



The Octagon A.M.

February 6, 2008

PFE, SC, Base Metals Market

BUY: Pacific Energy Resources^{1,2,3,4}

PFE-TSX: \$1.70

Target: \$2.50↓

Warren Verbonac

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HOLD↑: Shoppers Drug Mart Corp.⁴

SC-TSX: \$49.63

Target: \$48.50

Robert Gibson, CFA

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Base Metals Market

(No Recommendation)

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Accretive Acquisitions Result In A Value Story – Perhaps The Deepest Discount To Asset Value In The Sector

- PFE released its year-end 2007 reserve report. The present value of the P&P reserves has increased to \$2,540 million from \$171 million at year-end 2006.
- If the Q3/07 net debt of \$500 million and diluted shares outstanding of 250 million are still relatively current, the new asset value could be \$8.00 a share – although we caution that this is a preliminary estimate that will change when the 2007 year-end financial statements are released.
- Of the \$1,404 million of proved reserves, \$876 million are undeveloped, meaning with sufficient capital, at minimal risk, production could increase significantly.
- This is possibly the deepest value situation in the oil and gas sector.
- While the Company is trading at such a large discount, it could become the target of a well-financed senior producer looking for low-risk development opportunities.
- We are reducing our target to \$2.50 (from \$3.00), while maintaining our **BUY** recommendation.

2008 Outlook

- Shoppers released its fourth quarter results. Sales rose 7.5% to \$2,168.8 million and net income jumped 16.0% to \$153.7 million (\$0.71 per share).
- Management provided some guidance for 2008. They expect total sales to increase by between 10.5% and 12.0%. This is based upon pharmacy same-store sales growth of 5.0% to 6.0% (we have been using 5.5%) and front store same-store sales growth of 4.5% to 5.5% (we are using 3.0%). This will be a 53 week fiscal year, which will add approximately 2.0% to sales.
- We are moving to a **HOLD** recommendation, while maintaining our target price, and have included our EPS outlook for 2009 of \$2.67.

Daily Update

- Is Chinese economic growth dependent on the US? At one time, the US was by far the largest consumer of all resources, either directly by consumption of the raw materials or indirectly by imported finished goods. Today, the US is second to China, or third behind China and Europe, in its consumption of metals.
- While it is clear that China is the largest consumer of metals, the argument is that China's growth is related to exports, those exports contain metals, and the US is the main buyer of Chinese exports. While that may have been true a few years ago, it is no longer the case. In 2007, China's leading growth sector was investment in domestic consumption and investment for export has slipped to third place. In addition, US consumers no longer buy the lion's share of China's exports; they now consume approximately 18% of China's exports.

- It appears that while a slowdown in the US economy will affect China's growth, China is well placed to mitigate any US-induced slowdown in the country's own growth by boosting spending and easing credit, which it has been steadily tightening over recent months.
- In 2007, Chinese economic growth rate was 11.4%. Recently, the World Bank downgraded its forecast for Chinese growth in 2008 to 9.6%. The downward revision comes on expectations that a slowing global economy, particularly the US, will weaken China's export performance this year. Despite the downgrade, the World Bank expects China to effectively de-couple from the rest of the world under their own internal investment momentum.
- At the recent Indaba conference in South Africa, speakers were convinced that the Chinese economy has largely detached from the US. While all speakers thought that China's GDP growth would slow this year, all forecasts were in the 10–11% range, signifying another strong year.
- Metals are a global business. We believe that China's political need to deliver continued growth to check income disparity within the country and its need to correct infrastructure weaknesses exposed by the recent severe winter weather will result in strong Chinese growth in 2008. As the strong growth becomes apparent in the second quarter of 2008, metal prices will rally.



Upcoming Economic Indicators

Date	Country	Event	Consensus
2/6/08	US	MBA Mortgage Applications	- -
2/6/08	CA	Building Permits MoM	0.00%
2/6/08	US	Nonfarm Productivity	0.50%
2/6/08	US	Unit Labor Costs	3.50%
2/6/08	CA	Ivey Purchasing Managers Index	47
2/7/08	US	Initial Jobless Claims	341K
2/7/08	US	Continuing Claims	2720K
2/7/08	US	Pending Home Sales MoM	-1.00%
2/7/08	US	ICSC Chain Store Sales YoY	0.50%
2/7/08	US	Consumer Credit	\$7.5B
2/8/08	CA	Unemployment Rate	6.00%
2/8/08	CA	Net Change in Employment	10.0K
2/8/08	CA	Housing Starts	210.0K
2/8/08	US	Wholesale Inventories	0.30%

Source: Bloomberg





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Speculative BUY: The stock is in a high growth sector where price patterns are more volatile and of inherently greater risk.

