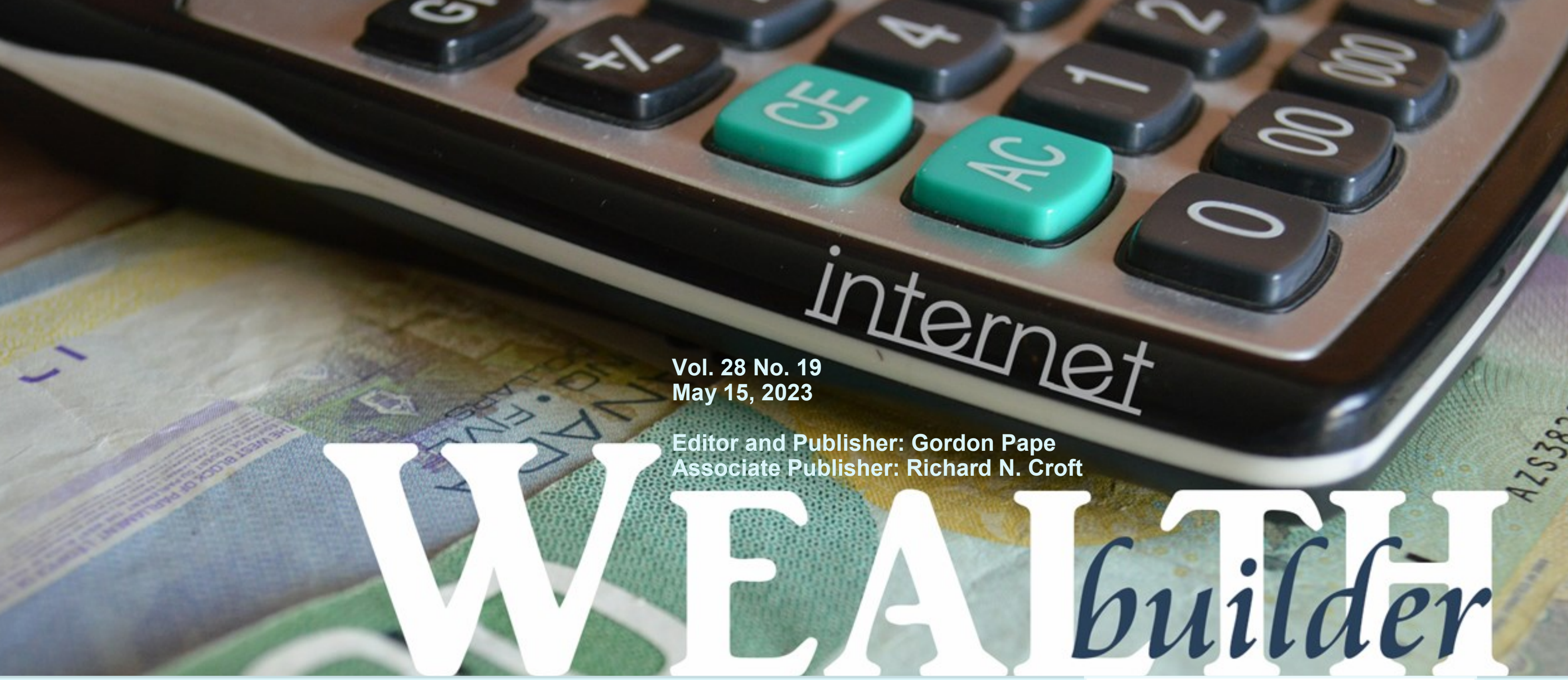

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UTILITIES RECOVER

By Gordon Pape, Editor and Publisher

Utility stocks are normally unpretentious workhorses in a portfolio. They aren't flashy and don't generate large capital gains. But they usually provide stability and cash flow, which is a combination that appeals to many investors in uncertain times.

Last year was an exception. Although the dividends continued to flow, the rapid run-up in interest rates by the central banks hit utility stocks hard. The S&P/TSX Capped Utilities Index (total returns) began 2022 at 881.48. It finished at 788.38 for a loss of 10.6%. Suddenly, utility stocks didn't look quite so stable.

