Remaining Surplus</b>	<b>0.6</b>	<b>0.0</b>	<b>0.3</b>	<b>0.0</b>
Non-Budgetary Transactions	-6.0	-0.8	-7.7	0.5
<b>Financial Source/Requirements</b>	<b>-3.0</b>	<b>8.4</b>	<b>-4.7</b>	<b>3.5</b>
<b>Net Federal Debt</b>	<b>478.5</b>	<b>472.3</b>	<b>469.3</b>	<b>466.3</b>
<b>Annual Change, %</b>				
Personal Income Tax (PIT)	5.4	7.7	3.2	4.9
Corporate Income Tax (CIT)	11.4	10.4	3.7	-2.7
Goods & Services Tax (GST)	-9.6	-7.8	-1.2	4.4
Total Tax Revenue	3.4	5.6	2.0	2.9
<b>Total Revenue</b>	<b>2.2</b>	<b>4.5</b>	<b>1.9</b>	<b>2.9</b>
Transfers: Persons	7.1	6.0	4.9	2.9
Transfers: Other Cdn. Gov'ts*	-1.8	2.0	4.5	4.9
<b>Total Program Spending</b>	<b>7.8</b>	<b>7.9</b>	<b>5.6</b>	<b>3.6</b>
<b>Memo Items, %</b>				
Tax Revenue / GDP	13.4	13.6	13.4	13.1
Total Revenue / GDP	15.8	16.1	15.8	15.5
Program Spending / GDP	13.1	13.1	13.3	13.2
Net Debt / GDP	33.2	32.8	31.4	29.7
Debt Service / Revenue	15.3	14.7	14.3	13.8

\* Includes Bill C-48 third-party trusts totalling \$3.3 billion.

Source: Department of Finance.

**Exhibit 7: Economic and Interest Rate Assumptions***annual percent change unless otherwise noted*

	Scotia Economics			Finance	
	2006	2007f	2008f	2007f	2008f
<b>Canada</b>					
Real GDP	2.7	2.3	2.7	2.3	2.9
GDP Deflator	2.2	1.7	2.0	1.5	2.0
Nominal GDP	4.9	4.0	4.7	3.9	5.0
Employment	1.9	1.8	1.2	1.5	1.3
T-bills 3-mos*, %	4.0	4.0	3.8	4.2	4.2
Bonds 10-yr*, %	4.2	3.9	4.2	4.1	4.5
<b>U.S. Real GDP</b>	3.3	2.4	2.7	2.5	2.9

\* Average, not end of period.

Source: Department of Finance; Scotia Economics.

**DEBT MANAGEMENT**

**For FY07, the larger-than-expected \$9.2 billion surplus and a much smaller non-budgetary transactions requirement results in a hefty \$8.4 billion source of funds.** Actuarial adjustments in the government's pension liabilities related to prior-year service result in a \$4.7 billion source of funds. For some expenses booked in FY07 cash payments are not due until FY08. With cash payments also due next year for liabilities recorded in previous years, a \$4.7 billion financial requirement is forecast for FY08, reversing to a \$3.5 billion financial source the following year.

**This year's Budget includes the 2007-2008 Debt Strategy.** The planned reduction in the share of fixed-rate debt from two-thirds in FY03 to 60% by FY08 will be accomplished. Treasury bills outstanding are projected to climb by about \$3 billion during FY08 to \$138 billion. Gross issuance of domestic marketable bonds is expected to be \$35 billion, about \$1.5 billion higher than FY07. Long bond issuance will expand by about \$1 billion. Given maturities, however, the stock of bonds is forecast to fall by about \$2 billion to \$254 billion. Real Return Bond issuance will be slightly over \$2 billion. Similar to FY07, two auctions will be foregone, in FY08 the adjusted timing is removing a five-year auction in Q3, and a two-year auction in Q4.

**To support a well-functioning bond market and trim overall financing costs, beginning in 2008, the borrowing requirements of the Business Development Bank of Canada, Canada Mortgage and Housing Corporation (not including Canada Housing Trust) and Farm Credit Canada will be met through direct lending from the government.** The government in turn will borrow to fund these operations under amended borrowing authority legislation. Annual bond issuance from these three corporations is estimated at up to \$10 billion. This will add an additional 30% or so on to the projected gross issuance in 2007-08 of about \$35 billion. Currently these Crown corporations issue their own debt, some of which carries a higher interest cost than Government of Canada securities. The corporations also pay fees and commission on their borrowing, while the Government directly distributes its debt through an auction process. The estimated total reduction in borrowing costs from this change is estimated at up to \$90 million over five years. Outstanding debt of the three corporations plus its 2007 issuance will remain outstanding in the marketplace. The Export Development Corporation that requires funding primarily in foreign currencies will continue to borrow on a stand-alone basis, as will the Canada Wheat Board and the Canada Housing Trust (that administers the Canada Mortgage Bond program).

**Adjustments to the *Financial Administration Act*** would remove the existing statutory limit on borrowing to offer greater flexibility in debt management, but at the same time would require greater disclosure on anticipated borrowing and the use of funds in the *Debt Management Strategy* as well as greater detail in the *Debt Management Report*. More detailed information on outcomes would be included in the *Public Accounts* for the Auditor General's review.