BUY: The stock is expected to exceed the average total return of the industry sector, on a risk-adjusted basis, over the next twelve months.

HOLD: The stock is expected to be in line with the average total return of the industry sector, on a risk-adjusted basis, over the next twelve months.

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Distribution of Ratings

Out of approximately 27 stocks in the Octagon Capital Corporation coverage universe, the ratings distribution is as follows:

Speculative BUY	7.4%
BUY	70.4%
HOLD	11.1%
SELL	3.7%
Under Review	7.4%

Distribution of ratings is updated the first of every month.

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Pacific Energy Resources Ltd.

PFE-TSX: \$1.70

Target Price: **\$2.50** (from \$3.00)

Recommendation: **BUY**

BUY: Pacific Energy Resources Ltd. 1,2,3,4

February 6, 2008

Overview

- PFE released its YE2007 reserve report. The present value of the P&P reserves has increased to \$2,540 million from \$171 million YE2006.
- If the Q3/07 net debt of \$500 million and diluted shares outstanding of 250 million are still relatively current, the new asset value could be \$8.00 a share.
- Of the \$1,404 million of proved reserves, \$876 million are undeveloped, meaning with sufficient capital, at minimal risk, production could increase significantly.
- This is possibly the deepest value situation in the oil and gas sector.
- The Company is trading at such a large discount and could become the target of a well-financed senior producer looking for low-risk development opportunities.
- We are reducing our target to \$2.50, while maintaining our **BUY** recommendation.

Price	\$1.70	Market cap. (\$mm)	\$ 311.4
Shares O/S Diluted (mm)	183.2	Net debt	497.3
Avg. daily vol.	100,000	Enterprise Value	\$ 808.7

	2005	2006	2007e	2008e
EPS	-0.05	-0.19	-0.16	0.02
CFPS	0.01	-0.05	0.00	0.19
Production/mm shares	11.1	9.9	23.5	41.6
P/CF	n/a	n/a	(490.3)	8.8
EV/DACF	n/a	n/a	(1,087.7)	14.2
Revenues (mm)	\$7.4	\$13.0	\$140.9	\$281.4
Cash Flow	0.2	(3.7)	(0.7)	57.0
Net earnings	(1.7)	(13.6)	(34.3)	4.8
Oil & NGLs (bpd)	347	705	4,535	10,961
Natural gas (mmcf/d)	0.4	0.0	3.0	8.1
Equivalent (6:1 boed)	405	705	5,039	12,311

Quarterly CFPS (diluted)				
Q1	\$0.01	\$0.01	-\$0.03	\$0.04
Q2	\$0.01	\$0.01	\$0.00	\$0.02
Q3	\$0.02	\$0.00	\$0.00	\$0.05
Q4	\$0.01	\$0.00	\$0.05	\$0.09

Changes to Estimates	Previous Estimates		Current Estimates	
	Q4/07	FY08	Q4/07	FY08
Revenue			\$77.7	\$281.4
Cash Flow			\$12.1	\$57.0
Net Earnings			\$2.7	\$4.8
CFPS (diluted)			\$0.05	\$0.19



Accretive Acquisitions Result In A Value Story – Perhaps The Deepest Discount To Asset Value In The Sector

(Pacific Energy reports in US dollars; all figures have been converted to Canadian dollars, except as noted. All per share numbers are on a diluted basis.)

Pacific Energy released its year-end 2007 reserve report, and although we need the balance sheet to provide an accurate asset value, it appears there is quite an increase in the \$5.27 per diluted share that we last calculated at the end of Q3/07.