All of Canada's major utilities were hit. Rising interest rates raised borrowing costs for these capital-intensive companies. At the same time, share prices fell as investors demanded higher yields for holding risky, interest-sensitive stocks.

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We've continued to see interest rates rise this year, but there's been a turnaround in the performance of utilities. As of the close on May 11, the TSX total returns capped utilities index was ahead 9.52% year to date. Investors had almost recovered the losses of 2022 in less than four and a half months.

What happened? Here's how I see it.

Interest rate expectations. Looking ahead, it appears the latest rate hike cycle is over, or close to it. Inflation is edging down with each passing month, reducing the need for more rate hikes to bring it under control. That doesn't mean there won't be a few more, but we're unlikely to return to the intensity we experienced last year.

Oversold stocks. The utilities pendulum swung too far to the downside last year. It was due to correct itself – which it has.

Attractive yields. In early March, Fortis shares were yielding 4.2%. Canadian Utilities was paying 5.1%, and Emera was yielding 5.2%. Those are attractive returns from rock-solid companies and investors started to take notice.

Although other utility stocks have higher yields, my go-to choice in this sector has long been Fortis Inc. Here's an update on the stock.

Fortis Inc. TSX, NYSE: FTS

BUY

Originally recommended on Aug. 15/05 (#2531) at $20.80. Closed Friday at C$61.55, US$45.42.

Background: Fortis is an electricity and natural gas distribution utility based in St. John's, Newfoundland and Labrador. It has total assets of about $65 billion and generated revenue of $11 billion in 2022. The company serves about 3.4 million utility customers in five Canadian provinces, nine US states, and three Caribbean countries. It has 9,100 employees.

Performance: The shares touched a 52-week low of $48.45 in mid-October but have been gradually working their way up since. After a setback in early March, the price took off and the shares are now trading at over $61.

Recent developments: The company released first quarter results earlier this month and they came in ahead of expectations. Net earnings attributable to shareholders were $437 million ($0.90 per share). That compares to $350 million ($0.74 per share) in the first quarter of 2022. Adjusted net earnings were $439 million ($0.91 per share). That was up $70 million ($0.13 per share) from the same period in 2022.

Management said the profit increase reflected rate base growth, higher retail electricity sales, and lower depreciation expense.

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Fortis—continued from page 2...

Fortis invested $995 million in capital expenditures in the quarter and said the company is on track to spend $4.3 billion on capex in 2023. Projects include construction of the Eagle Mountain Woodfibre Gas Line in British Columbia.

Divestiture: The company is selling its 93.8% ownership interest in the Aitken Creek Natural Gas Storage Facility to Enbridge for approximately $400 million. Management says the proceeds will be used to strengthen the balance sheet and support the financing of its regulated utility growth strategy.

Dividend: The quarterly dividend is $0.565 per share ($2.26 per year). The shares yield 3.7% at the current price. The company expects annual dividend increases of 4-6% through 2027.

Outlook: The company's $22.3 billion five-year capital plan is expected to increase the midyear rate base from $34.1 billion in 2022 to $46.1 billion by 2027. This translates into a five-year compound annual growth rate of 6.2%.

Action now: Buy for yield and modest capital growth.

YOUR QUESTIONS Buy Topicus?

Q – I recently read an article with regards to a spinoff of Constellation Software (TSX: CSU). The company is called Topicus (TSX-V: TOI). It is currently trading close to its 52-week high, and from what I can decipher it's very well-run and growing exponentially. I was hoping I could get your opinion on this company and what you see in the future for it. – Paul C.

A – Constellation Software is a very successful Canadian company so investors would naturally be interested in a related venture. Topicus was spun-off in early January 2021, with Constellation shareholders receiving 1.86 shares of the new company for each common share of Constellation they owned. Topicus immediately started trading on the Toronto Venture Exchange in the $60 range. The shares reached a high of about $136 in September of that year before pulling back. A year later, they were back around the $60 range. In short, the stock has been volatile.

The company is based in The Netherlands. It provides vertical market software and platforms to about 100,000 customers in 26 European countries.

The business is doing well. First quarter revenue was up 30% year-over-year (organic growth was 8%) to €264.4 million compared to €203.8 million in the same period of 2022. (One euro equals C$1.47.) Net income increased to €21.1 million

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A RECESSION WITH HIGH OIL PRICES?