## MARKET IMPLICATIONS

### ***Carolyn Kwan & Mary Webb***

From a financial market perspective, the first level of uncertainty has been removed, with the early media reports indicating that the Bloc Quebecois would support the passing of the budget. The government's commitment to annual debt reduction of at least \$3 billion appears realistic with reasonably prudent underlying assumptions on the government revenues and economic growth assumptions.

In the end, there was little immediate market reaction to the debt management strategy or to any specific measures contained in the Budget. Many of the measures were already communicated before today's release, lessening the surprise for markets. In aggregate, the annual \$3 billion debt repayment in subsequent years is unlikely to change the Bank of Canada's projections or its current policy stance. This is especially true given that the economic growth assumptions align quite closely with those of the BoC. The direct influence on fixed income markets from the addition of agency bonds into the overall market beginning in 2008 will help to enhance liquidity going forward, a positive for a market facing declining bond supply since 2002-03.

With respect to general fixed-income markets, the inclusion of maple bonds (a \$26.8 billion market in 2006, accounting for two-thirds of the aggregate foreign bond investment) in the securities allowed to go into pensions and RSPs will also increase demand on the margin.

## INDUSTRY INITIATIVES

### ***Patricia Mohr & Carlos Gomes***

In view of public interest in environmental issues, the proposed measures affecting industry lean heavily towards environmental initiatives, many of which had already been announced prior to the Budget:

**\$1.5 billion Canada EcoTrust for Clean Air and Climate Change** — providing financial support to provinces and territories identifying major projects that will result in reductions in greenhouse gas emissions and air pollution. Projects could include the development of technology and infrastructure enabling carbon sequestration in Alberta and clean coal and electricity generation across Canada.

**Biofuels Development** — to promote the development of a biofuels industry in Canada (mostly grain-based ethanol as well as canola oil-based biodiesel) and help to reduce greenhouse gas emissions as well as pollution, the Budget provides \$2 billion in funding over seven years to achieve a national biofuel content requirement of 5% in gasoline by 2010 and 2% in diesel and heating oil by 2012 (regulations have yet to be developed for the latter). This funding consists of \$1.5 billion for ongoing operating incentives and \$500 million for "Sustainable Development Technology Canada" for production of next-generation renewable fuels. R&D into new varieties of canola (producing more oil) or cellulosic ethanol based on forest "waste" could put Canada at the forefront of technology in this rapidly expanding global industry. Excise tax exemptions for ethanol and biodiesel will be eliminated as of April 1, 2008.

The United States currently imports 60% of its crude oil & petroleum products and is highly vulnerable to "geopolitical supply risks". As a result, mandated requirements for the use of ethanol additives in gasoline (mostly based on corn) have been implemented, resulting in near-record corn prices in early 2007.

An expected doubling of U.S. corn-based ethanol production over the next several years will likely pull more planted acres from soybeans and wheat in the United States — tightening U.S. and international supply/demand conditions for oilseeds and wheat. These developments — combined with rapidly growing production of biodiesel in Europe (based on rapeseed or canola oil) have already contributed to higher international prices for Western Canada’s canola (+ 37% year over year) and wheat (14% year over year) — leading to a “new day “ for Canadian farmers. Canada’s grain-handling companies and fertilizer producers are also benefitting.

**Levies/Credits to promote fuel-efficient vehicles** — Ottawa also unveiled plans for rebates of up to \$2,000 on the purchase of new fuel-efficient vehicles consuming 5.5 litres or less per 100 kilometres, while imposing levies on vehicles with fuel consumption in excess of 13 litres per 100 kilometres. This means that a buyer of a Toyota Prius — which has seen its sales level off at roughly 2,000 units in each the past three years, due to high sticker prices — would receive a \$2,000 rebate.

At the other end of the spectrum, new passenger vehicles that consume more than 13 litres of fuel per 100 kilometres will be hit with a \$1,000 levy. The levy will rise to \$4,000 for vehicles that consume at least 16 litres of fuel per 100 kilometres — such as some large SUVs. The rebate plan is expected to cost about \$160 million over the next two years, while Ottawa expects to collect \$215 million from the levy over those years. These measures favour Japanese manufacturers over the traditional Big Three.

The Budget also sets aside up to \$36 million over the next two years to provide incentives to replace high pollution-emitting older vehicles built before the 1995 model year. Estimates suggest that these vehicles account for about 35% of the entire Canadian vehicle fleet.

#### **MAJOR INDUSTRY TAX MEASURES**

**Enhanced Capital Cost Allowances for Manufacturing** — to assist the competitive position of the manufacturing sector, which faces intense pressure due to the appreciation of the Canadian dollar and increased global competition, the Budget provides manufacturers with an incentive to invest in new machinery and equipment. All machinery and equipment purchased between March 19, 2007 and the end of 2008 will benefit from an accelerated 50% depreciation rate, up from the current 30%. Ottawa also plans to develop a “global commerce strategy “ and a Canadian advantage in global capital markets.

**Phase-out of ACCA for Oil Sands Investment** — the accelerated capital cost allowance (ACCA) for mining investment — which was extended to “in-situ “ oil sands in 1996 — will be phased out for both new “in-situ “ bitumen and oil sands “mining “ projects between 2011 and 2015. While the ACCA for projects already under construction will be grandfathered and the phase-out will be fairly long, in our view this is a disappointing measure in view of the importance of oil sands development for the Canadian economy — not only in Alberta but across Canada — and escalating capital costs in an uncertain longer-term oil price environment. The regular 25% CCA rate will remain in place.