The present value of the proved and probable reserves at year-end 2007 was \$2,540 million, a significant increase from the \$171 million in the prior year. If the Q3/07 net debt of \$500 million and diluted shares outstanding of 250 million are still relatively current, the new asset value could be \$8.00 a share – although we caution that this is a preliminary estimate that will change when the 2007 year-end financial statements are released. Although we have been using diluted shares to calculate asset value, since dilutive instruments are about 50% of the shares outstanding, some of the dilutive paper may expire without being exercised, resulting in a higher diluted asset value. In summary, both the California offshore and Alaskan assets, which comprise the bulk of the Company, were made at prices very accretive to asset value.

Of the \$1,404 million of proved reserves, \$876 million are undeveloped, meaning with sufficient capital, at minimal risk, production could increase significantly. The reserve life index of the proven developed producing oil reserves is 5.2 years, and of total proved oil reserves is 16.1 years (using our forecast average production for 2008).

Of the \$1,136 million of probable reserves, \$804 million are in Alaska, where no company-operated drilling is scheduled for this year.

There is an additional \$424 million of possible reserves, but as there are no drilling plans to exploit this potential, we have not included them in the asset value calculation.

The reserves were estimated by DeGolyer & MacNaughton, and Netherland, Sewell & Associates. Essentially all of the Company's reserves are oil.

The first of a series of personnel changes has been initiated. A new Vice-President, with years of oil and gas operating experience, has been hired; and a new Chief Financial Officer is being sought. As well, new directors are expected to be added to the board this year.

Analyst: Warren Verbonac · (403) 750-0497 · wverbonac@octagoncap.com

Investment Conclusion

This is possibly the deepest value situation in the oil and gas sector. The reason for the discount is that these assets have not been exploited to maximize their production and cash flow. Assuming the offshore Eureka platform begins to restart production by the end of this quarter, production could increase from approximately 10,000 bd currently to over 14,000 bd by year-end, providing cash flow of an estimated \$57 million, or \$0.19 per share (\$0.30 basic).

Additional reasons for the discount are the high operating costs, which will improve as additional production is brought onstream; the high level of debt (approximately 10x this year's cash flow) and the debt service charges that divert capital away from developing production; and hedges, which limit the price of oil to the mid-\$60s per barrel. Pacific Energy's two largest exploration targets, Corsair in Alaska and Pacific Creek in Wyoming, are unlikely to be drilled this year due to capital constraints.

The main event this year for Pacific Energy will be bringing Eureka production back onstream, and perhaps some strengthening of the balance sheet (some of the California onshore producing assets are being offered for sale. We have not yet adjusted our production downward for these assets).

At current levels, the stock is trading at 8.8x this year's diluted cash flow estimate and at 5.7x basic – at the high end of the range for the sector. On a cash flow multiple basis, although the stock may appear expensive, the premium results from the high asset value. While the Company is trading at a large discount (at 20% of asset value), it could become the target of a well-financed senior producer looking for low-risk development opportunities. Thus, while we continue to see some chance of the Company being taken over at an attractive premium to the current price (and well in excess of our target), on an ongoing basis, the stock is likely to be a market performer until it accelerates its drilling program and cash flow. We are reducing our target to \$2.50, while maintaining our **BUY** recommendation.





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Shoppers Drug Mart Corp.

SC-TSX: \$49.63

Target Price: **\$48.50**

Recommendation: **HOLD** (from SELL)

COMPANY BULLETIN

February 6, 2008

Overview

- Shoppers released its fourth quarter results. Sales rose 7.5% to \$2,168.8 million and net income jumped 16.0% to \$153.7 million (\$0.71 per share).
- Management provided some guidance for 2008. They expect total sales to increase by between 10.5% and 12.0%. This is based upon pharmacy same-store sales growth of 5.0% to 6.0% (we have been using 5.5%) and front-store same-store sales growth of 4.5% to 5.5% (we are using 3.0%). This will be a 53 week fiscal year, which will add about 2.0% to sales.
- We are moving to a **HOLD** recommendation and have included our EPS outlook for 2009 of \$2.67.