By Gavin Graham, Contributing Editor

The most recent quarter point increase in short term interest rates by the US Federal Reserve means rates have increased by 500 basis points (bps) or 5% in just over a year.

This is the largest and fastest increase in the last forty years. We haven't seen anything like this since Fed Chair Paul Volcker was breaking the back of high inflation in the 1970s and early 1980s. As a result, the yield curve has become steeply inverted. In other words, short term rates are between 0.5%, for the two-year US Treasury, and 1.5% (the Fed Funds rate) higher than the benchmark 10-year yield of 3.45%. The inverted yield curve has a nearly faultless record of predicting a recession or at least a sharp economic slowdown.

While the Fed and other commentators are pointing to the still elevated level of CPI inflation, which is running at 6% rather than their 2% target, and fifty-year lows in unemployment (3.5% in the US, 5.1% in Canada), these are lagging indicators. Employment is always the last economic indicator to reflect changes in conditions, as it's both expensive and difficult to cut jobs, unless the employer is convinced employees won't be needed again soon.

Instead, overtime will be reduced or, especially after the pandemic, working from home encouraged, which is less costly for companies. Similarly, with the sharp increases in commodity prices due to the invasion of Ukraine now dropping out of annual comparisons, it's virtually guaranteed that the CPI will fall further, even if it doesn't get back down to 2%.

Nonetheless, the likelihood is that energy prices will remain substantially higher than has been the case for the last fifteen years. The invasion of Ukraine and the resulting sanctions imposed on Russian oil and gas exports has reminded the world of the vulnerability of energy supplies to geopolitical factors. While Europe enjoyed a surprisingly mild winter in 2022-23 and gas prices plummeted as a result, the quadrupling of natural gas prices last summer meant governments were scrambling to subsidize energy bills to avoid consumers facing the choice between heating and eating.

The decision by the Biden administration to release oil supplies from the Strategic Petroleum Reserve last summer undoubtedly helped keep the price of gasoline under some sort of restraint. Commentators satirically suggested that the right to $4 a gallon gasoline was enshrined in the

Continued on page 5...

Oil—continued from page 4...

Constitution. But the move resulted in the Strategic Reserve being reduced to its lowest level in forty years.

In the meantime, the US administration is putting out conflicting messages. Energy companies are berated for not pumping more oil to keep prices down while at the same time the entire fossil fuel industry is supposed to switch over to carbon neutral output by 2035. This has left energy companies evidently determined not to increase capital expenditure or go looking for new reserves, as they will not be rewarded for doing so by investors.

As a result, even with oil below $75 a barrel for much of the last few months, cash has been piling up on oil companies' balance sheets. The Wall Street Journal's lead article on May 9th was headlined "Big Oil has $150 billion in Cash and Investors want a Share". The article starts by saying: "Wall Street has a few ideas on how to spend the mountain of cash – and new drilling isn't near the top of the list."

The uncertain economic outlook has weighed on the price of crude oil in 2023, making the energy sector the S&P 500's worst performer. But cash continues to flow into the coffers of the energy giants. The six energy majors, often described as Big Oil, are ExxonMobil and Chevron in the US, the UK's BP and Shell, France's TotalEnergies, and Italy's ENI. Together, they had nearly $160 billion (all numbers in US dollars) in cash and equivalents at the end of the first quarter. Of this, ExxonMobil (NYSE: XOM) and Chevron (NYSE: CVX) had $48.3 billion, up $1 billion from the end of 2022. The last time they had more than $40 billion in cash was in 2008, when oil had been at an all-time high of $145 per barrel.

Furthermore, as opposed to chasing production growth as producers have traditionally done, Exxon and Chevron have been spending more on returning cash to shareholders than on capital expenditures. This is a major shift in priorities. The two companies had spent more on capital expenditures than shareholder returns for 28 straight quarters up to June 2020. They have completely reversed that pattern every quarter since. In the first quarter this year, they paid out $14.8 billion in dividends and buybacks compared to $8.4 billion in capital expenditures.

Given how cyclical the energy industry has been, such conservatism is understandable. Chevron's CFO Pierre Breber told analysts: "We know the good times don't last".