# Portfolio Strategy

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## POSITIVE FOR THE ECONOMY, NEUTRAL FOR MARKETS

Increased spending and provincial transfer payments proposed in the 2007 federal budget are very stimulative and should help the Canadian economy grow close to potential. With much of Canadian financial market dynamics sensitive to global developments (commodity prices, U.S. monetary policy, U.S. dollar), yesterday's federal budget will effectively impact domestic-sensitive assets such as bonds and equity sectors outside the resource complex – i.e., approximately 58% of the S&P/TSX. We believe the Bank of Canada had already factored in such a robust level of spending and we don't expect any change in policy. Interest rates should still be heading lower in the second half of 2007 when U.S. monetary policy eases. Bond investors should be pleased with the continuation of debt reduction, and Canada's balance sheet should continue to lead other G-7 countries. In terms of Canadian equity outlook, we would note that over 45% of S&P/TSX earnings are derived from global considerations. There was no mention of capital gains deferral, which may disappoint investors.

## Gas & Electric Utilities; Chemicals

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### CANADIAN RENEWABLE POWER AND FERTILIZER COMPANIES TO BENEFIT FROM ENVIRONMENT-RELATED BUDGET PROMISES

The Conservative-led federal government kept the spotlight on the environment in yesterday's budget speech with the following highlights:

- reiterated its recent commitment of its \$1.5 billion ecoTrust Program;
- rebalance the tax system to encourage investments by the oil sands industry in clean and renewable energies;
- dedicate \$2 billion over the next seven years for the production of renewable fuels;
- offer up to a \$2,000 rebate for the purchase of alternative fuel/fuel efficient vehicles; and
- introduce a Green Levy on "gas guzzlers" of up to \$4,000 per new vehicle;

Yesterday's budget announcements will be voted on shortly by the opposition parties. Initial indications are that both the Liberals and NDP have already stated that they will not support Budget 2007, while the Bloc will. We highlight the recently introduced ecoTrust and ecoEnergy Renewable programs below:

#### ***ecoTrust Program***

- The Harper minority government announced on February 12, 2007, a \$1.5 billion incentive program to be invested on a province-by-province basis for the funding of climate change, air pollution, and GHG emissions projects.
- The ecoTrust Program will be allocated to each province according to an equalization formula, which is in accordance with the federal government initiative to correct the "fiscal imbalance."
- The program is designed to allow each province to **individually develop its own strategies** with respect to the management of their specific environmental concerns.

#### ***ecoEnergy Renewable Program***

- The Harper minority Government announced on January 19, 2007, a \$1.5 billion incentive program for renewable energy sources that include wind, solar, and geothermal power, among others (i.e., run-of-river, and hydro).
- The ecoEnergy Renewable Program will provide a \$10/MWh incentive to 2017 to those renewable power projects that are constructed before 2012. The program is meant to support new renewable capacity of up to 4,000 MW.

#### ***Greenhouse Gas (GHG) Emissions Targets***

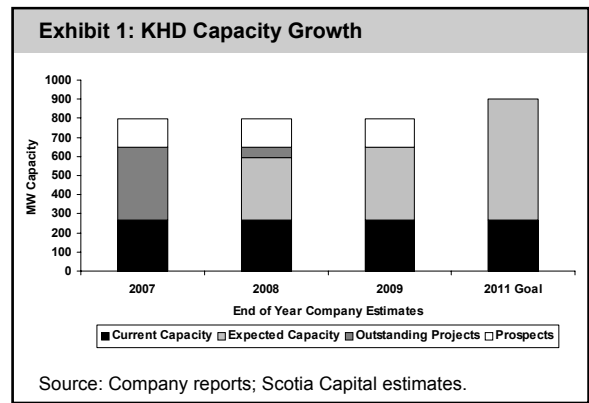
- We were surprised to find little mention on specific GHG targets in yesterday's federal budget. However, when we dug a little deeper into the details, we read that the government will announce shortly short-term targets for reductions in GHGs, as well as the already established long-term goal of reducing GHGs by 45%-65% from 2003 levels by 2050, consistent with Britain's most recent proposals.
- We recently read that the federal government, in conjunction with the Alberta government, has set up a new task force that will study ways to capture and store Alberta's GHG emissions. Specifically, the group will look at the "economic, technical, and regulatory hurdles that lie in the road of large-scale

implementation of carbon capture and storage.” The task force will be headed by TransAlta CEO Steve Snyder.

- On March 8, 2007, the Alberta government introduced legislation to reduce GHG emissions, by way of Bill 3, or the *Climate Change and Emissions Management Amendment Act*. The Bill states that companies that emit more than 100,000 tonnes of GHGs per year must reduce emissions intensity by 12% starting July 1, 2007, a **ridiculously short time frame**. It is expected that the regulation will apply to about 100 facilities that represent 70% of Alberta’s industrial emissions. If reducing emissions by 12% is not initially possible, large emitters will be able to invest in an Alberta-based technology fund. The fund will be used to develop infrastructure to reduce emissions, and to support research on viable climate change solutions. Large emitters will be required to pay \$15/tonne for every tonne below the 12% target. Alternatively, large emitters could also invest in Alberta-based projects outside their operations that reduce emissions on their behalf.