Price	\$49.63	Market cap. (\$mm)	\$10,749.9	
Shares O/S (mm)	216.6	Net debt	1,065.5	
Avg. daily vol.	675,408	Enterprise Value	\$11,815.4	
	2006	2007	2008E	2009E
EPS	\$1.95	\$2.27	\$2.48	\$2.67
CFPS	2.65	3.12	3.34	3.65
Book value / share	12.58	14.27	16.79	19.50
P/E	25.4	21.8	20.0	18.6
P/CFPS	18.7	15.9	14.9	13.6
P/BV	3.9	3.5	3.0	2.5
EV/EBITDA	14.3	12.3	11.3	10.5
System Sales	\$7,786	\$8,478	\$9,318	\$10,256
EBITDA	828.1	962.1	1,043.6	1,128.2
EBIT	683.5	790.0	852.1	911.0
Net earnings	422.5	493.6	538.2	581.9
EBITDA margin	10.6%	11.3%	11.2%	11.0%
Net margin	5.4%	5.8%	5.8%	5.7%
Return on equity	15.5%	15.9%	14.7%	13.7%
Quarterly EPS (fd)				
Q1	\$0.33	\$0.39	\$0.47	\$0.50
Q2	\$0.44	\$0.52	\$0.53	\$0.58
Q3	\$0.57	\$0.66	\$0.75	\$0.81
Q4	\$0.61	\$0.71	\$0.72	\$0.78

Values in 2005 and 2006 have been updated to reflect AcG-15.

Changes to Estimates	Previous Estimates		Current Estimates	
	FY08	FY09	FY08	FY09
Revenue	\$9,386.6		\$9,318	\$10,256
EBITDA	\$1,020.3		\$1,043.6	\$1,128.2
Net Earnings	\$535.0		\$538.2	\$581.9
EPS	\$2.47		\$2.48	\$2.67



2008 Outlook

Event

Shoppers announced its fourth quarter results yesterday. Earnings of \$153.7 million, or \$0.71 per share, came in above our estimate of \$0.69 and last year's \$132.5 million, or \$0.61 per share.

We are moving to a **HOLD** recommendation and have included our EPS outlook for 2009 of \$2.67.

Impact

Neutral. The numbers came in as expected. Store growth – either new or relocation – continues to be the main driver. Generics continue to be a bigger part of the prescription sales mix, which drive down same-store sales.

Details

Sales rose 7.5% to \$2,168.8 million. Prescription same-store sales increased 5.6% for the third quarter in a row. The continued shift towards generic drugs had a deflationary impact. Front-store comparable sales were disappointing, rising only 2.6%. Management attributed this to adverse weather and a major promotional event.

During the quarter, 30 drug stores were opened or acquired, 7 of which were relocations. One drug store was closed. Drug store selling space increased 5.4% to over 9.7 million square feet. For the year, Shoppers opened or acquired 121 stores, 44 of which were relocations.

Newer stores are not as profitable as established stores. This was evident in a 47 basis point increase in SG&A costs in the quarter. Therefore, gross margins must have shown a remarkable improvement because the EBITDA margin increased meaningfully to 13.1%, from 12.2% last year. Management attributed this, in part, to the maturation of their real estate program. It would also be due to the benefit of higher margin generic drugs and cosmetic sales.

Shoppers lowered the price on books, magazines, and greeting cards. This hurt the top line, but it would appear that Shoppers' vendors took some of the pain, so that overall profitability was not negatively impacted.

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Associate: Tracy Nong · (416) 306-2549 · tnong@octagoncap.com

Outlook

Management provided some guidance for 2008. They expect total sales to increase by between 10.5% and 12.0%. This is based upon pharmacy same-store sales growth of 5.0% to 6.0% (we have been using 5.5%) and front-store same-store sales growth of 4.5% to 5.5% (we are using 3.0%). This will be a 53 week fiscal year, which will add about 2.0% to sales.

Management did not appear to be concerned about the effect of a weakening economy. We are not as confident and believe that discretionary and impulse spending will suffer, which accounts for a large percentage of Shoppers' front-store sales. Therefore, we are using a lower front-store sales number.

The addition of 120 to 130 new stores in 2008 should increase square footage by 10%. To achieve this growth, management expects to spend \$500.0 million. With a 34.4% increase in the dividend to \$0.86, there will be precious little left over for debt reduction.

