Desjardins

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Transportation Survey

Benoit Poirier, CFA • (514) 281-8653 • benoit.poirier@desjardins.com
Michael Kypreos, Associate • (514) 518-4864 • michael.kypreos@desjardins.com
Etienne Larochelle, CFA, Associate • (438) 466-4457 • etienne.a.larochelle@desjardins.com

CITT member survey—freight market continues to bounce along the cycle bottom

The Desjardins Takeaway

Following major disruptions that affected the freight industry, we conducted a survey in collaboration with the Canadian Institute of Traffic and Transportation (CITT) to identify key market trends. The CITT is a non-profit dedicated to the advancement of professionals and businesses in logistics. Every year, it hosts Canada's Logistics Conference (which we attended; see our recap), with ~250 participants from many subsegments within the logistics industry (eg CN, CP, truckers and retailers). In this second edition of our annual survey, 64 CITT members responded to our questions (data gathered in July/August). We will be presenting the survey results, as well as our feedback, to CITT members in a webinar on Wednesday, September 11. For those interested, we will also be hosting a transportation tour in Halifax on September 23–24 (see flyer for details), which will provide another data point for market insight.

Highlights

Impact of current North American freight disruptions. The disruptions appear to have been all smoke but no fire as the majority of survey respondents are sticking with the status quo. This bodes well for rails (but not trucking) as any jump in Canadian trucking long-haul spot rates should be temporary (rates may remain elevated for a week or two until the dust settles), with rates most likely returning to pre-TCRC strike levels eventually.

Views on the transportation outlook. The majority (66%) of respondents believe we have not reached an inflection point in the trucking market (for various reasons, the most common being that additional capacity exits are needed). This is despite 84% of participants reporting that their end customer inventories are now at adequate levels. Competition remains fierce, especially between trucks and rail in the domestic intermodal space, as 41% of respondents view the pricing dynamic as 'very competitive' between the two (vs only 23% selecting 'not competitive'). On a brighter note, fewer respondents now believe we are in a freight recession vs last year (64%, down from 79%), and there is a growing belief that freight volumes will rise moving forward (42% expect freight volumes to increase vs only 24% last year). However, this is expected to be gradual, with most (39%) predicting that it will be at least another 6–12 months before we see a material recovery in freight market conditions.

Readthrough for our coverage universe. The survey results reinforce our TFII thesis that there are limited near-term catalysts for investors through year-end. Any temporary benefit from rail-to-truck conversion will not be material enough to prop up TFII's results, in our view (Canada-based conventional TL represents <5% of revenue). On the other hand, TTNM should benefit. Given the rails' more diversified and defensive nature, we continue to view them as a safe place to wait out a market inflection (and collect a nice dividend while doing so). As the duration of the TCRC labour stoppage came in below our previously disclosed cut-off for calculation purposes, if there are no additional network disruptions, we now expect both rails to be able to achieve their respective annual EPS guidance targets.

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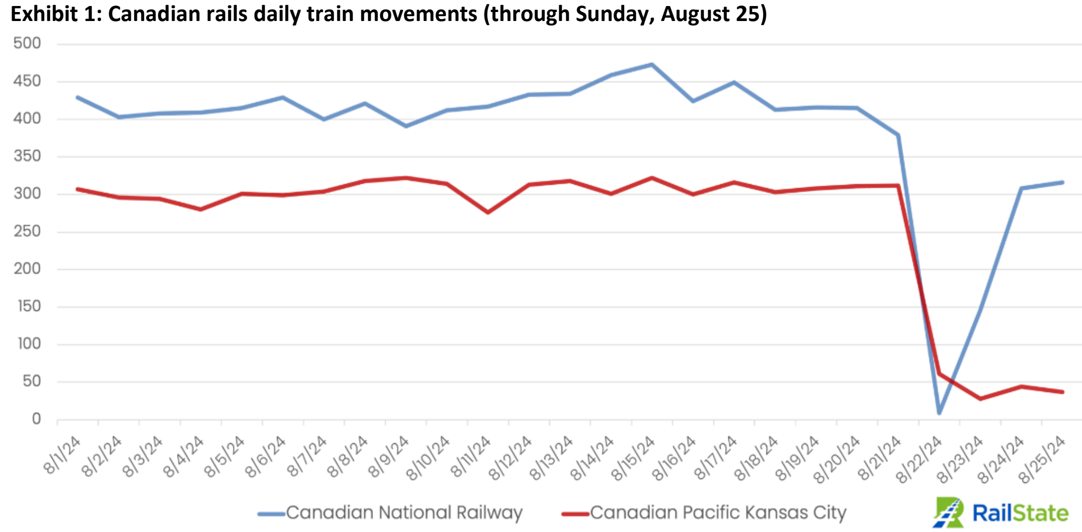
Transportation/freight market conditions

Rails update—2024 guidance is likely still achievable for both CN and CP as CIRB orders employees back to work…but is Canada's reputation at risk? Last Saturday (August 24), the CIRB announced that it would impose binding arbitration on TCRC workers following an approximately one-day lockout at CN and approximately two-day work stoppage at CP. The unions have announced that they would appeal the measure. According to rail industry data provider RailState, the following day, total train movements across both railways was less than half (48.5%) of the average daily volume vs before the work stoppage. CN began running trains on Friday (August 23) and significantly increased its train volumes over the weekend; that Sunday, CN's system-wide train movements were 74.8% of their volume vs before the work stoppage. CP's traffic on Sunday was 12.1% of its average volume, as the union stated that members would resume work only one minute after midnight on Monday morning (see Exhibit 1).

As the duration of the labour stoppage came in below our previously disclosed cut-off for calculation purposes of approximately three days for CN and approximately six days for CP, if there are no additional network disruptions we now expect both rails to be able to achieve their respective annual EPS guidance targets. However, from a broader perspective, we are becoming increasingly worried about Canada's trade/business reputation on the global stage. This summer was filled with uncertainty for shippers who had exposure to Canada, as several labour negotiations across the country's supply chain were taking place at the same time (some still remain unresolved)—Canada Border Services Agency workers, Teamsters Canada Rail Conference union, Port of Montréal longshoremen's union, BC ports International Longshore and Warehouse union, WestJet's Aircraft Mechanics Fraternal Association union and Air Canada's Air Line Pilots Association union. While we continue to strongly believe that Canadian ports have several competitive advantages given the investments in capacity expansion over the years (and with some benefiting from shorter sailing times and a weaker loonie), it would appear that Canada's reputation is at risk and could raise questions about the reliability of Canadian ports/supply chains, especially after last summer's two-week work stoppage at the West Coast ports. Any threat of increased regulation would be a negative for CN's and CP's share prices, in our view.

