

CANADA'S SMALL BUSINESS JUGGERNAUT

A Special Report from BMO Capital Markets Economics

October 2009

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Small businesses in Canada—the backbone of communities across the country—have faced huge opportunities and challenges from the economic boom and subsequent bust of the past several years. Industries such as construction, retail, professional services and truck transportation have heavy concentrations of small firms, which have experienced a roller coaster of strong growth from 2000 to 2007, followed by a significant contraction through the recent recession. Aside from powerful cyclical forces, small businesses are also facing, and leveraging, important longer-term secular trends driven by demographics and the development of digital technologies. The aging of the population has provided longer-term growth opportunities for firms providing non-institutional health care where small businesses account for more than two-thirds of total employment in the industry. And, the growing importance of the Internet is opening new and exciting avenues for small businesses to advertise, market, and distribute their services and products.

Small business provides both heft and dynamism to our economy. There are more than one million small businesses in Canada¹ accounting for nearly 98% of the total number of private enterprises in the country (*Chart 1*). Small businesses employed roughly five million people last year, comprising nearly half of the private-sector labour force. **Between 1998**

and 2008, small businesses created more than one-third of all new private sector jobs. In 2008, they created roughly 70,000 jobs, almost 70% of the Canadian total.

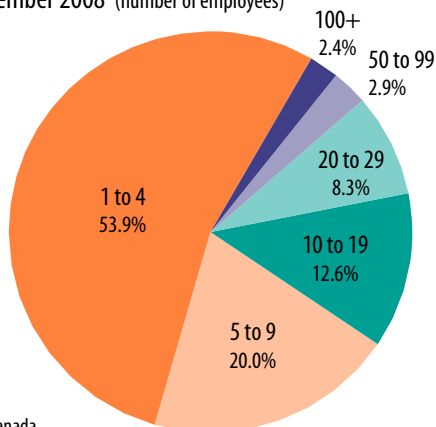
What's more, approximately 15% of the employed labour force in Canada in 2008 was self-employed. This number has risen sharply during the financial crisis and ensuing recession, but it also reflects the growing number of retirees who shift to self-employment. Many of these people continue to work full-time, but prefer the flexibility and like being their own boss at this stage of life. Indeed, the fastest-growing component of the labour force is workers age 55 and older.

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CHART 1

ENTERPRISE DISTRIBUTION BY FIRM SIZE

Canada – December 2008 (number of employees)



Source: Statistics Canada

¹ In this report, we are using Industry Canada's definition of "small business" as firms with fewer than 100 employees; this definition excludes self-employed entrepreneurs if they have no employees.

Period of Opportunity

Recessions always cause restructuring and enormous economic disruption and the most recent recession is no exception. Canada has weathered this storm fairly well, but many industries are contracting and rationalizing as the stronger players acquire the weaker ones and weak players merge or fail. Economist Joseph Schumpeter called this process 'creative destruction'—survival of the fittest.

While painful, recessions and ensuing recoveries yield enormous opportunity. **The great majority of Canada's small businesses will survive this latest recession and, as it now turns into recovery, the survivors will become stronger than ever.** Further, new small businesses are incubators for innovation and big ideas. Every recession has spawned start-ups and consultancies in which experienced people with varying talents put their skills to work in entirely new ways.

Canadian small business survivors have a particular advantage because of the continued strength of our banking system and the relative stability of our domestic economy. Our financial markets have performed very well in comparison to the rest of the world and credit has remained relatively less costly and more available for firms in Canada. **Indeed, one of the surprising features of this recession is that business bankruptcies have so far remained essentially unchanged on a year-to-date basis, compared with the 64% surge in the United States.** Additionally, as emerging-market growth continues to revive, commodity prices will strengthen further, boosting the commodity-rich Western and Atlantic Provinces.