It's not just the majors either. ConocoPhillips and 48 other smaller energy companies funneled 42% of their cashflow into shareholder returns against 35% for capital investment in the first quarter of 2023. That was down from 67% in capex in 2020.

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Oil—continued from page 5...

Given the capital discipline being displayed by oil companies, the ongoing global political uncertainties, the high returns oil companies are getting by retaining cash with interest rates at present levels, and the lack of new investment, oil and gas prices look set to remain at present levels or even higher over the next eighteen months to two years. This is more than sufficient to offset any effect on demand from a recession in the developed economies.

We should expect growing demand from emerging markets, especially now that China has ended its zero-Covid lockdown policies.

Investors should maintain a sensible exposure to the sector. While ExxonMobil and ConocoPhillips are already IWB recommendations, I'd like to add Chevron to the list. It offers a high yield and is a well-positioned oil major. The company has underperformed against its rivals over the last twelve months, with the stock off 6.5%. By contrast, Exxon is up 19%, Shell by 41%, BP by 16%, and ENI by 3%. Details follow.

Your questions—continued from page 3...

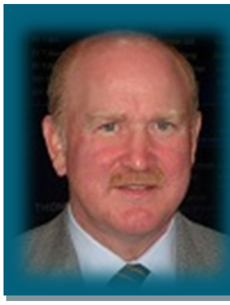
(€0.17 on a diluted per share basis) from €20.4 million (€0.14 per share) in the prior year.

Like its parent, Tropicus is growing by acquisition. The company spent €22.7 million in the quarter on new purchases.

Overall, this looks like a company with a bright future. It's essentially trying to replicate Constellation's success story in a European environment and, so far, is succeeding.

But – there's always a but. The shares are trading at around $95, resulting in a p/e ratio of 93.62. That's a high price to pay for future earnings that may or may not happen, especially considering that Europe is traditionally a slower growing economy than North America.

In sum, it's an interesting company. But at this price it needs to be viewed as speculative. – G.P.



GAVIN GRAHAM RECOMMENDS

Recommendations are colour-coded:
Green indicates Buy
Yellow indicates Hold
Red indicates Sell

Chevron Corp NYSE: CVX — BUY

The business: Chevron was formed by the merger of Chevron and Texaco in the 1980s. It is the second largest private oil and gas company in the US and the third largest by market capitalization in the world after ExxonMobil and Saudi giant Aramco.

Performance: The stock has been an underperformer in the Energy sector, although it has rallied from its March 52-week low of $132.54. (All prices in US dollars.)

Recent developments: In the first quarter of 2023, ended March 31, oil and gas production was down 3% to 2.98 million barrels of oil equivalent (boe) per day. The reduced output was due to a contract expiration in Thailand and the sale of shale properties in South Texas.

Despite lower production, net earnings climbed 5% to $6.57 billion ($3.46 per share). Profits from refining were up five-fold to $1.8 billion, even though profits from oil and gas production fell 25% on lower oil prices. Brent crude, the global benchmark, was down 16% to an average of $82 per barrel compared to a year ago. CFO Pierre Breber commented: “Brent prices are high yet down quite a bit, but you are still seeing a mid-double-digit return for every dollar spent by the company”.

The company ended the quarter with $15.7 billion in cash. That was down 11% from a year ago but still above what it needs to run the business, Mr. Breber said. The company considers it “economically inefficient” to hold so much cash, he said. “The intent over time is that the cash will be returned to shareholders in a steady way.”

Chevron would only use the money to pursue deals if there were benefits to shareholders he added, noting: “We are always looking (but) we have a very high bar because we don’t need to do a deal.” Capital expenditure was up 55% from a year ago to $3 billion, primarily driven by investment in US projects.

Dividend and buybacks: Chevron has increased its base dividend for 36 consecutive years, with its most recent

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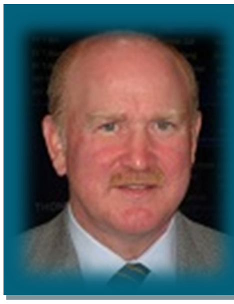
Chevron—continued from page 7...

increase being 6% to $1.51 per quarter in May ($6.04 annually). That's equivalent to a 3.86% dividend yield.