Exhibit 1: Canadian rails daily train movements (through Sunday, August 25)



Source: RailState

Ports update—plenty of cargo diversions as shippers deal with labour uncertainty in Canadian and US East/Gulf Coast ports. Toward the end of June, we published a note following indications that steam ship lines had started to cancel calls to Vancouver and Prince Rupert ahead of a potential rail strike. Analyzing the TEU statistics for July (latest reading), it appears that the impact was more pronounced at Prince Rupert, as volumes were down 9.9% mom while Vancouver held up surprisingly

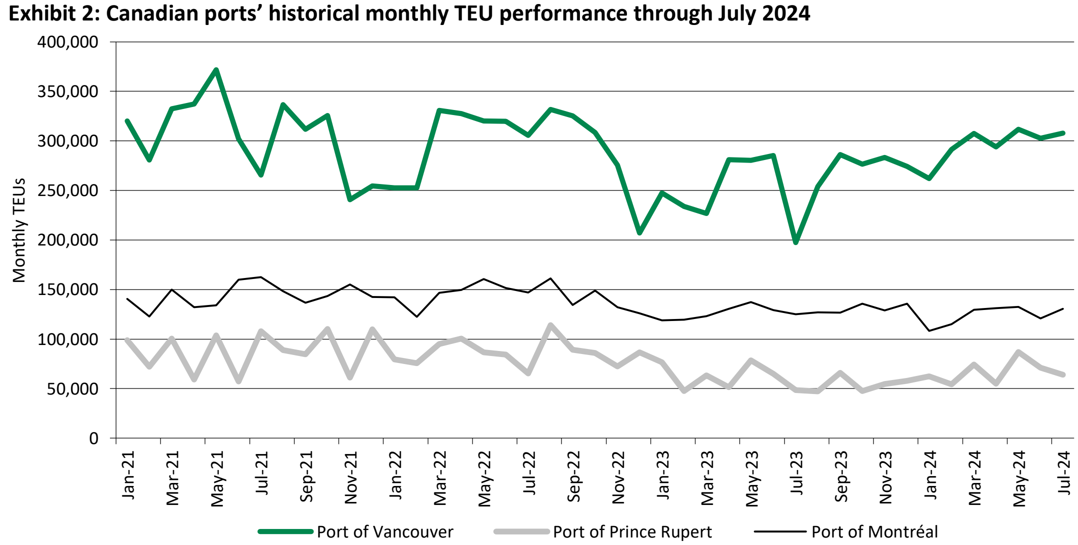
Benoit Poirier, CFA
Michael Kypreos, Associate
Etienne Larochelle, CFA, Associate

well, up 1.7% mom above the coveted 300,000 TEU/month level (TEUs were up 7.8% mom at Montréal; see Exhibit 2—year-over-year numbers do not provide a clear picture as TEUs last year were impacted by the 13-day West Coast ILWU dockworkers' strike). Looking at pre-pandemic trends, Canadian West Coast ports typically benefit from a seasonal volume uptick from June to July—so, what occurred at Prince Rupert is negative for CN (exclusive port). According to RailState, on Sunday, August 25, the Port of Vancouver saw only seven trains (vs a typical level of 20/day). The port of Prince Rupert saw no freight volume from August 22–24 as volume returned only on Sunday, with mostly intermodal trains returning to the port to pick up containers.

In the US, July TEUs at six large ports—Los Angeles, Long Beach, Houston, Virginia, Seaport and Oakland—were up 29.0% yoy and 6.7% mom (up 13.3% yoy on a rolling 12-month basis). Looking specifically at the West Coast ports of Los Angeles and Long Beach, TEUs were up a whopping 37.3% yoy and 52.6% yoy, respectively (see Exhibit 3; the largest year-over-year increase in the last 12 months for Long Beach and the second largest for Los Angeles). A recent JOC article indicated that ship arrivals in the Los Angeles–Long Beach port complex are currently averaging almost 55/day, up from 45–49/day in the first six months of the year.

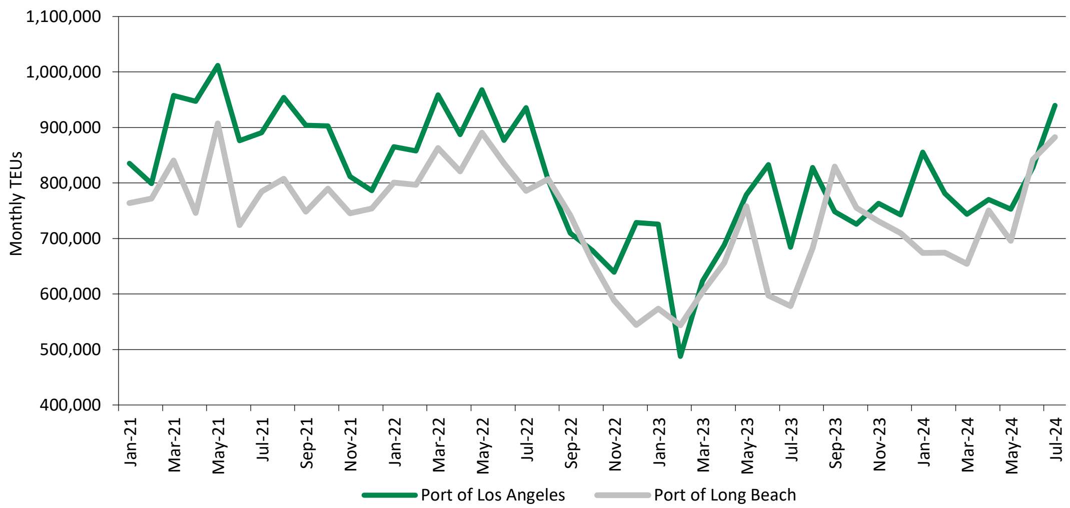
While ship diversions from Canada likely played a part in this early peak season volume influx to the US West Coast, there are also several other key drivers at play—retailer restocking, the scramble to move imports in before the election (given the 60% tariffs Donald Trump intends to impose if elected to a second term), rail congestion issues at the Port of Tacoma, east-to-west share shift due to the possible ILA dockworkers' US East/Gulf Coast port strike on October 1, continued Red Sea attacks and drought conditions at the Panama Canal. We will continue to monitor port volumes closely, given that last year it took several months following the ILWU strike for regular seasonal volumes to return to Prince Rupert (shippers were locked into longer-term agreements with rival US ports to divert initial loads). This could put some pressure on 4Q, but we are not overly concerned by the impact as historically these types of diversions are temporary and last only 3–4 months (cheap Canadian dollar, lower congestion, capacity limitations at US ports and distance from Asia should lure customers back). Additionally, if a US East/Gulf Coast dockworkers' strike occurs in October, the Canadian East Coast ports such as Montréal, Halifax and Saint John should benefit from cargo diversions and return the favour to the US.