Undoubtedly, the strong Canadian dollar has been a burden to manufacturers. However, many of the service-providing industries in which small businesses are highly represented compete in local markets and do not face international competition. The stronger dollar also reduces the cost of material and finished goods imports and lowers the cost of importing technology and talent. Within the manufacturing sector, substantial restructuring in the face of the sharp rise in the loonie since 2003 put Canadian firms in a stronger position to weather the recession, contributing to the flat profile for business bankruptcies.

Canadian manufacturers, hit hard by global excess capacity in autos and other key sectors, are finally seeing the clouds part as inventory depletion has spurred rising auto production and allowed stronger players to scoop up distressed firms (think Magna buying Opel). Such M&A activity on its own creates demand for professional services. Creative destruction during recession increases spinoffs, deploys talent and offers outsourcing opportunities for small business.

We have seen vivid examples of restructuring in the mega-company world. Businesses like Wal-Mart, McDonald's, Best Buy and Honda have out-competed Linens 'n Things, Circuit City and General Motors, rendering the survivors fitter for the long term. The big names

make the news, but many smaller companies also benefit as the landscape opens up. Excess supply is melting away as competitors are dropping out, inventories are depleting and pent-up demand is building. As economic activity strengthens, people with jobs realize they are likely to keep them and consumer confidence rises. This improves business conditions for retailers and other service providers. To be sure, we may well have a more moderate recovery than normal as our major market to the south struggles with high household and government debt burdens and people everywhere have become more cautious. The disadvantages of bubble psychology are now self-evident so a moderate but sustainable recovery is welcome.

Small businesses will also benefit from a shift in psychology—a new and healthy wariness of the establishment or the status quo. Things have changed. The recession is making small business survivors more prudent and conservative—but also more confident, and stronger. Bootstrapping new businesses through sweat equity will pay off. No longer are the excesses of boundless angel and venture capital a temptation to build too fast or hire too many. Survivors have been forced to cut costs and increase productivity. This means that as the recovery takes hold, revenue increases go directly to the bottom line.

The Internet —a Boon to Small Business

The Internet has provided an enormous vehicle of opportunity for small business. It gives firms—no matter what size or location—the ability to reach a global customer base. Social networking and online advertising turn an unknown product into tomorrow's blockbuster as information goes viral.

This has transformed the very nature of small business. The Internet makes markets more efficient, bringing specialized buyers and sellers together. No one knows the size of your business on the Internet. When someone hits your website for the first time, the surfer has no idea if you are a one-person company or a thousand-person company, they are just looking for a solution to meet a need. The Internet has changed the way people get information and shop. And, of course, the Internet has made it much easier to start a new business through its marketing and e-commerce potential.

In the wake of the global credit crisis, business has learned the dangers of too much reliance on a single customer, sector or industry. Canadian exporters had almost all of their eggs in the U.S. basket and were hit hard by the collapse in American demand. While the rest of the world also moved into recession, the rebound will be much more dramatic in emerging-market nations. We need to establish better trade relations with the behemoths of the future—China especially, but also India, Russia and Brazil. Digital technologies help to streamline the process of broadening our markets to the billions of new entrants into the burgeoning middle class.

Today, business understands the importance of maintaining sufficient capital to ride the cyclical bumps. There is a new appreciation for the dangers of building up too much overhead or overinvesting in every new technological system. Businesses—big and small—with too much payroll, too high costs, too much rent and too many facilities have failed. Survivors will have learned to be flexible, to be low-cost/high-value businesses. While settling into your comfort zone may be tempting, especially in troubled times, growing personally and professionally means taking calculated risks. Whether it's expanding into unknown markets, refocusing customer bases, or jettisoning non-core businesses, successful enterprises are not afraid to forego the familiar and embrace the risks that can lead to higher rewards.

Small Business Sectoral Trends in Canada

Small businesses are highly represented in the following industries:

- Construction
- Non-institutional health care
- Professional services
- Retail
- Accommodation & food services
- Truck transportation
- Forestry

About 25% of small businesses operate in the goods-producing sector and the remaining 75% are in service industries. One important trend has been the rising prevalence of female business entrepreneurs. It is estimated that 46% of small and medium-sized enterprises (SMEs) have some degree of female ownership. According to Industry Canada, 16% of SMEs are majority-owned by women, 19% are equally owned by men and women, and 11% have minority female ownership. The accommodation and food services industry, at 22%, has the highest share of businesses majority-owned by women. The lowest share is for SMEs in agriculture and primary industries, where it is only 5%.