**Impact on Renewable Companies Under Coverage**

**Canadian Hydro Developers (KHD-T):** With 650 MW-750 MW of renewable energy capacity projects that could be constructed by 2012, and therefore qualify for ecoEnergy Renewable incentives of up to \$10/MWh, the budget is a clear positive for KHD. Since the start 2007, we have added \$1/share to KHD’s one-year target due to increased probability that its renewable portfolio of projects, which includes Alberta’s Dunvegan run-of-river, among others, will be approved. The forthcoming Canada-wide short-term and already established long-term GHG emissions reduction targets are also an indirect renewable energy positive, as industries may be required to buy credits from clean-air emitters like KHD. We reiterate our 1-Sector Outperform and \$8.00/share one-year target, as well as KHD as our top pick for 2007.



**Boralex Inc. (BLX-T):** Boralex could see some improvement from the announced initiatives, but with just 1% of its current capacity operating in Canada, its exposure to Canadian incentive programs is miniscule to date. However, we expect the company to participate in the September 2007 Quebec RFP, as it holds access to a 1,600 km<sup>2</sup> piece of private land northeast of Quebec City. We maintain our 3-Sector Underperform rating and \$11.00/share one-year target price.

**Alternative and Renewable Fuels Support**

As part of its Budget 2007, the government pledged \$2 billion for renewable fuels over seven years as follows: (1) \$1.5 billion as an operating incentive and (2) \$0.5 billion for “next-generation” renewable fuels (presumably cellulosic-based ethanol as well as coal, petcoke and asphaltine-based gasifiers). Therefore, this is also supportive of our position to continue to remain Overweight fertilizer stocks, which will benefit from continued incremental use of sugar-based (i.e., corn, wheat) and oil-based (i.e., canola) grain seeds that will require incremental fertilizer use. The \$1.5 billion pledge will go to producers of renewable alternatives to gasoline/diesel, such as ethanol and biodiesel. Incentive rates will be up to \$0.10/litre for renewable alternatives to gasoline and up to \$0.20/litre for renewable alternatives to diesel for the first three years, then decline thereafter. The federal government also introduced a performance-based rebate program of up to \$2,000 for the purchase of new alternative fuel or fuel efficient vehicles. Additionally, a “Green Levy” of up to \$4,000 per vehicle was introduced on “gas guzzlers” to curb consumer spending on inefficient and high-emissions vehicles.

## Income Trusts

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### NO NEW DETAILS ON TRUST TAXATION

**Budget 2007 did not provide any new details regarding the Tax Fairness Plan and the taxation of income trusts.** The budget document indicated the government's intention to enact the Tax Fairness Plan as introduced on October 31, 2006, but specifics of the actual legislation were not provided. There were no changes to the proposed tax rates or the implementation date of 2011. The Budget 2007 document states that the government is “*leveling the playing field in the taxation of publicly-traded income trusts, partnerships, and corporations.*”

**The budget is unlikely to have any significant effect on valuations in the broad trust sector, which we believe is already discounting the impact of taxation beginning in 2011.** In general, we believe the market has revalued trusts to be more in line with their common equity peers within the same industry group, giving a slight premium for the four-year tax holiday period. We expect most trusts will remain structured as such for four years, but will likely convert to corporations once the tax advantage of the structure is eliminated.

#### ***Diversified Business Trusts (Navdeep Malik, Chris Blake, Turan Quettawala)***

**In the absence of any meaningful changes to the Tax Fairness Plan, we continue to highlight three broad investment themes that we believe will characterize the business trust sector in 2007 and throughout the four-year tax holiday period.** We point investors towards trusts that (1) offer attractive valuations relative to their respective common equity peers; (2) have strong growth prospects that could potentially allow them to sustain or grow their distributions (relative to current levels) even after a tax is applied in 2011; and (3) may be attractive takeover candidates to strategic or financial buyers. Many of our top picks have these characteristics.

#### ***Oil & Gas Royalty Trusts (Brian Ector)***

**We do not expect the federal budget will have any impact on valuations within the energy trust sector.** Post the October 31 trust taxation announcement, investors have largely focused on relative valuations versus traditional E&P companies, and have looked for answers to the question of what the trust sector will look like four years from now. We believe the multiple contraction, bringing valuations in line with those of senior producers, has largely played out, and going forward, performance is likely to be more highly correlated to movements in crude oil and natural gas prices. Currently, the energy trust sector trades on par with the senior producers at a 2007E enterprise value to debt-adjusted cash flow (EV/DACF) multiple of 6.2x (versus a 1.6x premium prior to October 31). On a net asset value (NAV) basis, we estimate the proposed tax changes have reduced our calculated NAVs, on average, by about 10%. We continue to expect most trusts to revert back to dividend-paying corporations leading up to 2011.

**We reiterate our view that valuations today appear reasonable with the trust taxation issue largely reflected in current unit prices.** We believe the trust sector is currently discounting a long-term WTI equivalent oil price of US\$57.50 per boe, which compares with the forward strip for 2007 of about US\$54.70 per boe, and for 2008 of US\$59.30 per boe. We are forecasting a one-year total return for our coverage universe of 22%. Our 1-Sector Outperform rated trusts remain: Crescent Point Energy Trust, Focus Energy Trust, Freehold Royalty Trust, and Vermilion Energy Trust.