Exhibit 2: Canadian ports' historical monthly TEU performance through July 2024



Source: Desjardins Capital Markets, port websites

Exhibit 3: Ports of Los Angeles and Long Beach historical monthly TEU performance through July 2024



Source: Desjardins Capital Markets, port websites

Trucking update—lack of activity uptick ahead of Labour Day weekend is a bearish sign for TL... With regard to the struggling TL market, spot rates have retreated from recent highs, with the latest reading for August coming in at US$2.01/mile (according to DAT data, including fuel), down 2.4% mom and 3.4% yoy. This remains below ATRI's 2023 TL operational cost estimate of US$2.15/mile, signalling that spot loads remain an unprofitable endeavour for many trucking firms (current rate environment is not sustainable). This lack of activity dragged the contractual rate down to its lowest level since 2020 at US$2.39/mile in August (see Exhibit 4). This weakness in trucking shows that containerized import volumes are not necessarily a driver or leading indicator for TL volumes (domestic manufacturing is a stronger driver). According to DAT, the latest load-to-truck ratio (the higher the better) fell to 4.18 in July (down from 4.72 in June; see Exhibit 5), bucking the positive trend in the data since February. According to FreightWaves' latest market update, tender rejection rates have yet to find momentum and continued to trend sideways throughout August. The concern moving forward is that there has been a muted reaction ahead of the Labour Day weekend. Over the past week, the Outbound Tender Rejection Index, which measures relative capacity in the market, was unchanged at 4.41% (the higher the better), significantly declining since mid-April and staying below the coveted level of 5%—for context, at cycle highs, levels were at >25% (see Exhibit 6). In years past, including 2023, rejection rates have built momentum starting around August 15 through Labour Day, but that has yet to happen this year (a bearish signal).

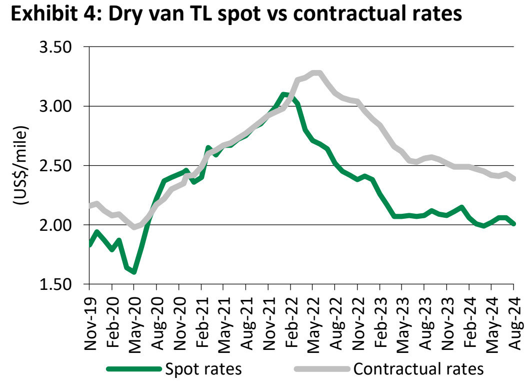
While obtaining precise capacity data remains challenging, according to the FMCSA's operating authority data, net losses in operating authorities have experienced a lower rate of decline compared with the beginning of the year. In recent weeks there has been a net loss of only 221 carriers—this compares with the start of the year, when weeks ending in January saw a net loss of 2,489 unique operating authorities (see Exhibit 7). According to FreightWaves contributors, this data could suggest that the great reset in trucking capacity may be nearing its completion. That said, in our view, the fact that TL rejection rates (a proxy for truck capacity) have yet to find momentum ahead of the key Labour Day long weekend sheds doubt on this thesis. According to FTR, there are still ~92,000 more for-hire carriers in the US than existed pre-pandemic (although most are one- and two-truck operations), and there are also ~15% more drivers today than in 2020. We expect contract rates to continue to be flat for the remainder of the year, as there have been no tangible signs of a visible demand uptick yet.

Benoit Poirier, CFA
Michael Kypreos, Associate
Etienne Larochelle, CFA, Associate

…and LTL market to begin lapping tough comps. As we have stated previously, we believe that TL spot rates/conditions will be key for an inflection in LTL stock prices. This is because some of the typical LTL industry freight has moved to the TL market, chasing cheaper rates (ODFL confirmed this on its call, stating that some of Yellow's freight did move over to TL carriers). We are confident that as soon as TL spot rates begin to turn, the traditional LTL freight will return to the LTL market, and we would expect LTL stock prices/TFII to react in advance. Looking at current LTL market conditions, this broad trucking weakness is indicative of the continuing difficult volume environment, with sequential LTL industry tonnage (according ATA's seasonally adjusted data) decreasing in five of the last six months and down 7.7% yoy in June. This very likely has not improved since, as ODFL's operating update showed a decrease of 0.9% yoy in tonnage for the carrier in July. The ISM Manufacturing Index, which has historically been a strong leading indicator of LTL tonnage (see Exhibit 8; it is a good proxy for the domestic industrial economy), was 46.8 in July (below Bloomberg consensus expectations of 48.8); this resulted in a contraction for the fourth consecutive month (following a one-time peak above 50 in March). Production, new orders and backlogs all dipped below 50, pointing to weakening output and a deteriorating outlook. The ISM index has been in contraction territory for 20 of the past 21 months, not a bullish sign for LTL—which has in turn translated into negative earnings estimate revisions for publicly traded LTL carriers (2025 EPS estimates have decreased ~10% on average since the start of the year, but the market is still pricing in a material recovery—see Exhibits 9 and 10 as well as our recent note).

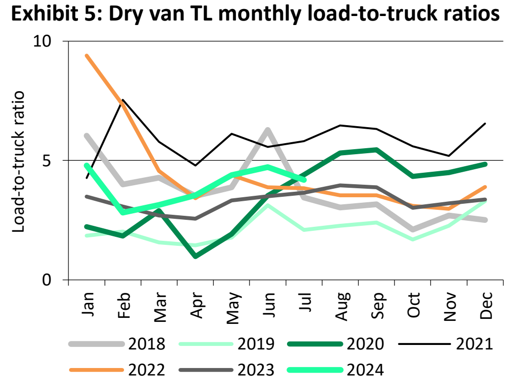
Despite this negative volume backdrop, LTL pricing has remained rational (US LTL PPI up 7.1% yoy in July), mainly due to disciplined management teams, high barriers to entry and greater industry consolidation following the Yellow bankruptcy. Moving forward, we expect year-over-year volume comparisons to become much more difficult as LTL carriers will begin lapping the share gains from Yellow's bankruptcy in July 2023; however, from a pricing/yield perspective, despite this we still expect continued year-over-year growth (the only times industry pricing was pressured was during the GFC and for a brief period in 2015, mostly due to fuel surcharges). Unless we go into a deep recession, we do not expect to see a decrease in LTL pricing given the industry's cost inputs are extremely prone to inflation—we expect national LTL carriers to begin announcing standard GRI increases toward year-end in the typical ~4–5% range. A series of interest rate cuts in the final months of the year could be the catalyst for the industrial side of the economy to capture some positive momentum into 2025. For TFII specifically, our view has not changed—while we like the name long-term, we view the current valuation as unjustified given the lack of near-term catalysts (no immediate trucking recovery, TL spin-off more than a year away, large M&A unlikely and reduced pace of buybacks). Any temporary benefit from rail-to-truck conversion in Canada due to the labour disruption will be short-lived and not material enough to prop up financial results, in our view (Canada-based conventional TL represents <5% of revenue).

