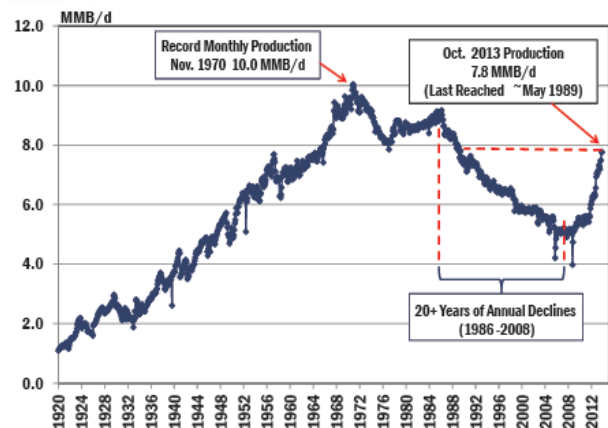


Wednesday June 25th, 2014

There is a lot of talk these days about the fate of Canadian oil. Specifically, there is much discussion surrounding two questions.

1. Does the U.S. still need Canadian oil?

There has been tremendous growth in oil production in the U.S. in recent years. Because of all this production, the concern is that they will soon have so much oil that they will no longer need Canadian oil. The chart to the right shows the history of oil production levels in the U.S. Production grew quite steadily from 1920 to the early 1970s, and stuttered somewhat until the mid-1980s. From then however, oil production declined each year for the next 20 years.



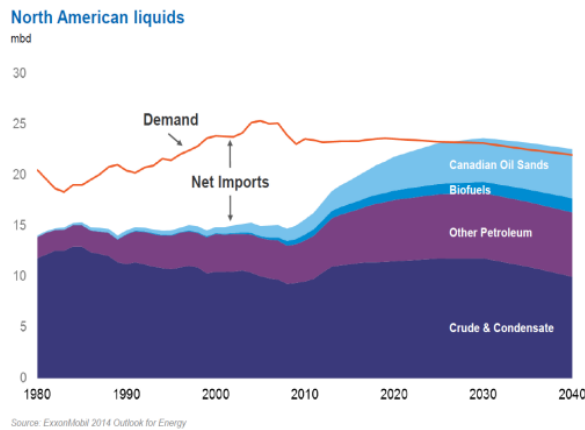
Since 2008, however, this trend has reversed.

New technologies, like directional drilling and hydraulic fracturing, have led to enormous growth in U.S. oil production. Calendar years 2012 and 2013, in particular, represent the two years with the largest growth of crude oil production in U.S. history.

The significant growth in American oil production has changed the global landscape. Once a distant third player in world oil production, the U.S. is now closing the gap it previously had with Saudi Arabia and Russia. In fact, it is now estimated that the U.S. will surpass both to become the world's largest oil producer by 2020.

This growth is a big deal for Canada since 90% of our energy exports go to the U.S. And if they are producing a lot more oil, their dependence on our exports could fall.

Like our neighbours to the south, Canada's oil production has similarly been growing over the last decade. What is perhaps more striking is the large increase in supply that's expected over the next 10 years. So with Canadian and U.S. oil production on the rise, will they even need our exports?



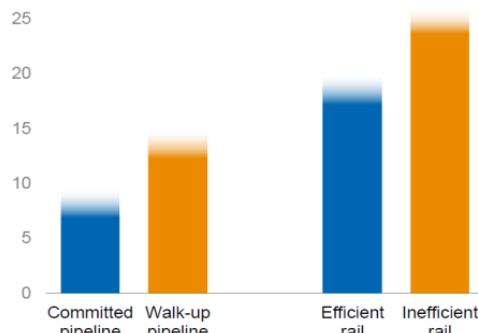
We believe they will. In spite of the meaningful growth of oil production in both Canada and the U.S., North America still doesn't have enough to meet demand. The chart to the left illustrates the supply and demand for oil in North America. Supply is further

broken down by the source. The gap between demand and supply highlights the significant amount we continue to import into North America to make up the difference. And based upon the charted projections, this story appears likely to remain in place until closer to 2025.

2. Even if Americans need Canadian oil, is it stranded?

So while the evidence shows that the U.S. still needs Canadian oil, there appears to be insufficient capacity on our current pipeline system to move all of the oil being produced, leaving it stranded. While pipeline infrastructure has been developed, it has not been able to keep pace with surging production levels. Until new pipeline capacity is built,

Alberta to U.S. Gulf Coast
\$/bbl, indicative



there is a gap between the oil we are producing and what we can fit in our existing system.

Fortunately, rail has filled that gap. Since 2011, Western Canada has been relying more and more on rail to make up for the lack of pipeline capacity. At the end of 2013, the number of rail cars and tonnes of oil being moved nearly tripled from their respective 2011 levels.

Rail is a decent medium-term solution, but pipelines remain the most efficient and economic way to transport large quantities of oil. The chart to the left shows the costs of four different methods of shipping oil:

1. **Committed pipeline** – the shipper has a long-term contract to ship
2. **Walk-up pipeline** – no long-term contract, pricing based on a spot rate
3. **Efficient rail** – train is dedicated to that particular shipper, and travels directly to its destination

4. **Inefficient rail** – train may be shipping other goods as well, and may not travel directly to its destination

A comparison of the costs associated with each option clearly shows that pipelines, whether committed or walk-up, are far more efficient than rail.

Although sufficient capacity is not yet available, we remain confident that it will come from both the expansion and reversal of existing pipelines, as well as from new pipelines being built. While delays are likely, we believe that pipelines will ultimately be built since they are, without a doubt, the most efficient way to move oil.

In the short-term, the uncertainty surrounding these questions is creating opportunities for Sionna – to add to existing Energy names. We have also been able to high-grade our exposure in the sector. We have been reducing our weights in lower quality names and using the proceeds to add to higher quality names that are now trading at similar valuations.

The Sionna Team



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