Geographical Trends in Canadian Small Business

Several factors differentiate communities with respect to the heft and dynamism of their small business sectors. These include:

- Population growth
- Key industries
- Industrial diversity
- Location (whether the community is a regional hub or service centre for a larger area)

We examined the latest data to assess small business strength in communities across Canada in two ways: 1) we ranked the number of small business enterprises per one-thousand population to get a handle on the current intensity of small business in particular communities; and, 2) for the larger communities, we ranked the growth in the number of small firms over a five-year period ending in mid-2009.

We calculated these strength measures for each of the 33 Canadian census metropolitan areas (CMAs) and for each of the 111 census agglomerations (CAs). Both CMAs and CAs are defined as having an urban core with adjacent urban and rural areas that are highly integrated economically and socially with that core. Put simply, CMAs encompass the largest cities in Canada. CAs encircle much smaller urban cores.² Roughly 80% of the Canadian population lives in CMAs and CAs, but these geographical units represent only 4% of Canada's land mass.³ There is a strong positive correlation (70%), however, between the growth in population and growth in small businesses in CMAs over the 5-year period. We suspect that, if these data were available for CAs, it would show a similar pattern.

The CMAs with the strongest growth in the number of small businesses were located in three regions: the Greater Golden Horseshoe region in southern Ontario (Toronto, Guelph, Oshawa, and Barrie), the Calgary-Edmonton corridor in Alberta, and British Columbia's Lower Mainland and southern Vancouver Island (Abbotsford and Vancouver on the mainland and Victoria on Vancouver Island) (*Maps 1, 2, and 3*).

British Columbia and Alberta have the highest small-business intensity as measured by the per capita number of small enterprises (Table 1). CMAs and CAs in those provinces dominate their respective top-10 lists for small businesses per 1000 population. These two western provinces have long had the highest number of small businesses per capita because of the makeup of their economies. Tourism, resources, construction and health-care services have been very strong. Until the recession hit last year, retail industry growth was also vigorous, reflecting the robust population and employment growth that accompanied the boom in resources. And, vibrant economic

² Both of these geographical units have an urban core and an adjacent urban and rural area that have a high degree of social and economic integration with the urban core, as measured by commuting flows. To form a CMA, the urban core must have a population of at least 50,000 and the area (CMA) must have a population of at least 100,000. CAs are much smaller, having a population no smaller than 10,000. The geographical boundaries of CAs vary greatly over time, making long-term time-series comparisons very difficult. For a more detailed definition, see <http://www12.statcan.ca/english/census06/reference/dictionary/geo009a.cfm>.

³We examined growth in the number of small businesses over the past five years for CMAs only. This information is not available for CAs because of the many geographical boundary changes in the source data for the various smaller communities. Enterprise counts as of December 2007 are based on the 2006 standard geographical classification (SGC 2006) while counts for 2004 were based on the 2001 SGC boundaries.

expansion spurred growth in the number of professional services firms as well. British Columbia also has the advantages of burgeoning activity for the 2010 Olympic Games in Vancouver and strength in transportation services to facilitate growing trade with Asia. Abbotsford and Kelowna are the two fastest growing metropolitan areas in British Columbia and among the 10 fastest growing cities in the country.

Whereas the two most western provinces also appear in Table 2, the top-10 CMA rankings for five-year growth in the number of small businesses, communities in Ontario are also well represented. This reflects the relatively high degree of industrial diversity in Ontario, providing a wider venue for the creation and growth of small businesses. The province is also a gateway to the United States, generating growth opportunities in truck transportation and logistics. Additionally, it has a relatively high share of manufacturing, in which there has been substantial layoffs, first

due to restructuring in the face of the sharply rising loonie, and subsequently due to the deep recession. The auto sector, so important in Ontario, has weathered tremendous rationalization and change. Many of these displaced workers are joining small businesses or starting their own.