Exhibit 4: Dry van TL spot vs contractual rates



Source: Desjardins Capital Markets, DAT

Exhibit 5: Dry van TL monthly load-to-truck ratios



Source: Desjardins Capital Markets, DAT

Benoit Poirier, CFA
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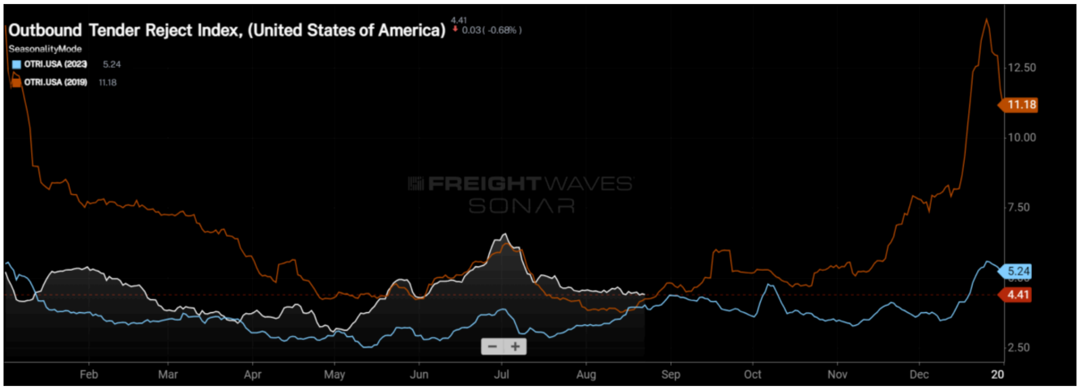
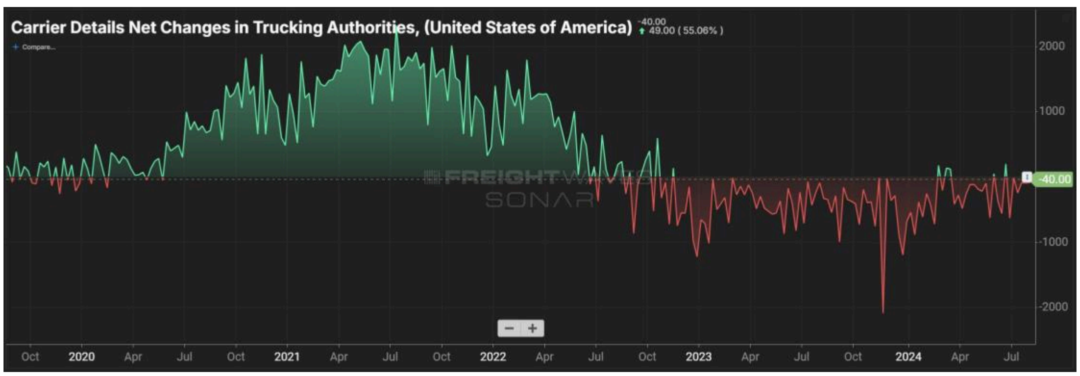
Etienne Larochelle, CFA, Associate

Exhibit 6: Outbound Tender Reject Index seasonality—2024 (white), 2023 (blue) and 2019 (orange)



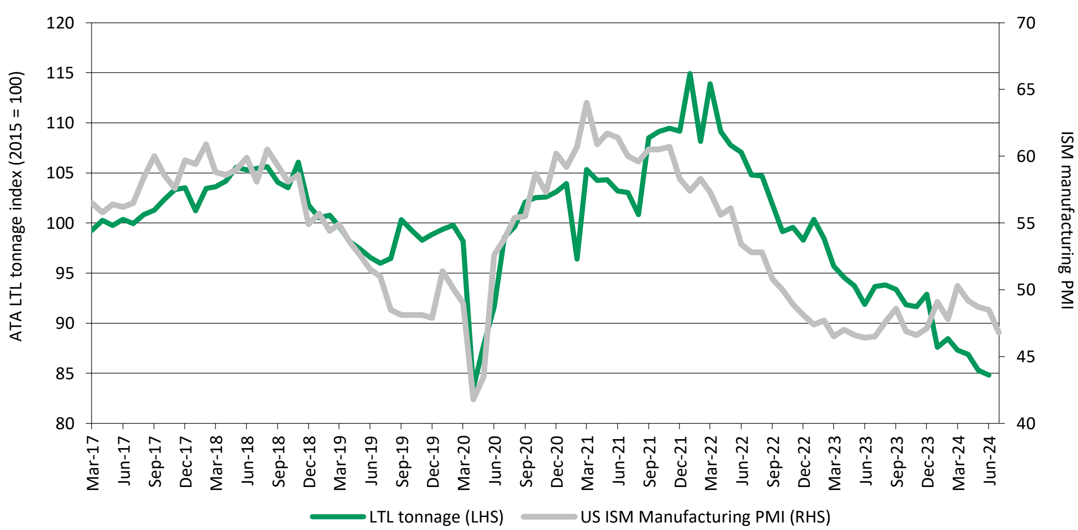
Source: FreightWaves

Exhibit 7: Monthly change to US trucking revocations, reinstatements and grants in operating authorities



Source: FreightWaves

Exhibit 8: US LTL tonnage vs US ISM Manufacturing PMI



Source: Desjardins Capital Markets, ATA, ISM, Bloomberg

Benoit Poirier, CFA
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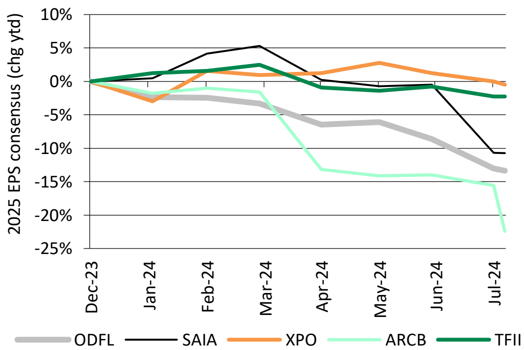
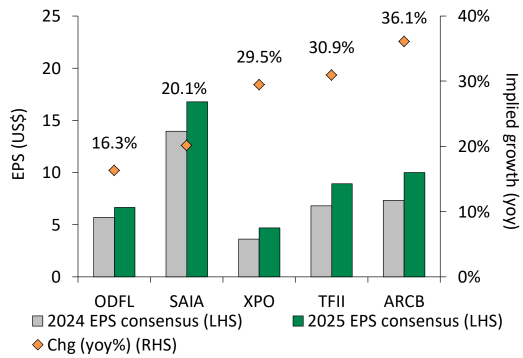
Etienne Larochelle, CFA, Associate

Exhibit 9: 2025 US LTL EPS expectations have fallen…



Source: Desjardins Capital Markets, FactSet

Exhibit 10: …but consensus is still pricing in a material recovery in 2025—no easy task

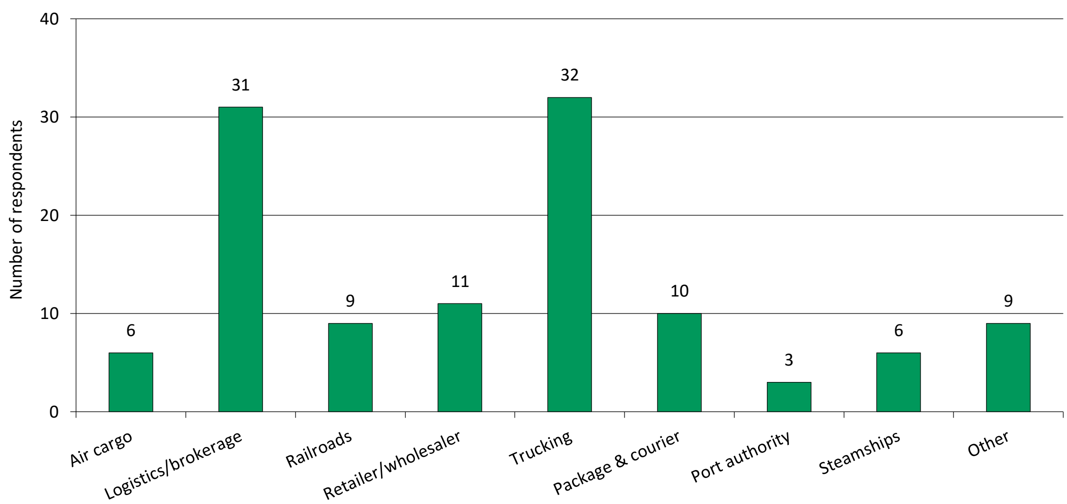


Source: Desjardins Capital Markets, FactSet

Overview of survey respondents

Roughly half of survey respondents have operations related to the trucking and logistics/brokerage sector. Approximately 40% have their main operations in Ontario while the balance is mostly diversified across the rest of Canada.

