Sionna Investment Managers

INSIGHT

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Relative Value in Resources

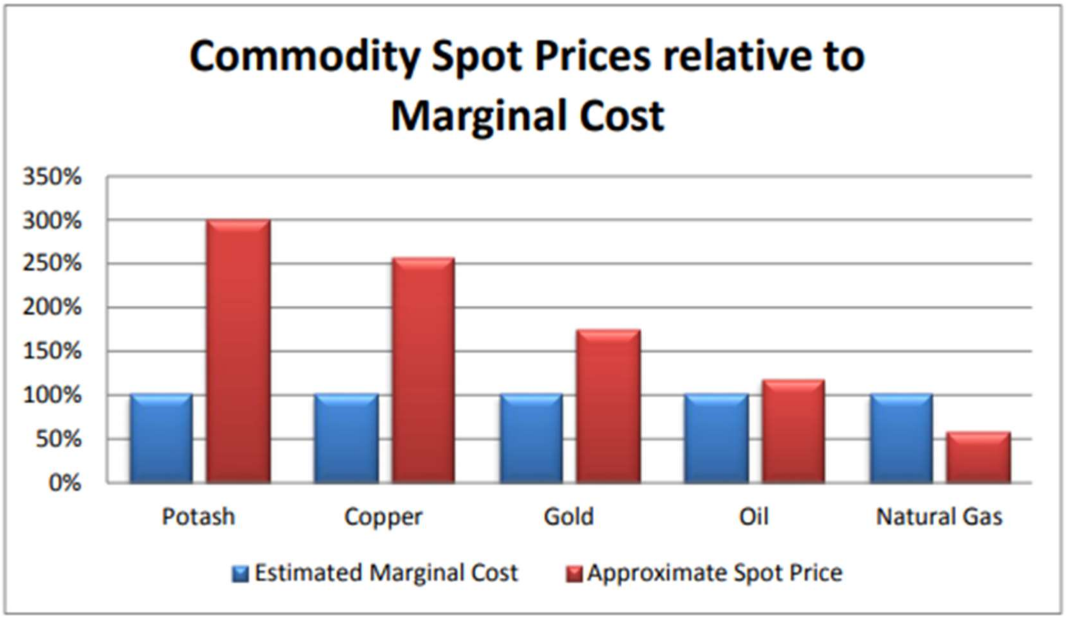
Canada has long been associated with commodities, and our stock market is no different. Half of the value of the S&P/TSX Composite Index is derived from cyclical stocks in the resource sectors, energy and materials.

At Sionna, we analyze all companies, including resource companies, by estimating the normalized earnings power for the business. From there, we apply a conservative price-to-earnings multiple based on the stock's historical trading pattern. Finally, we make additional qualitative judgments based on factors like financial strength, quality of management, and asset values to determine what we think the company is worth.

Understanding what a company earns in a normal environment is important in order to value that business. Sionna believes that commodity prices revert to the marginal cost of supply, which is the price at which firms bring the last unit of incremental supply to the market before it becomes unprofitable to do so. In the long term, supply and demand should drive prices to marginal cost. For a resource-based business, understanding the marginal cost of supply for the underlying commodity is the key to estimating normalized earnings.

When spot prices are above the marginal cost of supply, companies have earnings above normalized levels and will likely have downward pressure going forward. The opposite is true when spot prices are below the marginal cost of supply. Then, companies have lower than normal earnings, implying a greater likelihood of rising spot prices and higher future earnings.

Commodity	Estimated Marginal Cost of Supply*	Spot Price**	Difference between Spot Price and Marginal Cost	Earnings Pressure
Potash	$150/ton	$450/ton	200% higher	Down
Copper	$1.75/lb	$4.47/lb	155% higher	Down
Gold	$800/oz	$1400/oz	75% higher	Down
Oil	$85/bbl	$97/bbl	14% higher	Flat
Natural Gas	$7/mcf	$3.92/mcf	44% lower	Up



The chart above lists five key commodities in the Canadian market (potash, copper, gold, oil, natural gas) and their respective marginal costs and spot prices. The chart shows that the spot prices of potash, copper and gold are well above their marginal cost of production, oil is closer to marginal cost and natural gas is well below. Therefore, Sionna prefers to hold companies such as EnCana (natural gas), trading at 1.45x P/B with a 2.3% dividend yield and earning power that is likely to rise, versus Potash Corporation, trading at 6.8x P/B with a 0.5% dividend yield and earnings power that is likely to decline.

Based on our relative value philosophy, we continue to prefer companies in the energy sector over stocks in the materials sector. We think this approach to investing in resource stocks is conservative and should provide downside protection and capital preservation.

Source:
*Sionna Estimates as at Feb 28, 2011
**Bloomberg for Copper, Oil, Nat Gas as at Feb 28, 2011, sell side estimates for Potash as at Feb 28, 2011
EnCana and Potash fundamentals via CPMS as at Feb 28, 2011

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