The other issue worth noting is the \$93.7 million Shoppers has set aside as "deposits". These are amounts the Company has set aside with respect to offers for pharmacies. It is important to note that these stores will most likely be smaller than a typical "new" Shoppers store and not have the size or selection of a Shoppers front-store offering. Given the top and bottom line potential of high-end cosmetics and groceries, we believe the acquisition of smaller, older stores would hurt margins in the long run. If the independent pharmacist continues to feel economic hardship, we would expect Shoppers to accelerate its growth through acquisition. As a result, we are lowering our square footage per store assumption for stores acquired in 2008 and 2009.

Valuation and Recommendation

Shoppers Drug Mart's peer group trades much lower than Shoppers on a forward P/E multiple basis. We feel comfortable using a multiple of approximately 20x on our 2008 EPS estimate to arrive at our target price of \$48.50. Using other valuation metrics such as EV/Revenue and EV/EBITDA, Shoppers is significantly overvalued. Given that the stock is trading close to our target price, we are moving to a **HOLD** recommendation.

Exhibit 1: Quarterly Summary

Shoppers Drug Mart Corp.								
(millions, except per share values)								
	Q4/07	Q4/06	yr/yr growth	Q3/07	Quarterly growth	2007	Annual 2008E	growth
System Sales	\$2,168.8	\$2,018.1	7.5%	\$2,542.7	-14.7%	\$8,478.4	\$9,317.8	9.9%
Prescription	\$975.0	\$897.0	8.7%	\$1,215.0	-19.8%	\$3,989.0	\$4,439.8	11.3%
Front store	\$1,194.0	\$1,121.0	6.5%	\$1,328.0	-10.1%	\$4,489.0	\$4,877.9	8.7%
EBITDA	\$283.4	\$246.9	14.8%	\$283.7	-0.1%	\$962.1	\$1,043.6	8.5%
margin	13.1%	12.2%		11.2%		11.3%	11.2%	
EBIT	\$242.1	\$208.8	15.9%	\$228.7	5.8%	\$790.0	\$852.1	7.9%
margin	11.2%	10.3%		9.0%		9.3%	9.1%	
Net Income	\$153.7	\$132.5	16.0%	\$142.6	7.8%	\$493.6	\$536.2	8.6%
margin	7.1%	6.6%		5.6%		5.8%	5.8%	
E.P.S.	\$0.71	\$0.61	15.8%	\$0.66	7.8%	\$2.27	\$2.47	8.4%

Source: Company reports, Octagon Capital



Exhibit 2: Comparable Company Financial Summaries
(\$ in millions, except per share data)

Company Name	Stock Price	Shares Outstanding	Market Cap	TEV	Debt/Capital	Last 12 Months			Next 12 Months			Last 12 Months			Next 12 Months		
						Revenue	EBITDA	EPS	Revenue	EBITDA	EPS	TEV/Rev	TEV/EBITDA	P/E	TEV/Rev	TEV/EBITDA	P/E
CVS Caremark Corp. (NYSE:CVS)	\$ 38.00	1,476.9	56,121.9	65,519.7	25.1	76,329.5	5,890.4	1.92	87,151.9	7,436.0	2.35	0.9	11.5	20.4	0.8	9.1	16.7
Jean Coutu Group PJC Inc. (TSX:PJC)	\$ 10.77	251.1	2,704.3	2,862.5	8.2	7,198.4	341.9	0.88	NA	NA	NA	0.4	9.0	13.1	NM	NM	NM
Longs Drug Stores Corp. (NYSE:LDG)	\$ 45.35	37.7	1,710.7	1,904.8	20.9	5,242.3	256.5	2.26	5,473.7	296.2	3.00	0.4	7.5	20.3	0.4	6.5	15.3
Rite Aid Corp. (NYSE:RAD)	\$ 2.97	795.3	2,362.1	8,291.7	69.6	22,142.6	669.2	(0.22)	26,961.9	1,081.6	(0.22)	0.4	13.3	NM	0.3	8.2	NM
Walgreen Co. (NYSE:WAG)	\$ 34.95	991.4	34,648.7	35,520.1	9.2	55,081.4	3,927.6	2.06	61,142.5	4,343.4	2.25	0.7	9.2	17.2	0.6	8.3	15.8
Average					26.6							0.5	10.1	17.8	0.5	8.0	15.9
Shoppers Drug Mart Corp. (TSX:SC)	\$ 49.63	216.8	10,759.2	11,830.3	26.7	9,317.8	1,043.6	\$2.48	10,256.2	1,128.2	\$2.67	1.3	11.3	20.0	1.2	10.5	18.6