Exhibit 11: In which subsegment(s) of the transportation/logistics industry are your main operations?



Note: Respondents had the choice of selecting more than one answer
Source: Desjardins Capital Markets, CITT

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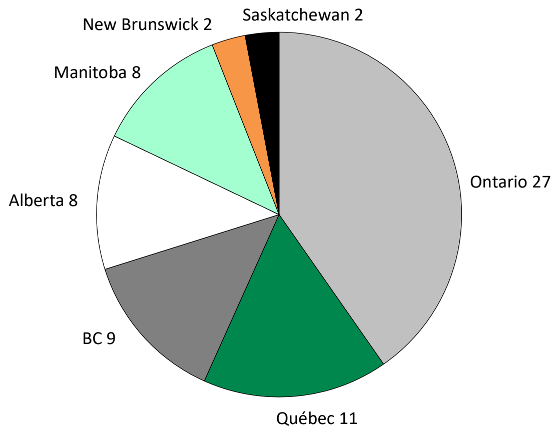
Exhibit 12: Where is your head office or main operation(s) located within Canada?

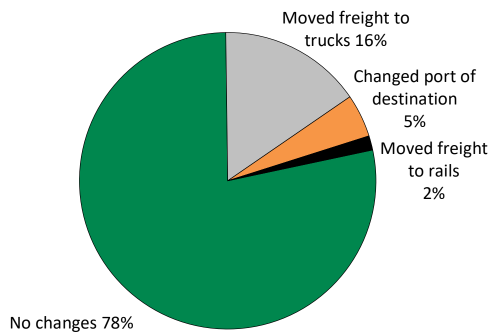


Note: Respondents had the choice of selecting more than one answer
Source: Desjardins Capital Markets, CITT

Impact of the current North American freight disruptions

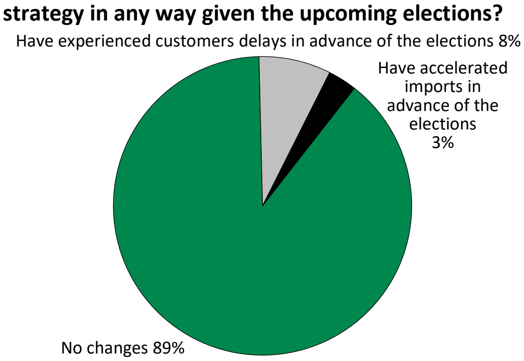
The disruptions appear to have been all smoke but no fire as the majority of survey respondents are sticking with the status quo. This bodes well for rails (but not trucking) as any jump in Canadian trucking long-haul spot rates should be temporary—rates may remain elevated for a week or two until the dust settles—with rates most likely returning to pre-TCRC strike levels eventually. With regard to the upcoming peak season, which many experts believe has been pulled forward (for reasons indicated in the paragraphs above), the outlook is more positive as the majority of survey respondents expect the current hot pace to continue through year-end. It is important to keep in mind, however, that elongated TCRC diversions at Canadian ports or a US East Coast dockworkers' strike could throw a wrench into the potential peak-season outcomes.

Exhibit 13: Have you taken precautions due to recent labour uncertainties?



Source: Desjardins Capital Markets, CITT

Exhibit 14: Have you modified your shipping strategy in any way given the upcoming elections?



Source: Desjardins Capital Markets, CITT

Benoit Poirier, CFA
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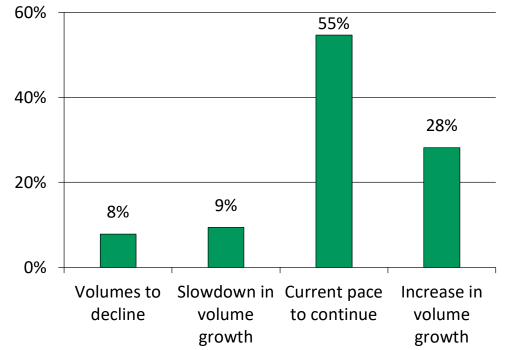
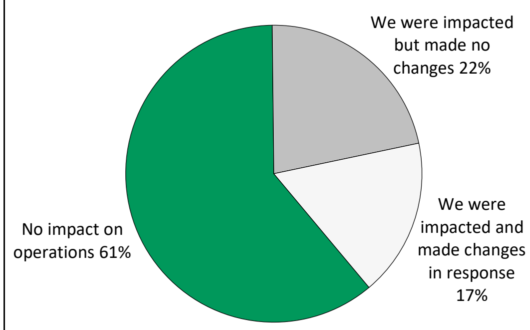
Etienne Larochelle, CFA, Associate

Exhibit 15: What are your expectations regarding volumes for the upcoming peak season?



Source: Desjardins Capital Markets, CITT

Exhibit 16: Has the rise in ocean shipping rates/disruption impacted your strategy?



Source: Desjardins Capital Markets, CITT

Views on the transportation outlook

The survey answers reveal some interesting insights into current transportation market conditions. To start, the majority (66%) of respondents believe we have not yet reached an inflection point in the trucking market (for various reasons, the most common being that additional capacity exits are needed). This is despite the fact that 84% of participants reported that their end customer inventories are now at adequate levels, which is an improvement vs only 67% a year ago. While the inventory situation has clearly improved since last year (in line with large North American retailers' public commentary and the elevated level of ocean imports)—suggesting that some stability has returned to the market—this alone has not been enough of a demand driver to keep trucking rates afloat. Adding to this, competition remains fierce, especially between trucks and rail in the domestic intermodal space, as 41% of respondents view the pricing dynamic as 'very competitive' between the two (vs only 23% selecting 'not competitive')—a challenging indicator for rail operators' pricing power over the coming months. On a brighter note, fewer respondents now believe we are currently in a freight recession compared with last year (64%, down from 79% last year), and there is a growing belief that freight volumes will rise moving forward (42% expect freight volumes to increase vs only 24% last year). However, this recovery is expected to be gradual, with most (39%) predicting it will take at least another 6–12 months before we see a material recovery in freight market conditions. To conclude, while the market remains competitive and uncertain, there is cautious optimism for a gradual improvement, although this will not happen overnight. This reinforces our thesis on TFII that there are limited near-term catalysts for investors through year-end. Given the rails' more diversified and defensive nature, we continue to view them as a safe place to wait out a market inflection (and collect a nice dividend while doing so).