Toronto has benefited from its ethnic diversity as well as a broad industrial base, making it the destination of choice for immigrants. All of the growth in the population of Canada comes from immigration, as the resident population might move from city-to-city, but the total for Canada is quite stable (to down slightly). The number of births and deaths for Canadian residents are roughly offsetting. Toronto is also the centre for key financial and professional services and the small businesses they generate. One of Canada's tourist hubs, Toronto attracts substantial foreign investment and will soon be the home of five 5-star hotels, which generate a slew of small business enterprises.

Oshawa, with its affordable housing, strong industrial base, diversified services sector, new University of Ontario Institute of Technology, and resulting fast population growth has also been a small business incubator over the past five years. Direct access to various transportation modes,

TABLE 1
SMALL BUSINESS INTENSITY

(number of small businesses per 1,000 population)

CMAs		Intensity	CAs		Intensity
1	Kelowna, BC	39.7	1	Fort St. John, BC	71.2
2	Calgary, AB	38.9	2	Lloydminster, AB/SK	69.0
3	Vancouver, BC	37.2	3	Canmore, AB	57.9
4	Edmonton, AB	36.6	4	Camrose, AB	54.9
5	Victoria, BC	35.0	5	Okotoks, AB	54.1
6	St. John's, NL	32.9	6	Grande Prairie, AB	53.8
7	Moncton, NB	32.4	7	Brooks, AB	51.0
8	Abbotsford, BC	32.2	8	Swift Current, SK	51.0
9	Saskatoon, SK	31.9	9	Salmon Arm, BC	50.4
10	Toronto, ON	30.0	10	Estevan, SK	50.2

Source: Statistics Canada

TABLE 2
SMALL BUSINESS GROWTH IN CMAs

2004–2009 (percent change in number)

		Growth Rate
1	Toronto, ON	15.1
2	Guelph, ON	13.8
3	Abbotsford, BC	10.2
4	Vancouver, BC	9.3
5	Oshawa, ON	9.1
6	Kelowna, BC	8.4
7	Calgary, AB	7.4
8	Barrie, ON	6.6
9	Ottawa-Gatineau, ON/QC	6.3
10	Victoria, BC	6.1

Source: Statistics Canada

including an international airport, an educated and skilled workforce using leading-edge technologies, and low development charges contribute to Oshawa's small business strength, especially in transportation and automotive industries, health-care services, sustainable energy, IT, and bioscience.

Similarly, Guelph recorded the second fastest growth in the number of small businesses during the past five years, spurred by three-way partnerships between private companies, universities, and government in the bioscience industry. It is also a hub for surrounding agricultural areas, where small businesses are highly represented.

Barrie also appears in the top-10 ranking for small business growth. Over the past five years, Barrie has enjoyed one of the fastest population growth rates (11.8%) of all CMAs, spurred by attractive real estate prices and development costs, very good infrastructure, and improved rail transportation for commuters.

Provincial capitals also breed small businesses to serve the public sector—a meaningful factor for Edmonton, Victoria, St. John's and Toronto. The biggest public-sector draw is, of course, the country's capital. Ottawa-Gatineau is the centre of government and its workers, but is also the bedroom community for many consultants, publicists, pollsters and other providers of goods and services to government and its workers. As well, the region is a hotbed for many small technology companies and is a primary tourist attraction for residents and visitors to Canada.