Source: Capital IQ, Company Reports, Octagon Capital





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Base Metals Market

Daily Update

February 6, 2008

	Price per Pound (US\$)			LME Inventory			% Change since Dec. 31, 2007	
	Last	2/5/2008	2/4/2008	Change	2/5/2008	2/4/2008	Price	Inventory
Copper	3.267	3.311	3.331	-1.28%	174,775	177,050	7.88%	-11.5%
Nickel	12.054	12.047	12.565	-0.68%	46,650	46,968	2.78%	-2.7%
Zinc	1.090	1.090	1.118	1.92%	113,025	110,900	4.86%	26.8%
Lead	1.260	1.290	1.244	0.77%	49,075	48,700	9.72%	7.9%
Aluminum	1.187	1.173	1.193	-0.04%	954,450	954,850	11.36%	2.6%

Source: Bloomberg

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Yukon Gold Corp. Inc. (YZC-TSXV) – Plans Scoping Study as First Step Toward Production at Its Marg Deposit

Yukon Gold Corporation Inc. (Yukon Gold) announced the results of an internal review of the 100%-owned Marg Deposit dated February 1, 2008. The internal review postulates that a positive production decision might be feasible based on a 2,700-tonne-per-day mining and processing operation over a minimum mine life of seven years. The internal review, amongst other items, recommends metallurgical test work and further exploration to expand the resource base, which will provide additional mine life.

The 43-101 has an indicated resources of 1.72 million tonnes of 1.97% copper, 2.40% lead, 4.59% zinc, 59.72g/t silver, 0.95g/t gold and inferred resources of 4.8 million tonnes of 1.81% copper, 2.28% lead, 4.64% zinc, 54.47g/t silver, 0.77g/t gold at a 1% copper cu-off.

The internal review was based on comparisons with proximate deposits and associated feasibility studies at current metal prices, estimated trucking and shipping costs, industry treatment and refining costs, average metallurgical recoveries, and concentrate grades from five VMS deposits.

Yukon Gold explores and develops mining properties with a commitment to moving projects towards production. Yukon Gold's 100%-owned Marg deposit is an advanced stage copper/lead/zinc/silver/gold deposit in the Tombstone Belt in Yukon

Source: Company report(s)



Analysis

- Is Chinese economic growth dependent on the US? At one time, the US was by far the largest consumer of all resources, either directly by consumption of the raw materials or indirectly by imported finished goods. Today, the US is second to China, or third behind China and Europe, in its consumption of metals.
- While it is clear that China is the largest consumer of metals, the argument is that China's growth is related to exports, those exports contain metals, and the US is the main buyer of Chinese exports. While that may have been true a few years ago, it is no longer the case. In 2007, China's leading growth sector was investment in domestic consumption and investment for export has slipped to third place. In addition, US consumers no longer buy the lion's share of China's exports; they now consume approximately 18% of China's exports.
- It appears that while a slowdown in the US economy will affect China's growth, China is well placed to mitigate any US-induced slowdown in the country's own growth by boosting spending and easing credit, which it has been steadily tightening over recent months.
- In 2007, Chinese economic growth rate was 11.4%. Recently, the World Bank downgraded its forecast for Chinese growth in 2008 to 9.6%. The downward revision comes on expectations that a slowing global economy, particularly the US, will weaken China's export performance this year. Despite the downgrade, the World Bank expects China to effectively de-couple from the rest of the world under their own internal investment momentum.
- At the recent Indaba conference in South Africa, speakers were convinced that the Chinese economy has largely detached from the US. While all speakers thought that China's GDP growth would slow this year, all forecasts were in the 10-11% range, signifying another strong year.
- Metals are a global business. We believe that China's political need to deliver continued growth to check income disparity within the country and its need to correct infrastructure weaknesses exposed by the recent severe winter weather will result in strong Chinese growth in 2008. As the strong growth becomes apparent in the second quarter of 2008, metal prices will rally.