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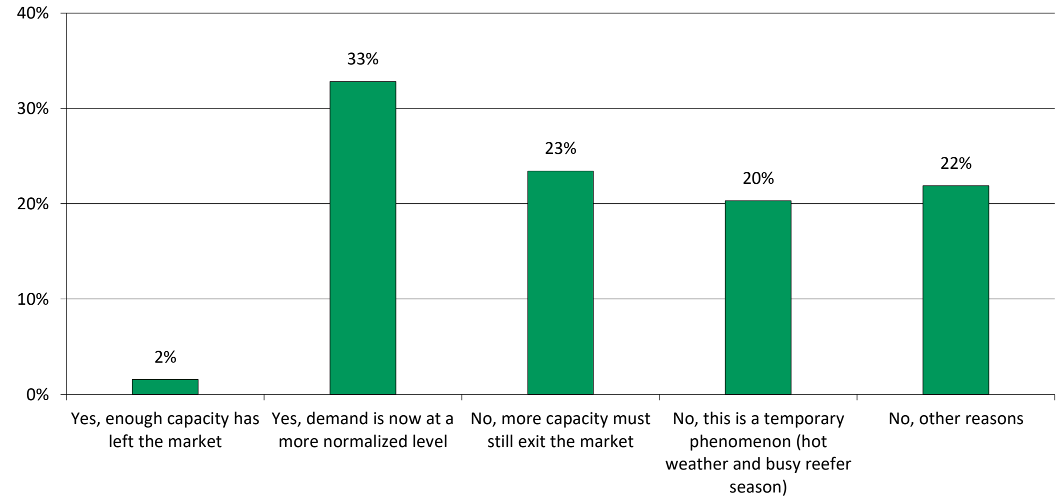
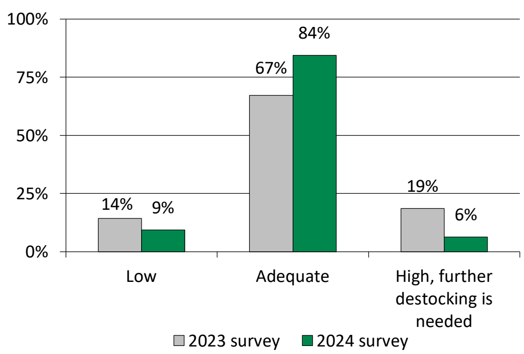
Exhibit 17: Do you believe we have finally reached an inflection point in the trucking market?



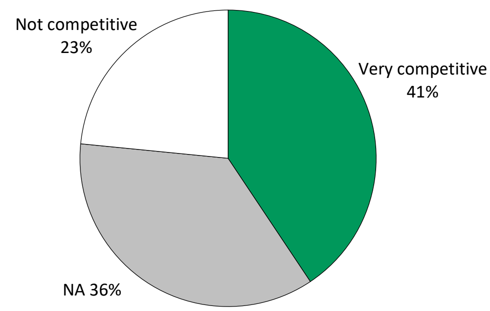
Source: Desjardins Capital Markets, CITT

Exhibit 18: How would you rate your end customers' overall inventory level right now?



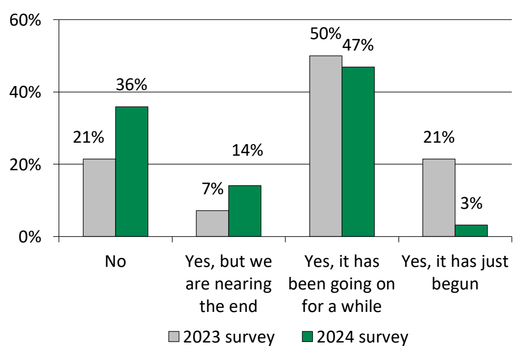
Source: Desjardins Capital Markets, CITT

Exhibit 19: How competitive is the pricing dynamic between trucks and railroads right now?



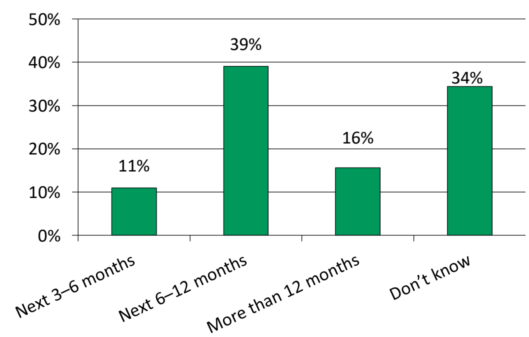
Source: Desjardins Capital Markets, CITT

Exhibit 20: Do you believe we are currently in a freight recession?



Source: Desjardins Capital Markets, CITT

Exhibit 21: If so, when do you expect a recovery in market conditions?



Source: Desjardins Capital Markets, CITT

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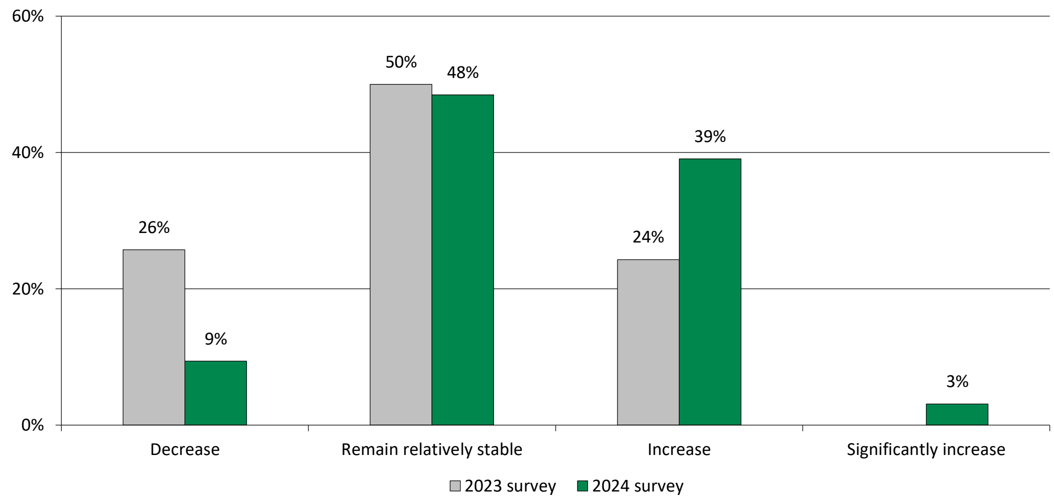
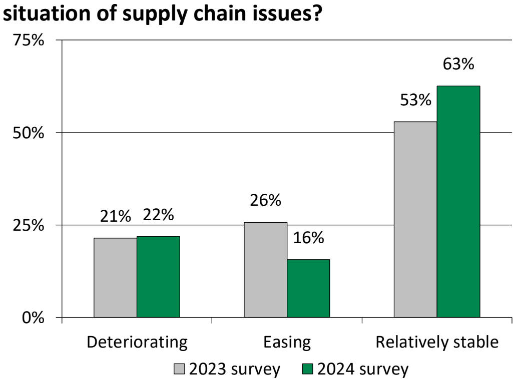
Exhibit 22: How do you expect freight volumes to evolve over the next six months?