Communities in Quebec, on the other hand, have been squeezed out of the top-10 rankings because of their relatively slow population growth. Nevertheless, Sherbrooke, Montreal, and Trois-Rivières showed respectably, capturing the 12th, 15th and 16th spots for per capita small businesses, while Montreal also came in 15th in five-year small business growth. Quebec has weathered the recession much better than Ontario, Alberta, and British Columbia. Part of this reflects the relatively stronger performance of Quebec's manufacturing sector, which has much less exposure to the auto industry than that in Ontario and is well represented in pharmaceuticals and aerospace equipment, which have held up well during the financial and economic crisis. Textiles, clothing, forestry, and furniture—industries in which Quebec had traditionally been strong—have faced aggressive headwinds for years from the strong loonie and increased global competition, forcing firms to rationalize and restructure well before the latest recession. More measured growth in business investment and housing than in the resource-fuelled West resulted in a smaller setback during the downturn.

Rivière-du-Loup maintained its small business intensity of 40.3 per 1000 population, but slipped from #7 in the CA rankings in our earlier study (in 2005) to a still-respectable #22 (out of 111) as fast-growing communities in Alberta and British Columbia took the top spots.

Notable Metropolitan Regions

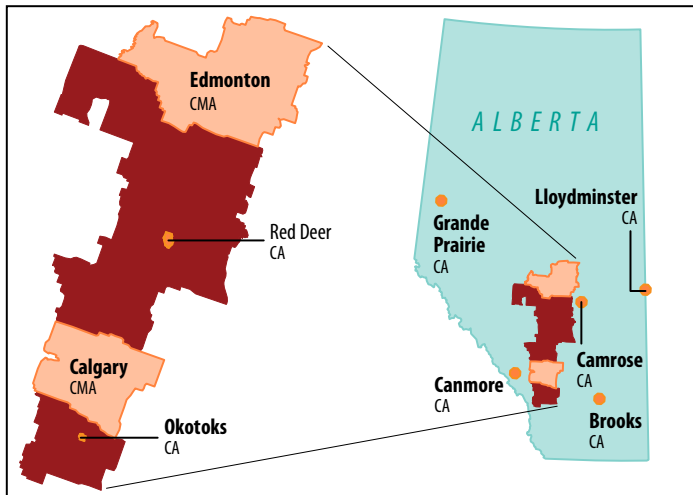
MAP 1

LOWER MAINLAND AND SOUTHERN VANCOUVER ISLAND



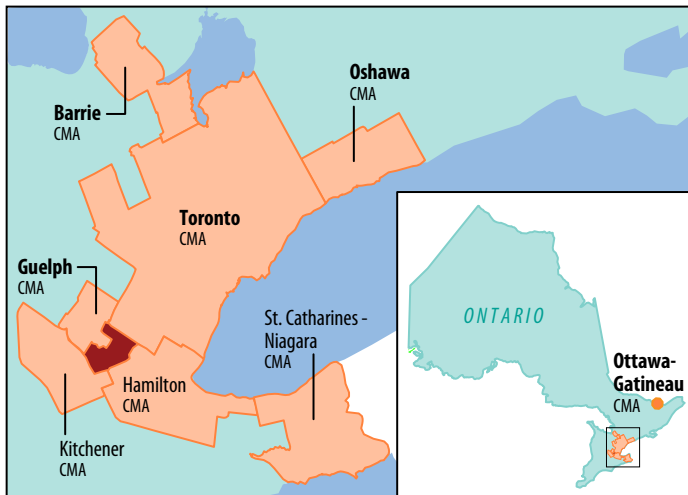
MAP 2

CALGARY-EDMONTON CORRIDOR



MAP 3

EXTENDED GOLDEN HORSESHOE



Source: Statistics Canada (2001 boundaries)

Top-10 CMA Small Business Hotbeds**Kelowna, British Columbia**

Home to approximately 180,000 residents, Kelowna is situated in south-central British Columbia in the Okanagan Valley, and is the third-largest metropolitan area in the province. The climate helps support the region's many wineries and orchards, while providing ideal conditions for tourism year-round. Longer-term growth is supported by the recent extension of Kelowna's airport runway to accommodate overseas flights, and the opening of a new bridge across Lake Okanagan which has helped to alleviate some of the traffic congestion.