In the first quarter, dividends paid totaled $2.9 billion and share buybacks of 22 million shares totaled $3.75 billion. In total, shareholder returns were $6.6 billion, an increase of 65% from last year. In the second quarter, Chevron has announced $4.375 billion in buybacks.

Over the past two years, Chevron has generated $80 billion in cash flow and $60 billion in free cash flow, so is well able to sustain this increased rate of dividends and share buybacks for the foreseeable future.

Action now: Chevron sells at eight times trailing twelve-month earnings. The stock is up only 25% over the last five years compared to 34% for ExxonMobil and 52% for the S&P 500, while yielding over 3.8%. Chevron is very reasonably valued, is expected to show growth in production and cash flow. It is generating enormous quantities of excess cash, which it has committed to return to shareholders over time. The stock is a Buy at current levels. The shares closed Friday at $156.62.



GAVIN GRAHAM'S UPDATES

Recommendations are colour-coded:
Green indicates Buy
Yellow indicates Hold
Red indicates Sell

Cameco TSX: CCO; NYSE: CCJ

BUY

Originally recommended on Nov 8/21(#22140) at C$33.63, US$27.00. Closed Friday at C$37.55, US$27.71.

Background: Saskatoon based Cameco is one of the world's largest uranium producers, with major mines in Saskatchewan and refineries in Ontario. With the reactivation of its flagship McArthur River mine last year and the Cigar Lake mine returning to full production after being closed due to Covid-19 for four months early in 2022, its production has recovered to 10.4 million lbs. of uranium. Cameco's 54.5% of Cigar Lake produced 9.3 million lbs. and the restarted McArthur River 1.1 million.

Performance: Having risen to $39.70 in February, Cameco has pulled back slightly to $37.55. Given the issue of US$767 million of new equity to help fund its acquisition of 49% of Westinghouse Nuclear, this is a resilient performance.

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Cameco—continued from page 8...

Recent developments: Revenue in 2022 grew 27% to $1.87 billion. Net earnings swung from a loss of $103 million (-$0.26 per share) to a profit of $89 million ($0.22 per share). Adjusted net earnings were $135 million ($0.33 per share), with cash generated of $305 million.

For the first quarter of 2023, to March 31, revenue rose 73% to $687 million, and earnings almost tripled to $119 million ($0.27 per share) from $40 million ($0.10 per share) due to higher deliveries and prices.

Dividend: Cameco continues to pay a nominal dividend of $0.12 per annum, equivalent to a 0.32% yield, as it prefers to retain its cash for its expansion projects.

Outlook: Cameco adjusted its revenue forecast to $2.22 billion to $2.37 billion for 2023, up from $2.12 billion to $2.27 billion. With McArthur River and Cigar Lake both producing at their licensed capacity of 18 million lbs. each, Cameco should be on track to produce 27.8 million lbs. It has $1.3 billion in cash on its balance sheet to help fund the Westinghouse acquisition, which is expected to close in the second half of the year.

Action now: Selling at virtually the same price as two years ago with revenues and earnings growing rapidly on restored production and higher uranium prices, Cameco remains a strong Buy. It's a play on clean energy and the security of the uranium supply in Canada.

First Quantum Minerals TSX: FM; OTC: FQVLF

BUY

Originally recommended on March 8/21 (#22110) at C$26.92, US$21.24. Closed Friday at C$31.83, US$23.49.

Background: First Quantum is one of the largest copper producers in the world, with production of over 775,000 tonnes in 2022 from its three major mines. They are the Kanshanshi and Sentinel in Zambia and the giant Cobre Panama mine in Panama. It also produces 25,000 tonnes of nickel from its Ravensthorpe mine in Australia.

Performance: Concerns over its dispute with the government of Panama over the level of guaranteed royalties from Cobre Panama led to a temporary suspension of output in early 2023. This partially accounts for First Quantum's lacklustre share price action, which knocked the price back to $24.60 in early February. The stock has since risen almost 30%.

Recent developments: For the year to Dec. 31, First Quantum saw earnings rise 24% to $1.03 billion ($1.49 per share) vs. $1.20 per share in 2021. (All numbers in US dollars.) This was despite copper production falling 5% to 775,859 tonnes.