Source: Desjardins Capital Markets, CITT

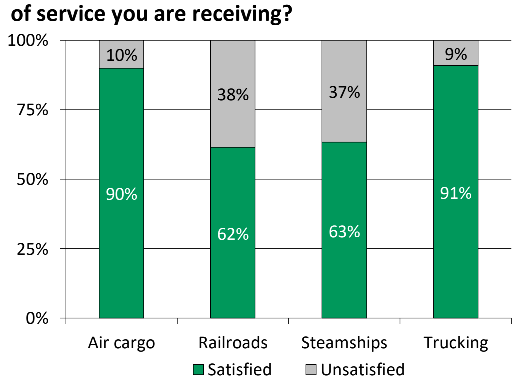
Service/supply chain update

Exhibit 23: How would you describe the current situation of supply chain issues?



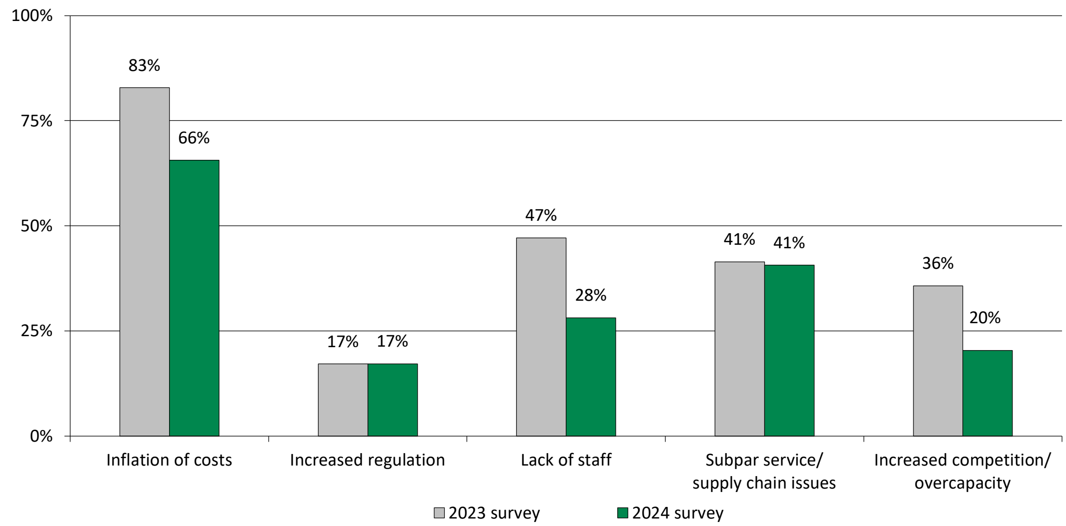
Source: Desjardins Capital Markets, CITT

Exhibit 24: Are you satisfied with the current level of service you are receiving?



Note: Respondents had the choice of selecting more than one answer
Source: Desjardins Capital Markets, CITT

Exhibit 25: Which of the following freight industry risk factor(s) is most concerning to you?



Note: Respondents had the choice of selecting more than one answer
Source: Desjardins Capital Markets, CITT

CITT community comments

- *"All levels of government must stop the aspirational goal of net zero and renewables. It has made a mess of the market and done nothing to look at the real issues such as lack of infrastructure."*
- *"Risk-averse public servants and politicians don't bode well for industry."*

Benoit Poirier, CFA
Michael Kypreos, Associate
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DISCLOSURES

COMPANY-SPECIFIC DISCLOSURES

Desjardins Capital Markets has performed investment banking services for Canadian National Railway Company in the past 12 months.

Desjardins Capital Markets has received compensation for investment banking services from Canadian National Railway Company within the past 12 months.

Desjardins Capital Markets has managed or co-managed a public offering of securities for Canadian National Railway Company in the past 12 months.

Desjardins Capital Markets has received compensation for non-investment banking, non-securities-related services from Canadian National Railway Company, Canadian Pacific Kansas City Limited and TFI International Inc. in the past 12 months.

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STOCK RATING SYSTEM

Top Pick	Buy	Hold	Sell	Not Rated
Desjardins' best investment ideas—stocks that offer the best risk/reward ratio and that are expected to significantly outperform their respective peer group* over a 12-month period	Stocks that are expected to outperform their respective peer group* over a 12-month period	Stocks that are expected to perform in line with their respective peer group* over a 12-month period	Stocks that are expected to underperform their respective peer group* over a 12-month period (includes recommendations to tender to a takeover offer)	Stock is being covered exclusively on an informational basis

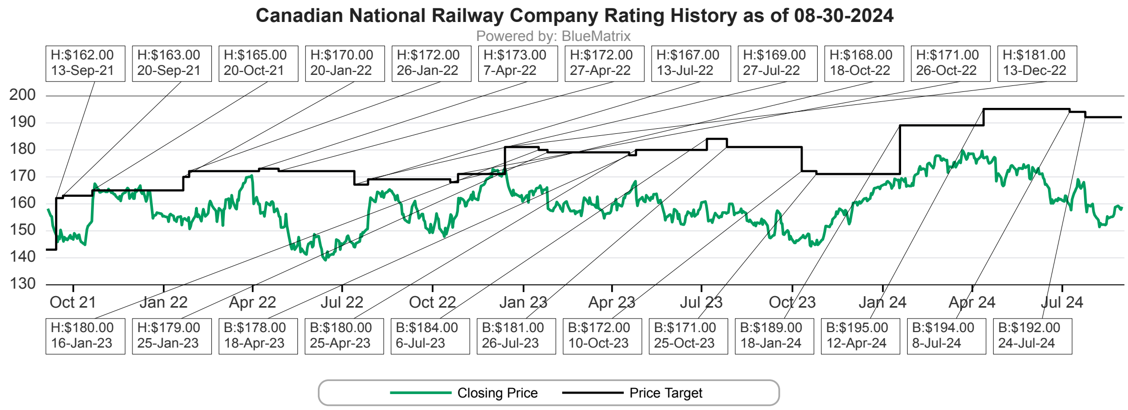
RISK QUALIFIERS

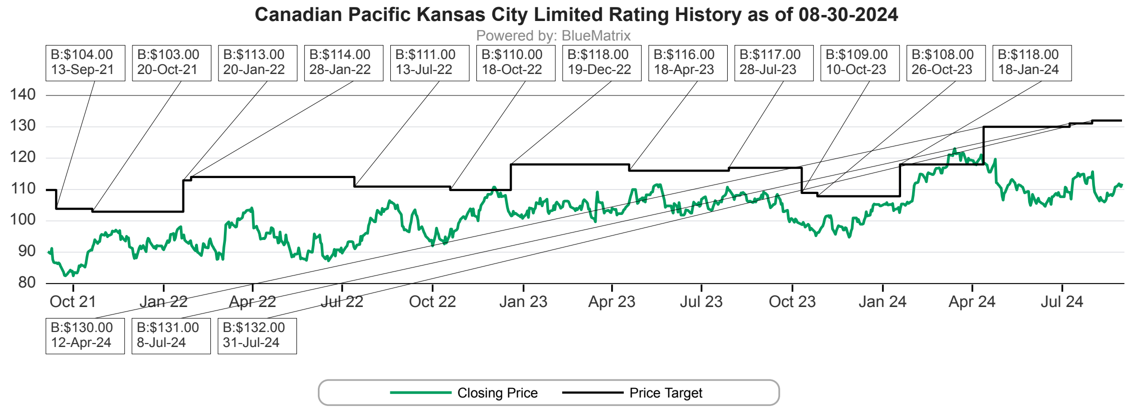
Average Risk	Above-average Risk	Speculative
Risk represented by the stock is in line with its peer group* in terms of volatility, liquidity and earnings predictability	Risk represented by the stock is greater than that of its peer group* in terms of volatility, liquidity and earnings predictability	High degree of risk represented by the stock, marked by an exceptionally low level of predictability