***Power and Energy Infrastructure Income Trusts (Tony Courtright)***

In our view, Budget 2007 did nothing to ameliorate the impact of the Tax Fairness Plan on Power and Energy Infrastructure Income Funds apart from doubling the proposed tax depreciation (CCA) rate for LNG projects (from 4% to 8%), which we would expect to improve project economics and facilitate stand-alone financing.

## Increased Commitment to Infrastructure Spending

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Budget 2007 allocates more than \$16 billion towards new infrastructure funding over the next seven years (2007-2014). According to government figures combining the funds allocated in Budgets 2007 and 2006, total federal spending on infrastructure will total \$33 billion over the next seven years, which represents the largest such investment in Canadian history.

- Major infrastructure initiatives highlighted in the budget include:
- \$17.6 billion in gas tax and other base funding for municipalities;
- \$8.8 billion to the Building Canada Fund to support investments in the core national highway system, urban transit, and water treatment facilities;
- \$2.1-billion fund for gateways and border crossings, including funding for the Windsor-Detroit corridor;
- \$1.25-billion national fund for public-private partnerships to leverage private capital and maximize the impact of government investments;
- increasing support for the Asia-Pacific Gateway and Corridor Initiative to \$1 billion<sup>1</sup>; and
- \$2.3 billion for provinces and territories to fund national priorities, such as trade-related infrastructure.

We expect these infrastructure funding commitments to have a broadly positive impact on a variety of companies within our coverage universe, including: *Armtec Infrastructure Income Fund*, *Finning International*, *Groupe Laperrière & Verrault*, *SNC Lavalin*, *Stantec*, *Toromont Industries*, and *Wajax Income Fund*.

In particular, we believe SNC should benefit from the new P3 funding, which includes Autoroute 30 in Quebec, STN should benefit from funding directed to municipalities, and GLV.A should benefit from increased investment in water treatment facilities.

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<sup>1</sup> The Asia-Pacific Gateway and Corridor Initiative is an integrated package of investment initiatives designed to improve the capacity and efficiency of the Asia-Pacific Gateway and Corridor. The Corridor is a network of transportation infrastructure that supports trade with the Asia-Pacific region, including the B.C. Lower Mainland and Prince Rupert ports, related road and rail connections, key border crossings and major airports.

## Transportation & Aerospace

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### FURTHER INVESTMENT IN TRADE INFRASTRUCTURE AND PUBLIC TRANSPORTATION; NO RELIEF FOR AIRPORTS AND AIRLINES

Although the transportation sector did not see any major surprises, the 2007 budget did include a number of initiatives focused on infrastructure, particularly as they relate to the growing importance of international trade flows. This year's budget includes an investment of more than \$16 billion over seven years, bringing federal support under a new long-term plan for infrastructure to a total of \$33 billion. Specific initiatives include:

- Bringing the total federal investment in the Asia-Pacific Gateway and Corridor Initiative to \$1 billion to ensure that Canada can take advantage of economic opportunities in Asia. Notably, this appears to be an additional \$400 million investment over last year's budget. Depending on the nature of this spend, it can be viewed as enhancing CP's efforts to expand its Western Canadian capacity, as well as CN's plans to build out Prince Rupert as a major West Coast port of entry.
- Providing each province and territory with an additional \$25 million per year, for a total investment of \$2.3 billion over the next seven years, to support investments in national priorities throughout the country. These investments include trade-related infrastructure like gateways, roads, highways, and other transportation facilities.

There was also a focus on promoting public transit systems, which could be modestly positive for Bombardier Transportation. Recall Bombardier won rail transit orders from both the Toronto and Montreal transit authorities in 2006. Specific initiatives include:

- Up to \$962 million in funding to help fund transit projects in the Greater Toronto Area.
- \$1.3 billion for public transit infrastructure and \$605 million over three years for a 15.5% tax credit for the purchase of monthly transit passes to increase public transit use.

Notably, the 2007 budget did not address any relief for the airline industry, specifically with regard to lower airport rents.

## Power and Pipelines

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### ENHANCED CCA RATES FOR LNG AND EXTENDED POWER PROJECT ELIGIBILITY

**A proposed doubling of the tax depreciation (CCA) rates applicable to liquefied natural gas (LNG) terminals (from 4% to 8%) should marginally improve project economics for the proponents of two competing Quebec LNG receiving terminals proposals, Rabaska - Gaz Metro LP (GZM.UN-T) and Enbridge Inc. (ENB-T); and Cacouna - TransCanada Corp. (TRP-T) and Petro-Canada (PCA-T), both of which proposals await regulatory and permitting decisions.**

**All corporate and trust issuers investing directly in renewable energy power generation equipment, waste fuel, and high efficiency cogeneration equipment should benefit from a proposed eight-year extension to the deadline for Class 43.2 equipment, which qualify for a 50% CCA rate, to assets acquired before 2020.** This extension should enhance medium-term project economics and facilitate stand-alone financing. We do not expect any immediate market impact from these proposals.

## Emergis Inc. (EME-T)

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### FEDERAL BUDGET SUPPORTS EHR STRATEGY

The 2007 Canadian federal budget allocates \$400 million in new funding to Canada Health Infoway, increasing the federal agency's budget by 33%. Electronic health record (EHR) funding represents 40% of new funds allocated towards major health care capital investments.

**Increase to Infoway's budget positive for Emergis.** Our view is that the federal government's \$400 million allocation to Infoway is supportive of Emergis' initiatives to secure EHR projects across Canada.