CEO Tristan Pascall said 2022 was challenging for the company and the entire mining industry, with volatile

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FM—continued from page 9...

commodity prices and rising costs and interest rates.

The dispute with Panamanian government over royalties and taxes saw production at Cobre Panama suspended for several weeks. A 20-year agreement was signed in March which provides for a minimum royalty of $375 million per year on 12-16% of its profits.

Employing 40,000 people and accounting for 5% of Panama's GDP, Cobre Panama cost First Quantum $6.8 billion. The new agreement makes it subject to more stringent environmental terms and sets up a closing plan. As a result, First Quantum's first quarter sales were down 28% to $1.6 billion, and earnings fell 80% to $75 million ($0.11 per share) from $385 million ($0.56 per share). The rainy season affected the Zambia properties in addition to the Panama suspension.

First Quantum announced at the end of March it is taking a 55% stake in the La Granja copper project in Peru with Rio Tinto for $105 million and is committed to investing up to $546 million to develop the project, which it will manage.

Dividend: First Quantum pays a quarterly dividend of $0.065 per share, equivalent to a yield of 0.8%.

Action now: With the Glencore bid for Teck Resources focusing investors' attention on the attractions of long-life mineral resources in politically stable jurisdictions, First Quantum, which has successfully increased its production 50% by bringing on Cobre Panama, must be on the radar screens of potential acquirors. With the clean energy transformation requiring enormous quantities of copper and nickel, it's surprising that the share price is only up by 18% since my recommendation. It remains a Buy.

Canadian Natural Resources TSX, NYSE: CNQ

BUY

Originally recommended on May 13/19 (#21918) at C$37.96, US$28.33. Closed Friday at C$75.19, US$55.49.

Background: Canadian Natural Resources is one of the largest North American energy exploration and production companies, with long established entrepreneur Murray Edward as a major shareholder. CNQ owns production facilities in western Canada, the North Sea, and offshore Africa. In 2022, it produced 1.281 million boe/d, up 4% from 2021 and 8% on a per share basis. This was driven largely by growth in production in its natural gas assets, which were up 23% to 2.1 Bcf/d.

Performance: Having more than doubled since being recommended in 2019, CNQ stock is down about 10% since the last update six months ago on lower oil and gas prices.

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CNQ—continued from page 10...

Recent developments: CNQ generated $19.8 billion in adjusted funds flow in 2022, and free cash flow of $10.9 billion after dividends and base capital expenditures. It reduced its net debt by $3.4 billion, ending 2022 with net debt of $10.5 billion. That was down 50% from the beginning of 2021.

The company returned $10.5 billion to shareholders through $5.6 billion in repurchases and $4.9 billion in dividends, including a special dividend of $1.50 a share in August 2022.

In the first quarter of 2023, to March 31, its production rose 3% to 1.319 million boe/d. However, revenue fell 19.7% to $8.6 billion, as oil prices were down 20% from the year before. Net earnings were down 42% to $1.8 billion ($1.69 per share) from $3.1 billion, while net debt rose $1.4 billion.

Dividend: CNQ raised dividends twice in 2022 by 45% to $0.85 per quarter and paid a special $1.50 dividend in August. Subsequently it raised the payout by another 6% to $0.90 per quarter in early 2023, making it twenty-three consecutive years of dividend increases. At the current level, the stock yields 4.8%.

Action now: CNQ remains one of the best managed exploration and production oil and gas companies with steady growth in production and increasing dividends. It remains a Buy.

Empire Company TSX: EMP.A; OTC: EMLAF

BUY

Originally recommended on Jan 18/16 (#21603) at C$24.32, US$17.77. Closed Friday at C$35.54, US$26.23.

Background: Nova Scotia based Empire Company is the parent of the Sobey's and Safeway supermarket chains. It also owns FreshCo, IGA, Thrifty's, Farm Boy, and the Lawton Drug Stores chains. It purchased 51% of the Ontario based high-end grocery chain Longo's for $357 million in 2021 and owns 41.5% of Crombie REIT, which in turn owns many of its supermarket sites. It owns 1,598 stores and 350 retail gas stations in 10 provinces and employs over 130,000 staff.