Calgary, Alberta

As one of the largest CMAs in Canada, Calgary is situated in southern Alberta (300 kilometres south of Edmonton) and is home to over one million residents. The oil and gas industry remains vital to the region's economic growth, and its proximity to the province's oil operations makes it a preferred destination for corporate headquarters in the energy and transportation sectors. The presence of many larger enterprises in Calgary has helped to support a wide network of small businesses in and out of the energy sector. Other key industries in the CMA include technology, construction, manufacturing, finance and transportation.

Vancouver, British Columbia

With a population of over two million people, Vancouver is Canada's third largest city and the economic centre of British Columbia. A diverse range of sectors makes the city an ideal stomping ground for small businesses in the services, industrial and resource industries. The city is also hosting the 2010 Olympic Winter games, which has helped to drive tourism and construction activity. Longer-term, Vancouver is ideally located as an access point to fast-growing Asian markets, and small business will benefit as trade to that region continues to expand.

Edmonton, Alberta

Located in the geographic centre of the province, Alberta's capital city is the gateway to the province's oil and gas regions and is home to just over one million residents. Although the energy sector remains the main catalyst for economic growth, development in knowledge-based areas such as research and education has contributed to the increasing diversification of the overall economy. Other key industries include construction, engineering services, banking, retail trade and government.

Victoria, British Columbia

Located on the southern tip of Vancouver Island, the provincial capital is home to approximately 350,000 residents and enjoys one of the warmest climates in Canada, helping support the region as both a tourist and retirement destination. Victoria also boasts a highly skilled labour force and is home to four post-secondary institutions and a centre for the Canadian Armed Forces. Other key industries in the region include technology, marine, and health.

St. John's, Newfoundland

Situated on the eastern side of the Avalon Peninsula, St. John's is the capital city and economic hub of Newfoundland. The region has benefitted from the area's rich natural resource base. The offshore oil & gas industry's production, development, and expansion initiatives have been a big driver of economic growth in recent years. There are currently three producing fields, Hibernia, Terra Nova and White Rose, with a fourth field, Hebron, currently under development.

Moncton, New Brunswick

Moncton is New Brunswick's most populous CMA with more than 125,000 residents, and is the third largest in Atlantic Canada. The city is well diversified with a strong presence in cyclical sectors such as transportation and shipping, but also more stable industries, including information technology, health care, retail and financial services. This diversity allows Moncton to spawn a large and diverse number of small businesses, and has helped the city weather the economic downturn much better than most.

Abbotsford, British Columbia

Abbotsford is home to more than 170,000 residents and is located in a highly productive agricultural area, which combined with its close proximity to Vancouver, has created a strong and diverse local economy. A wide range of industries employ over 62,000 people, with the largest sectors being manufacturing, retail trade, construction and agriculture. Favourable demographics (a median age of only 36.6 years), solid population growth, and affordable housing make the CMA an attractive place of business, with over 6,000 business licences issued in each of the past two years.

Saskatoon, Saskatchewan

Saskatoon has been among Canada's fastest growing cities in recent years, with population growth surging to as high as 3.5% y/y in late-2008. This is a stark change from average annual growth of less than 1% in the prior 20 years. An inflow of migrants from regions like Alberta and Atlantic Canada and strength in immigration have helped fuel this growth, attracted by a relatively low cost of living and rising employment prospects in the resource sector. Small businesses have been an immediate beneficiary, not only in the hot resource sector, but spin-off service industries—housing and consumer activity have been particularly strong in recent years.

Toronto, Ontario

Toronto is the provincial capital and home to a highly educated, multi-cultural and diverse population of over five million, supported by a wide range of sectors including financial, tourism, and manufacturing. It also houses three universities and five colleges. The largest employers are the banks, the provincial and local governments, and the University of Toronto. The city is considered a gateway to the U.S., given its close proximity to the border, the international airport that provides flights to over 50 countries, four major highways, and multi-modal railways.