**Ontario investment in health expected in provincial budget on Thursday, March 22.** Ontario's investment in EHR remains a major opportunity for Emergis as the province implements EHR technology in 14 regional health systems. We will provide an update on any major investments by Ontario resulting from Thursday's budget.

Our view remains positive on Emergis' stock, based on the significant recurring revenue base and the potential for further upside from regional electronic health record wins.

## Oil & Gas

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### OIL SANDS - ACCELERATED CCA REMOVED

In our opinion, discontinuation of the accelerated Capital Cost Allowance (CCA) was expected to some degree, and will not make or break oil sands projects. Nor do we see any material change to our oil sands production outlook which, from about 1.1 mb/d in 2006, could rise to 1.8-2.0 mb/d by 2010E and as much as 3.9 mb/d by 2015E. That said, the CCA change is sure to otherwise hasten future cash tax horizons to some extent as future oil sands expansion phases unfold.

Accelerated CCA has been in place for oil sands mining projects since 1972, and was extended to in-situ projects in 1996. The accelerated allowance enables a taxpayer to deduct up to 100% of the cost of eligible assets in the year incurred. Although this provision will be phased out under the 2007 federal budget, there are certain grandfathering considerations that will be provided. More specifically, accelerated CCA will continue to be available for oil sands related assets that were (1) acquired prior to March 19, 2007, or (2) purchased before 2012 which are part of a project phase on which major construction began before March 19, 2007. A gradual phase-out of the accelerated CCA will be applied to other acquired oil sands assets which do not qualify. Accelerated CCA for clean energy generation, which produces energy more efficiently or uses renewable energy sources, will be extended to equipment purchased before 2020.

Assessing the taxation hit for our oil sands coverage group, which consists of Suncor (1-Sector Outperform, our favourite), Western Oil Sands (2-Sector Perform), OPTI Canada (2-Sector Perform), and to a lesser degree Petro-Canada (2-Sector Perform) and Nexen (1-Sector Outperform) (which have interests in Syncrude), as well as Canadian Natural Resources (2-Sector Perform), EnCana (2-Sector Perform), Imperial Oil (3-Sector Underperform), and Husky (2-Sector Perform), is very preliminary at this stage. Moreover, these taxation changes are unlikely to be felt anytime soon given the grandfathering provisions. Accordingly, there are no changes to any of our investment ratings, target prices, or earnings/cash flow estimates as a consequence.

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### THE 2007 FEDERAL BUDGET INCLUDED A NUMBER OF TAX PROPOSALS:

#### ***Working Income Tax Benefit***

Effective for the 2007 taxation year, the Working Income Tax Benefit (WITB) will provide a refundable tax credit equal to 20% of each dollar earned in excess of \$3,000 to a maximum credit of \$500 for individuals and to a maximum credit of \$1,000 for families. The credit will be reduced by 15% of net family income in excess of \$9,500 for individuals and \$14,500 for families.

#### ***WITB for Persons with Disabilities***

WITB for Persons with Disabilities will include an additional disability supplement for each individual who is eligible for the disability tax credit. The supplement will equate to 20% of each dollar in excess of \$1,750 of earned income up to a maximum credit of \$250. The supplement will be reduced by 15% of net family income in excess of \$12,833 for individuals and \$21,167 for families.

#### ***Registered Disability Savings Plan***

An RDSP will be introduced sometime in 2008. Persons eligible for the Disability Tax Credit and resident in Canada (or their parent or legal representative) will be eligible to establish an RDSP. Contributions will be permitted until the end of the year in which the beneficiary attains 59 years of age and will be limited to a lifetime maximum of \$200,000, with no annual limit. Contributions will not be deductible but the income earned on amounts inside the plan will accrue tax-free. Income earned in the plan will be included in the beneficiary's income for tax purposes when paid out of the RDSP.

#### ***Canada Disability Savings Grants***

CDSGs will be paid as matching amounts to RDSP contributions made in the year as follows: On family net income up to \$74,357: 300% on the first \$500 in RDSP contributions and 200% on the next \$1,000; On family income over \$74,357, 100% on the first \$1,000 in RDSP contributions.

#### ***Canada Disability Savings Bonds***

Canada Disability Savings Bonds of up to \$1,000 will be paid annually to an RDSP where family net income does not exceed \$20,833. There will be a lifetime limit of \$20,000 on CDSBs paid in respect of an RDSP beneficiary.

#### ***Charitable Donations to Private Foundations***

Effective for gifts made on or after March 19, 2007, the budget proposes to eliminate the taxation of capital gains arising from donations of publicly listed securities and proposes to eliminate from tax, the employment benefit associated with employee stock options when those publicly listed securities are donated to the private foundation within 30 days of exercise.

**Registered Education Savings Plans**

The \$4,000 annual limit will be eliminated and the lifetime contribution limit will be increased to \$50,000. The maximum annual amount qualifying for the 20% Canada Education Savings Grant will be increased to \$2,500 (from \$2,000), increasing the maximum CESG to \$500. The maximum CESG for the year will increase to \$1,000 (from \$800). Part-time students will now also be eligible for RESP assistance.

**Elementary and Secondary School Scholarships**

Elementary and Secondary School Scholarships will be fully exempt from tax for 2007 and subsequent taxation years.

