ValueInvestor INSIGHT
The Leading Authority on Value Investing
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O Canada

Canada's relationship with the United States, to put it mildly, has seen much better days. Here's how long-time, Toronto-based portfolio manager Kim Shannon is processing the investment implications of that newly fraught relationship.

INVESTOR INSIGHT

Kim Shannon
Sionna Investment Managers

Editor's Note: *Canada's political and economic environments have been thrown somewhat into disarray by the Trump administration's seeming antipathy toward the country over trade, illegal substances, defense spending and a variety of other issues. To better understand the investment implications of that turmoil, we spoke recently with Kim Shannon, the founder and co-Chief Investment Officer of Toronto-based Sionna Investment Managers. Founded in 2002, Sionna manages nearly C$1.3 billion in assets, the majority of which are invested in Canadian-company stocks. While not at all happy about the most recent turn of geopolitical events, Shannon says she is finding plenty of opportunity in a Canadian market that "is the cheapest it's been relative to the U.S. in 25 years."*

Asking you to speak for your country here, how would you describe the reaction to rising geopolitical tension between the U.S. and Canada?

Kim Shannon: I would say we're still rather collectively in shock. The relationship between our two countries has been a symbiotic and most friendly one for almost everyone's entire lifetime. It's been a good partnership and while the current difficulty has sparked some collective soul searching, there's probably a general sense that we're being punished far more than we deserve. To suddenly have this enormous shift, it's unsettling.

What's the case for investors to pay more attention to Canadian stocks today?

KS: We'd make the case that it's generally a good time to pay more attention to Canadian stocks. Many people don't know this, but Canada has the fourth-largest equity market in the world, after only the U.S., Japan and the United Kingdom. Based on Dimson, Marsh and Staunton Global Investment Returns data going back nearly 125 years, Canadian stocks have generated the sixth-highest returns, with among the lowest standard deviations of risk. One reason for that is the high weighting of resources stocks in the market – people with a shorter time horizon might assume that would be a drag on returns, but over the full period it's been a positive. I would also argue the performance of the market reflects on our rule of law, the relative stability of our political environment and the consistent development of our economy.

There's a strong valuation case today for Canada. On almost any valuation metric you choose – price-to-earnings, price-to-book, dividend yield – Canadian stocks are the cheapest they've been relative to the U.S. in 25 years. Generally when you're two standard deviations from the norm, things tend to revert. At a time of such uncertainty, there's an even stronger case for low valuations and the margin of safety they provide. We think it's telling that the main Canadian-stock index has outperformed the S&P and Nasdaq indexes both year to date and over the past 12 months.

Let's talk about a couple Canadian ideas that you find particularly compelling today, starting with Suncor Energy [Toronto: SU], one of the biggest resources names in the market.

KS: Suncor essentially invented the oil-sands method of extracting oil, which involves removing bitumen, a form of crude oil, from sands that are both on the surface and underground. In many ways it's a mining process and the company has successfully reduced its costs of extraction over time. In 2023 its breakeven costs were around $53 per West Texas Intermediate barrel of oil, but that most recently was down to $47 per barrel and management's target is $43 per barrel by next year.

The company also benefits from a long-lived resource base. Its Reserve Life Index – a measure of how long a company's oil and gas reserves will last based on current production rates, assuming no new reserves are added – is currently around 25 years, comparable to other oil-sands producers but much longer than the roughly 10-year RLIs for conventional global peers. Not having to constantly replace reserves and resources is a significant operational advantage.

What assumptions are you making about the price of oil?

KS: We believe global breakeven pricing is generally moving up, and in our base case we use $75-80 per barrel as the point where supply and demand is closest to balance. Part of that is a function of first-tier U.S. shale reserves being depleted and replaced by higher-cost second-tier reserves. We also assume OPEC countries, in order to fund rising fiscal spending as their populations grow, will require higher breakeven prices than their reserve bases might warrant.

We generally believe oil and gas producers have stopped overinvesting in the future, putting a constraint on supply growth that for a long time wasn't present in the industry. In an expanding world where the demand for oil is likely to grow for quite a bit longer than was expected two or three years ago, that supply constraint should be a support for long-term oil prices. We expect that to result in higher cash flows and for more and more capital to be returned to shareholders in the form of dividends and share repurchases.

Elliott Investment Management remains a large shareholder after running an activist campaign to improve Suncor's performance. Has that proved to be a positive?

KS: Elliott's push for change resulted in Rich Kruger taking over as CEO, and we think he's done an excellent job in lowering operating costs, reducing capital spending, increasing profitability and returning more capital to shareholders. One additional cultural change is that management has gone from overpromising and underdelivering to underpromising and overdelivering. That's been a refreshing change for shareholders.