Top-10 CA Small Business Hotbeds**Fort St. John, British Columbia**

Located in northeastern British Columbia and home to more than 18,000 residents, Fort St. John has one of the highest concentrations of small businesses in the country, with its large resource base supporting key industries such as oil, natural gas, forestry and agriculture. Much of the region's natural gas deposits, estimated at among the largest in North America, are still untapped. Fort St. John also supports a growing tourism sector, attracting overseas visitors with wilderness and eco-adventures. As a regional service centre, Fort St. John services roughly 64,000 persons in outlying areas.

Lloydminster, Alberta/Saskatchewan

With sections occupying regions of both Alberta and Saskatchewan, Lloydminster is home to over 27,000 residents and services a trading area in excess of 150,000 people. Industries such as energy, agriculture and transportation have traditionally been the key economic drivers. While the region has continued to expand in those areas (oil-related companies account for over 4,000 employees in the region), there has also been strong expansion in the retail, manufacturing and service industries.

Canmore, Alberta

Canmore's location—in the Rocky Mountains and next to Banff National Park—is the biggest draw to those who enjoy skiing, hiking, and mountain biking. It is also near a major city (100 kilometres from Calgary). Its population is fairly young, with the bulk concentrated in the 25-54 age bracket. There are roughly 17,000 residents in Canmore, of which nearly half are considered 'weekenders', or non-permanent residents who stay at their second homes. The major industries are mostly service-based, such as tourism and hospitality, retail trade, holistic and alternative medical practices, and technology (environmental and software development).

Camrose, Alberta

Located 100 kilometres southeast of Edmonton, Camrose is home to just 16,000 residents, but serves a larger market area of over 140,000, helping support the region's retail and service sectors. Although the University of Alberta's newest faculty (Augustana) is based here, the population is older, with roughly 25% between the ages of 45 to 65. The town is located on agricultural parkland and, thus, the major industry is agriculture. Health care and social services are also key industries, with extended health-care services (Rosehaven, Bethany) catering to the older population.

Okotoks, Alberta

Okotoks is one of the fastest growing communities in Canada. Situated 20 kilometres south of Calgary, Okotoks services a trade area of approximately 85,000 and acts as a regional centre for commercial and retail activity. Regional resources include clay, natural gas, oil, shale, sulphur, sand, gravel and water. The community and surrounding area is

well diversified from an industrial perspective. Major industries in Okotoks include agriculture, transportation, education, and professional and retail services.

Grande Prairie, Alberta

Situated on the southern edge of the Peace Region, Grande Prairie is home to almost 80,000 residents and serves as an economic and transportation hub for the surrounding region. Key industries include oil and gas, agriculture, forestry and construction. Located northeast of Grande Prairie, the McLennan oil sands deposit is slated for further development in the next few years. The region also boasts a vast area of arable farmland.

Brooks, Alberta

With over 13,000 residents, Brooks is situated in one of Alberta's most active gas fields and is home to approximately 200 production and service companies. Brooks is also home to a large beef processing plant (employing 2,300 in the region) and a highly-skilled labour force in the areas of agriculture, manufacturing, construction, wholesale and retail trade.

Swift Current, Saskatchewan

Swift Current is found midway between Regina and Medicine Hat on the Trans-Canada Highway. It is the largest centre in the southwest region of Saskatchewan and has prioritized tourism for local development. In late 2008, Living Sky Casino opened in this town of roughly 16,000 residents.

Salmon Arm, British Columbia

This town of 16,000 is located on the Trans-Canada Highway about midway between Calgary and Vancouver. It is nestled on Shuswap Lake, which is the closest warm-water lake to Calgary. Its key industries include forestry, agriculture and dairy farming, tourism and retailing, as well as a growing manufacturing sector. Indeed, the agriculture and intensive livestock operations generate more than \$75 million worth of business in the region. Salmon Arm is also a growing retirement area. It is the commercial hub of a fast-growing trading area with more than 40,000 people.

Estevan, Saskatchewan

Estevan is located close to the U.S. border (16 kilometres) and is centrally located at the junction of three major highways. The major industries in this town of approximately 12,000 residents are coal mining, power generation and oil and gas.

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