**New Child Tax Credit**

Effective for 2007, there will be a new non-refundable child tax credit for parents of \$2,000 for each child under 18 years of age at the end of the taxation year. The credit will be indexed and calculated by reference to the lowest personal tax rate for the taxation year. For 2007 the lowest personal tax rate is 15.5%. The credit will provide income tax relief of up to \$310 per child.

**Spousal and Other Amounts**

Effective for 2007, the spousal or common-law partner and wholly dependent relative tax credits will be increased by \$1,348, to match the level of the basic personal amount credit. There will be a corresponding elimination of the threshold above which the dependant's net income must be taken into account. This will provide individuals with up to \$209 in additional income tax relief. For 2008 and subsequent tax years, these credits will be increased by the same amounts as the basic personal amount.

**Public Transit Tax Credit**

The public transit tax credit will be expanded to include cost-per-trip electronic payment cards issued after 2006. The credit will apply to cards where the cost relates to the use of public transit for at least 32 one-way trips during an uninterrupted period not exceeding 31 days. The public transit tax credit is also being expanded to include weekly transit passes that are valid for use after 2006 where an individual purchases at least four consecutive weekly passes

**Lifetime Capital Gains Exemption**

Effective for dispositions that occur on or after March 19, 2007, the lifetime capital gains exemption (LCGE) for qualified small business shares and qualified farm or fishing properties will be increased to \$750,000. For dispositions of qualified property in 2007 the exemption will be adjusted to recognize both the current and proposed new exemption limits.

**Meal Expenses of Truck Drivers**

Over the next five years, the deductible portion of the cost of food and beverages consumed by long-haul truck drivers will increase to 80%. The deductible portion of expenses will increase to 60% for expenses incurred on or after March 19, 2007, and before January 1, 2008, and then an additional 5% for each following year.

***Phased Retirement***

The 2007 budget now offers more flexibility to employers to offer phased retirement programs for its older workers. In effect, it allows an employer to offer an employee a partial pension of up to 60% of the employee's accrued "Defined" pension benefits while at the same time allowing the employee to accrue benefits in respect of post-pension commencement employment. This is regardless of whether the employee is working full-time or part-time.

Qualifying employees will be limited to individuals who are at least 55 years of age and who are otherwise eligible to receive a pension without the plan imposing an early retirement reduction. The 60% limit will be the amount of pension benefit that would be paid from the plan if the employee were fully retired.

***Age Limit for Maturing RPPs and RRSPs***

Currently, taxpayers are required to stop contributing to their RRSPs at the end of the year in which they turn age 69 and then start a withdrawal program (RRIF). The 2007 budget proposes to extend this conversion to when the taxpayer reaches the age of 71. Individuals who turn 69 years of age in 2007 immediately benefit from the proposed change.

The measure will also benefit individuals who turn 70 or 71 years of age in 2007, in that if RRSP contribution room is available, RRSP contribution can be made in 2007 and 2008 for the 70-year-old and in 2008 for the 71-year-old.

***RRSP Qualified Investments***

Eligible investments have been expanded to include:

- Any debt or obligation that has an investment grade rating and that is part of a minimum \$25 million issuance.
- Any security that is listed on a designated stock exchange.

***Mineral Exploration Tax Credit***

The mineral exploration tax credit is a benefit available to individuals who invest in "Flow-Through" shares. It is equal to 15% of specified mineral exploration expenses incurred in Canada and renounced to Flow-Through share investors.

Budget 2007 proposes to extend eligibility for the mineral exploration tax credit to Flow-Through share agreements entered into on or before March 31, 2008.

***48-Hour Travellers' Exemption***

Budget 2007 proposes to increase the travellers' exemption to \$400 from its current amount of \$200 for Canadian travellers leaving the country for more than 48 hours but less than seven days.

***"Green" Levy on Fuel-Inefficient Vehicles***

Budget 2007 introduces a vehicle efficiency incentive designed to promote the purchase of fuel-efficient vehicles in Canada. The Green Levy will apply to new automobiles designed to primarily carry passengers, including station wagons, vans, and sport utility vehicles, but not pick-up trucks, in accordance with the vehicle's fuel efficiency rating.

This rating will be calculated on the basis of weighted average fuel consumption. The Green Levy will apply to new vehicles delivered or imported after March 19, 2007. The inventory of vehicles held by dealers on March 19 will not be subject to the levy.

As well, vehicles for which an agreement in writing between a dealer and a final consumer was entered into before March 20, 2007, will not be subject to the levy, provided that the final consumer takes possession of the vehicle before July 2007. The Green levy will also apply to imported used vehicles put into service after March 19, 2007.

### ***International Tax Measures***

#### *Withholding Tax on Interest*

It has been announced that Canada and the United States have agreed in principle to amend the Canada–U.S. tax treaty to eliminate withholding tax on cross-border interest payments. For interest paid between unrelated parties, the elimination of the withholding tax will take effect as of the first calendar year following the entry into force of the treaty changes. This could be a long process.

#### *Trust Tax Measures*

There is increasing pressure on the investment fund industry to issue Trust T3 tax slips in a timely manner to allow taxpayers sufficient time to prepare their annual income tax return. The federal government is working with the investment funds industry to develop a process that will balance the needs of both the taxpayers and commercial trusts (including income trusts) to meet their respective tax filing obligations. Draft regulations setting out a more efficient process for issuing 2007 T3 tax slips is expected to be released shortly.