Is "takeaway" capacity at all an issue for Suncor?

KS: We don't believe so. The Trans Mountain Pipeline has alleviated many of those concerns for Canadian producers, and there are a number of additional pipeline capacity expansion projects in the works that should mean they'll be able to efficiently transport all they produce for the foreseeable future. Takeaway capacity is also somewhat less of an issue for the company given that the majority of its refineries are located in Canada, where they also distribute at retail through company-owned Petro Canada stations.

How are you looking at valuation at today's price of around C$49.40?

KS: We estimate cash flows two years out based on expected production volumes and operating costs and using various commodity-price scenarios. In our base case we use $75-80 oil and $3.50-4.00 natural gas. We also assume cash flow after capital spending will go toward dividends – the current dividend yield is 4.6% – and share buybacks. In our base case we assign a mid-cycle 5.5x multiple to our 2027 cash-flow estimate to arrive at an estimated intrinsic value of around C$75 per share.

Describe the upside you see today in Great-West Lifeco [Toronto: GWO].

KS: This is a financial-services conglomerate that has been successfully expanding beyond its traditional life-insurance roots. Canada and the U.S. are the two

INVESTMENT SNAPSHOT

Suncor Energy
(Toronto: SU)

Business: Exploration, production, refining and marketing of oil and gas products; primary resources are oil sands, which it was the first company to commercially develop.

Share Information
(@4/29/25, Exchange Rate: $1 = C$1.38):

Price	**C$49.44**
52-Week Range	C$43.59 – C$59.58
Dividend Yield	4.6%
Market Cap	C$61.16 billion

Financials (TTM):

Revenue	C$50.69 billion
Operating Profit Margin	18.2%
Net Profit Margin	11.9%

Valuation Metrics
(@4/29/25):

	SU	S&P 500
P/E (TTM)	10.5	22.1
Forward P/E (Est.)	10.9	20.5

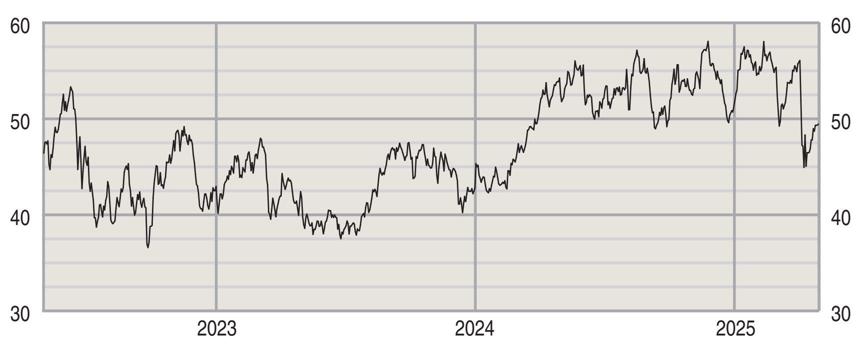
Largest Institutional Owners
(@12/31/24 or latest filing):

Company	% Owned
BlackRock	4.9%
Vanguard Group	4.3%
Elliott Management	4.3%
RBC Dominion Securities	2.7%
T. Rowe Price	2.4%

Short Interest (as of 4/15/25):

Shares Short/Float	n/a

SU PRICE HISTORY



THE BOTTOM LINE

The company as it continues to reduce its breakeven operating costs is poised to incrementally benefit as long-term global demand and supply dynamics for oil and gas support higher market prices than today's levels, says Kim Shannon. Based on her 2027 free-cash-flow estimates she sees potential 50% upside in the shares from today's price.

Sources: S&P Capital IQ, company reports, other publicly available information biggest geographic markets, each accounting for around 30% of earnings. In Canada, Great-West is the leading provider of group life and health insurance plans and is also active in retirement benefits and wealth management. In the U.S., the Empower division is a large provider of employer-sponsored retirement savings plans and is also building out a similar offering catering to individuals rolling over their assets from these employer-sponsored plans. Another 20% or so of the business sells a comparable suite of life, health and retirement products in Ireland, the U.K. and Germany, while the remaining 20% is in global reinsurance.

The U.S. is a big part of the story here. More U.S. employers are expanding their defined-contribution plan offerings and Great-West's Empower operation, having steadily built out its capabilities and product line, has been taking share in a still-fragmented industry. Its assets under administration have grown organically at 14% per year over the past five years, twice as fast as the industry overall. We think there's still considerable upside for growth, both through acquisitions and from the company cross-selling to its existing customer base, which is a significant asset in a business with a customer retention rate of 97%.