Performance: The share price has fallen 16% over the last twelve months, as concerns over possible price gouging by food stores and a cyber-attack hit sentiment. The stock is up 46% before dividends since being recommended in 2016.

Recent developments: For the third quarter of fiscal 2023 (to Feb. 4), sales grew 1.5% to $7.3 billion. Same store

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Empire Company—continued from page 11...

sales growth (SSSG) in stores open for over a year was flat, although its discount banners experienced double digit SSSG in the period.

Net earnings fell to $125.7 million ($0.49 per share) from $203.4 million ($0.77), reflecting the $39.1 million direct costs of the cyber-attack. This should be reduced to $32 million after insurance recoveries. The November disruption shut down Empire's pharmacy services for four days and interfered with operations such as self-checkout terminals and redemption of Scene+ points for a week.

CEO Michael Medline said: "These cyber -attacks are a nasty piece of business. I wouldn't wish them on my worst enemy." He added that Empire was now back to business as usual and is planning to accelerate investments in cybersecurity it had planned to make over the next few years.

Earnings in the comparable period in 2022 were increased by $0.14 per share due to unusually large real estate income as a result of lease surrenders. As a result, adjusted earnings after taking account of the cyber-attack were actually up 1.5% from $0.63 to $0.64 per share.

Political moves: Mr. Medline and the CEOs of Loblaw's and Metro appeared before the Parliamentary Committee on Agrifood and Agriculture to deny accusations that the sharp rises in food prices were caused by profit gouging.

Galen Weston of Loblaw's said: "The idea that grocers are causing food inflation is not only false, it's impossible. Retail prices have not risen faster than our costs." He noted Loblaw's earned $1 for every $25 spent in its stores (a 4% profit margin).

Mr. Medline said Empire is operating on "paper thin profit margins of 2.5%. We at Empire are not profiting from inflation. It doesn't matter how many times you say it write or tweet it, it's simply not true."

He added that Empire is starting to see signs of inflation peaking and abating this spring. The companies attributed higher prices to global events such as the invasion of Ukraine and bad weather but noted that Canadian food prices had actually risen at a lower pace than other countries such as the UK and USA.

Dividend: Empire has raised its dividend 37.5% over the last few years from $0.48 annually in 2019-20 to $0.66 in 2022-23, equivalent to a yield of 1.86%.

Outlook: The company's three-year Project Horizon is on track to deliver a $500 million increase in annualized EBITDA by fiscal 2023-24.

Action now: With its sell-off over the last few months, Empire is selling at a reasonable p/e ratio of 13.56 times. The company is set to benefit from the end of its major spending on its Voila eCommerce rollout and Project Horizon. It remains a Buy.

GORDON PAPE'S UPDATES

Recommendations are colour-coded:
Green indicates Buy
Yellow indicates Hold
Red indicates Sell

Thermo Fisher Scientific Inc. NYSE: TMO

HOLD

Originally recommended on April 26/21 (#22117) at $488.09. Closed Friday at $524.65. (All currency figures in US dollars.)

Background: Based in Waltham, Massachusetts, Thermo Fisher is a leading manufacturer of scientific instrumentation including laboratory and health monitoring equipment. It also provides software and services to the healthcare, biotechnology, and pharmaceutical industries, as well as to governments and academia.

Performance: The stock is in a month-long slump after trading at close to $590 in mid-April.

Recent developments: First quarter revenue and income were down from the same period a year ago. Revenue for the quarter declined 9% to $10.71 billion, versus $11.82 billion in 2022. Organic revenue was 8% lower.

Net income attributable to shareholders was $1.3 billion ($3.32 per diluted share), down from $2.2 billion ($5.61 per share) in the prior year. The company's results were hit by lower testing revenue for Covid-19.

Dividend and buybacks: Despite the decline in revenue and earnings, the company raised its quarterly dividend by 17%, to $0.35 a share ($1.40 a year). Despite the bump, the yield is still very low at 0.27%.

The company spent $3 billion on share buybacks during the quarter.

Action now: Hold.

No IWB next week

Have a safe and happy long weekend!

Next issue: May 29