## Notes

## Notes

## Appendix A: Important Disclosures

Company	Ticker	Disclosures*
Armtec Infrastructure Income Fund	ARF.UN	T, U
Canadian Natural Resources Limited	CNQ	H3, U
Crescent Point Energy Trust	CPG.UN	U
Emergis Inc.	EME	T
Enbridge Inc.	ENB	H3, S, U
EnCana Corporation	ECA	H, H3, T
Finning International Inc.	FTT	H3, P
Freehold Royalty Trust	FRU.UN	S
Groupe Laperriere & Verreault Inc.	GLV.A	T
Husky Energy Inc.	HSE	S
Petro-Canada	PCA	B1, H, H3, S
Toromont Industries Ltd.	TIH	H3
TransCanada Corporation	TRP	H3, S, U
Western Oil Sands Inc.	WTO	P

The following analysts certify that (1) the views expressed in this report in connection with securities or issuers they analyze accurately reflect their personal views and (2) no part of their compensation was, is, or will be directly or indirectly, related to the specific recommendations or views expressed by them in this report: Sam Kanes, Brian Ector, Navdeep Malik, Cherilyn Radbourne, Anthony Zicha, Tony Courtright, Paul Steep, and Greg Pardy

The Research Analyst's compensation is based on various performance and market criteria and is charged as an expense to certain departments of Scotia Capital Inc., including investment banking.

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For Scotia Capital Research analyst standards and disclosure policies, please visit <http://www.scotiacapital.com/disclosures>

\* *Legend*

- B1** The CEO and President of Petro-Canada is a director of The Bank of Nova Scotia.
- H** The Fundamental Research Analyst/Associate, in his/her own account or in a related account, owns securities of this issuer under his/her coverage.
- H3** The Head of Equity Research/Supervisory Analyst, in his/her own account or in a related account, owns securities of this issuer.
- P** This issuer paid a portion of the travel-related expenses incurred by the Fundamental Research Analyst/Associate to visit material operations of this issuer.
- S** Scotia Capital Inc. and its affiliates collectively beneficially own in excess of 1% of one or more classes of the issued and outstanding equity securities of this issuer.
- T** The Fundamental Research Analyst/Associate has visited material operations of this issuer.
- U** Within the last 12 months, Scotia Capital Inc. has undertaken an underwriting liability with respect to equity securities of, or has provided advice for a fee with respect to, this issuer.

## Definition of Scotia Capital Equity Research Ratings & Risk Rankings

We have a three-tiered rating system, with ratings of 1-Sector Outperform, 2-Sector Perform, and 3-Sector Underperform. Each analyst assigns a rating that is relative to his or her coverage universe.

Our risk ranking system provides transparency as to the underlying financial and operational risk of each stock covered. Statistical and judgmental factors considered are: historical financial results, share price volatility, liquidity of the shares, credit ratings, analyst forecasts, consistency and predictability of earnings, EPS growth, dividends, cash flow from operations, and strength of balance sheet. The Director of Research and the Supervisory Analyst jointly make the final determination of all risk rankings.

### Ratings

#### 1-Sector Outperform

The stock is expected to outperform the average total return of the analyst's coverage universe by sector over the next 12 months.

#### 2-Sector Perform

The stock is expected to perform approximately in line with the average total return of the analyst's coverage universe by sector over the next 12 months.

#### 3-Sector Underperform

The stock is expected to underperform the average total return of the analyst's coverage universe by sector over the next 12 months.

#### Other Ratings

*Tender* – Investors are guided to tender to the terms of the takeover offer.

*Under Review* – The rating has been temporarily placed under review, until sufficient information has been received and assessed by the analyst.

### Risk Rankings

#### Low

Low financial and operational risk, high predictability of financial results, low stock volatility.

#### Medium

Moderate financial and operational risk, moderate predictability of financial results, moderate stock volatility.

#### High

High financial and/or operational risk, low predictability of financial results, high stock volatility.

#### Caution Warranted

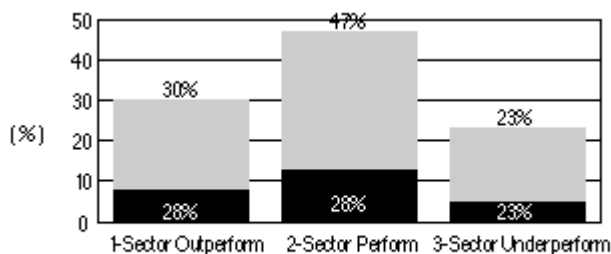
Exceptionally high financial and/or operational risk, exceptionally low predictability of financial results, exceptionally high stock volatility. For risk-tolerant investors only.

#### Venture

Risk and return consistent with Venture Capital. For risk-tolerant investors only.

## Scotia Capital Equity Research Ratings Distribution\*

### Distribution by Ratings and Equity and Equity-Related Financings\*



\*As at February 28, 2007.

Source: Scotia Capital.

For the purposes of the ratings distribution disclosure the NASD requires members who use a ratings system with terms different than "buy," "hold/neutral" and "sell," to equate their own ratings into these categories. Our 1-Sector Outperform, 2-Sector Perform, and 3-Sector Underperform ratings are based on the criteria above, but for this purpose could be equated to buy, neutral and sell ratings, respectively.

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