Management recently held an investor day and increased its target return on equity to 19% over the medium term, up from a base ROE of 17.5% in fiscal 2024. They expect the U.S. business to be the biggest driver of that improvement.

INVESTMENT SNAPSHOT

Great-West Lifeco
(Toronto: GWO)

Business: Diversified holding company with operating units that provide life insurance, health insurance, retirement benefits and wealth management products and services.

Share Information
(@4/29/25, Exchange Rate: $1 = C$1.38):

Price	**C$53.00**
52-Week Range	C$38.44 – C$57.61
Dividend Yield	4.6%
Market Cap	C$49.33 billion

Financials (TTM):

Revenue	C$34.74 billion
Operating Profit Margin	26.8%
Net Profit Margin	11.7%

Valuation Metrics
(@4/29/25):

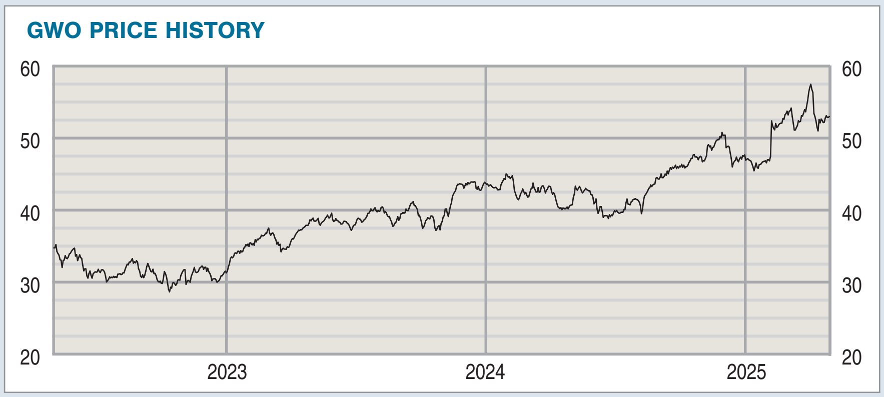
	GWO	S&P 500
P/E (TTM)	12.3	22.1
Forward P/E (Est.)	11.0	20.5

Largest Institutional Owners
(@12/31/24 or latest filing):

Company	% Owned
Power Corp. of Canada	70.4%
Capital Research & Mgmt	4.3%
Vanguard Group	1.2%
BlackRock	1.0%
T. Rowe Price	0.7%

Short Interest (as of 4/15/25):

Shares Short/Float	n/a



THE BOTTOM LINE

Kim Shannon expects the company's ongoing diversification efforts, primarily through its U.S.-based Empower retirement-benefits division, to drive solid and non-cyclical growth in earnings and profitability going forward that the market today, in pricing its shares at less than 9x her estimate of normalized earnings, doesn't seem to sufficiently recognize.

Sources: S&P Capital IQ, company reports, other publicly available information

Canadian holding company Power Corp. of Canada [Toronto: POW] owns 70% of Great-West's outstanding shares. Do you consider that good, bad or indifferent to the investment case?

KS: We consider it mostly positive, given Power Corp.'s long-term orientation and willingness to support investment now for benefit later. The limited public float does constrain somewhat Great-West's ability to buy back shares, but the company still returns capital to shareholders through a generous dividend. The dividend payout ratio has traditionally been 45-55% of base earnings and the current dividend yield is 4.6%.

How inexpensive do you consider the shares at today's price of C$53?

KS: If Great-West achieves its 19% return-on-equity target – and the company has a history of meeting such targets – we think it over the next few years can earn around C$6 per share. Based on historical averages, if we apply an 11x earnings multiple to that and add in dividends, we see a share value approaching the mid-C$70s.

Given the nature of its business, its balance sheet, and the conservative way it's managed, we expected in buying this earlier this year for it to be a somewhat defensive holding. It's early to say, but that so far has been the case. The stock has outperformed the broader Canadian market by nearly 600 basis points since we bought it. That wasn't the only reason to own it, but in this environment defensive names are even more appealing.

How are you processing this week's election results, retaining Mark Carney as Prime Minister?

KS: It became fairly clear going into the election that, whatever party came to power, the next government is likely to be less liberal in a literal sense than the Trudeau administration. I think that will prove to be true for the Liberal Party with Mr. Carney in the Prime Minister seat. Especially given the state of our relationship with the U.S., there seems to be a desire to be more business-friendly, to make it easier for our resources companies to grow and compete, and to generally support an economy that needs to be less reliant on our traditional partner to the south.

Am I optimistic? I don't know. We seem to be kind of on our own right now and we're going to have to step up and work with that. VII