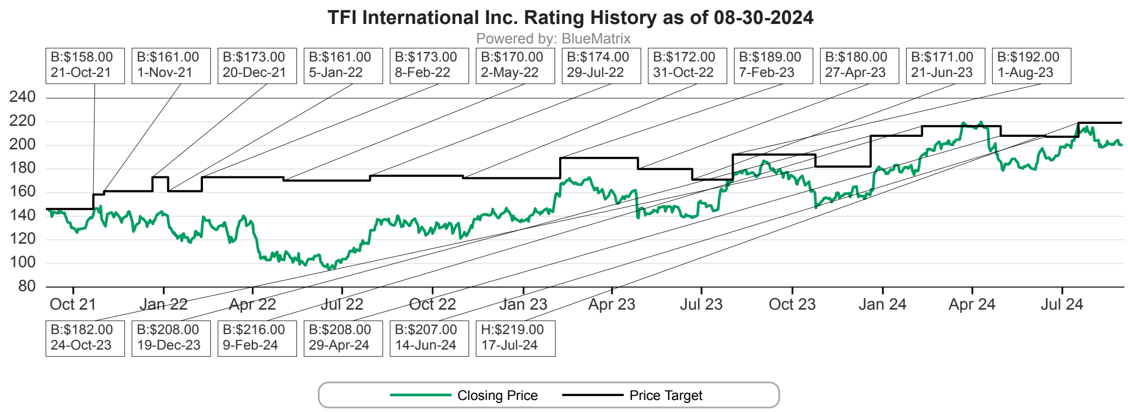
* Peer group refers to all of the companies that an analyst has under coverage and does not necessarily correspond to what would typically be considered an industry group. Where an analyst's coverage universe is such that 'relative' performance against a 'peer group' is not meaningful, the analyst will benchmark the rating against the most appropriate market index

Distribution of ratings

Rating category	Desjardins rating	Desjardins coverage universe (# of stocks)	% distribution	Desjardins Investment Banking (# of stocks)	% distribution
Buy	Buy/Top Pick	113	73	86	73
Hold	Hold	38	25	30	25
Sell	Sell/Tender	3	2	2	2
Total		**154**	**100**	**118**	**100**


Canadian National Railway Company Rating History as of 08-30-2024
Powered by: BlueMatrix
H:$162.00 13-Sep-21
H:$163.00 20-Sep-21
H:$165.00 20-Oct-21
H:$170.00 20-Jan-22
H:$172.00 26-Jan-22
H:$173.00 7-Apr-22
H:$172.00 27-Apr-22
H:$167.00 13-Jul-22
H:$169.00 27-Jul-22
H:$168.00 18-Oct-22
H:$171.00 26-Oct-22
H:$181.00 13-Dec-22
H:$180.00 16-Jan-23
H:$179.00 25-Jan-23
B:$178.00 18-Apr-23
B:$180.00 25-Apr-23
B:$184.00 6-Jul-23
B:$181.00 26-Jul-23
B:$172.00 10-Oct-23
B:$171.00 25-Oct-23
B:$189.00 18-Jan-24
B:$195.00 12-Apr-24
B:$194.00 8-Jul-24
B:$192.00 24-Jul-24
Closing Price
Price Target


Canadian Pacific Kansas City Limited Rating History as of 08-30-2024
Powered by: BlueMatrix
B:$104.00 13-Sep-21
B:$103.00 20-Oct-21
B:$113.00 20-Jan-22
B:$114.00 28-Jan-22
B:$111.00 13-Jul-22
B:$110.00 18-Oct-22
B:$118.00 19-Dec-22
B:$116.00 18-Apr-23
B:$117.00 28-Jul-23
B:$109.00 10-Oct-23
B:$108.00 26-Oct-23
B:$118.00 18-Jan-24
B:$130.00 12-Apr-24
B:$131.00 8-Jul-24
B:$132.00 31-Jul-24
Closing Price
Price Target


TFI International Inc. Rating History as of 08-30-2024
Powered by: BlueMatrix
B:$158.00 21-Oct-21
B:$161.00 1-Nov-21
B:$173.00 20-Dec-21
B:$161.00 5-Jan-22
B:$173.00 8-Feb-22
B:$170.00 2-May-22
B:$174.00 29-Jul-22
B:$172.00 31-Oct-22
B:$189.00 7-Feb-23
B:$180.00 27-Apr-23
B:$171.00 21-Jun-23
B:$192.00 1-Aug-23
B:$182.00 24-Oct-23
B:$208.00 19-Dec-23
B:$216.00 9-Feb-24
B:$208.00 29-Apr-24
B:$207.00 14-Jun-24
H:$219.00 17-Jul-24
Closing Price
Price Target

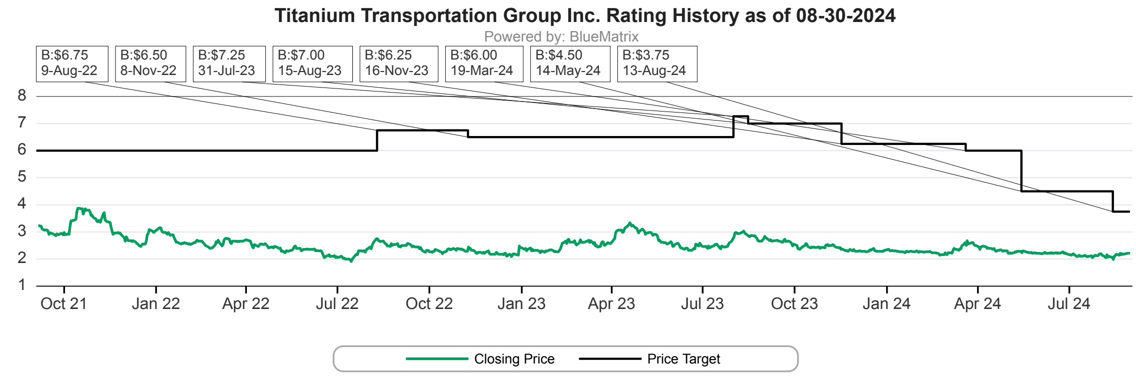


Chart legend: TP: Top Pick, B: Buy, H: Hold, S: Sell, NR: Not Rated, I: Company initiation, T: Transfer of coverage, S: Coverage suspended, DC: Coverage dropped

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OFFICES
Montreal
1170 Peel Street
Suite 300
Montreal, Quebec H3B 0A9
(514) 987-1749

Toronto
25 York Street
Suite 1000
Toronto, Ontario M5J 2V5
(416) 607-3001

Calgary
110 9th Avenue SW
Suite 410
Calgary, Alberta T2P 0T1
(877) 532-6601

Vancouver
401 West Georgia Street
Suite 1050
Vancouver, British Columbia
V6B 5A1
(604) 656-2665