News Highlights

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PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. November 16, 2015

Our thoughts and prayers go to our friends in Paris recovering from the tragic events on Friday.

Energy Sector

Crescent Point Energy Corporation – Last week, we met with Crescent Point's management who is on a non-deal road-show subsequent to the release of the third quarter results. We focused the discussion on some of the topics not covered by the quarterly release and conference call. Key points: The current dividend is covered under the current WTI (West Texas Intermediate) crude oil futures strip, with some margin. WTI could go to $40 and stay there for about a year before Crescent Point needs to revise its dividend. Decision to cut was part of larger strategic shift to position the company as a lower yielding mature oil company, similar to Canadian Natural Resources Limited, Cenovus Energy Inc. or Encana Corporation. Crescent Point is most likely to spend the bulk of its cashflow on development, followed by paying down debt, tuck-in acquisitions and supporting its dividend. The company would like to revert to progressively increasing the dividend, though this is not a priority for now.

Part of the strategic shift, Crescent Point is now focused on living within its means, i.e. internal cashflows, meaning the dividend, production growth and acquisitions need to fit into the internal generated cash flows. New strategy was well received by the (institutional) investors, with Crescent Point's US shareholding growing to about 24%, while institutions make up about 50%. The company's 5 year development plans are reviewed weekly against the crude price environment and adjustments are made as needed; e.g. in the first weeks of July, as WTI started dropping, Crescent Point made changes to reduce some $100 million of development capital from their $1.5 billion budget. Crescent Point is preparing its business for the worst. The company has plans in place for a $40 WTI environment through 2016, which call for $1 billion +/- 100 million expenditures in the year for flat production and preserving the dividend. A $60 WTI generates some $300 million of Free Cash Flow (FCF), which the company would likely use to further increase production and act on some of the longer term optionalities such as further delineation drilling in Flat Lake Torquay, Uinta or waterflooding in Midale or North Dakota Bakken. Its projected net debt to funds flow ratio is about 2.2 times in 2015, based on US $50 per barrel.

On the operations side, Crescent Point sees no need at the time being to alter their capital plans for the period from October to March of next year, but reserves options for the second part of 2016. Costs have been lowered by about 30% in most areas, with as much as 40% in Uinta (Utah), with most of it coming from suppliers' price concessions and about a third from technology induced efficiency. Lower overall costs incentivized the company to spend more on trying new technologies and these efforts have paid off. The sliding sleeve technology and improvements to waterflooding have been significantly improved economics at Viewfield and Shaunavon and will be expanded to other fields, notably the newly acquired Midale play exposure.

Crescent Point increased hedging during March to May of 2015, but slowed down since and finds it hard to justify adding to hedges in this environment. Having listened to the management's most recent views and action plans, we believe the company is well positioned to endure further crude price pressures, should this environment continue and be very well placed to benefit from a rebound, though dividend increases should be rather gradual.

Whitecap Resources Inc. reported a robust third quarter 2015 with production volumes exceeding the company's own forecast by 5% at 41,821 boe/d (barrels of oils equivalent per day) and funds flow of $116.1 million ($0.38/share). Whitecap drilled a total of 47 (42.1 net) wells in the third quarter with a 100% success rate spending $50.6 million in development capital. Whitecap has one of the strongest balance sheets among its peer group with a projected net debt to funds flow ratio of 1.7 times in 2015, based on US $50 per barrel. The company's lenders have recently confirmed its credit facility at $1.2 billion reflecting the quality of Whitecap's drilling inventory and lower decline, high netback production base. The company anticipates exiting 2015 with net debt of approximately $850 million which provides it with ample financial flexibility ($350 million unutilized).

Production increased 20% to 41,821 boe/d (76% oil and natural gas liquids (NGL)) compared to 34,940 boe/d (72% oil and NGLs) in Q3/2014. Whitecap generated funds flow of $116.1 million ($0.38/share) compared to $129.4 million ($0.52/share) in Q3/2014 even though realized crude oil prices were down 44% over the same time period. The company realized $37.3 million ($9.69/boe) in hedging gains contributing to a strong Q3/2015 cash netback of $30.16/boe. Whitecap successfully consolidated its working interest at Boundary Lake and expanded its Cardium resource play at Wapiti for $73.6 million (net of property dispositions).

For 2016, the company's Board of Directors has approved a budget of $205 million which is $30 million or 13% lower than the 2015 budget of $235 million. The budget is based on an average WTI crude oil price of US $50.00/ barrel (bbl) and a natural gas price of $2.75/ gigajoule (GJ). The approved capital budget includes the drilling of 108 (103.5 net) development light oil wells in core operating areas to achieve an average production rate of 41,500 boe/d (77% oil and NGLs) in 2016.

US rig count: 767, down 4 week/week, 60% year/year, continuing the negative trend seen all year and a new post-2002 low. Oil-targeted rigs +2, gas -6, reversing recent trends (oil has been worse than gas). Canada is -9 week/week and down 56% year/year, against the normal seasonal build. No particular regional highlights, with Permian basin rigs continuing to fall.

Financial Sector

Barclays PLC have reached a $120 million settlement on LIBOR with one of the groups of class action plaintiffs. Very little detail re: what this involves (is it one of many, one of the most important, etc, etc?) but on the face of it looks like a good settlement in our view. Crucially the agreement includes that Barclays will open records helping plaintiffs in litigation with other banks. We therefore suspect that this is likely to be the first of a long trickle of these claims across the Investment Banking sector.

Berkshire Hathaway Inc. – Warren Buffett's Berkshire Hathaway said it reduced its stake in Goldman Sachs Group, Inc. by 13% during the third quarter, paring a successful investment it made during the height of the global financial crisis. In a US Securities and Exchange Commission filing, Berkshire said it owned 10.96 million Goldman shares worth about $1.9 billion as of September 30, down from 12.63 million shares worth $2.64 billion three months earlier. Buffett told CNBC television that he cut the Goldman stake, and sold shares in longtime holding Wal-Mart Stores Inc, to help fund Berkshire's $31.7 billion takeover of aerospace parts maker Precision Castparts Corp. Buffett has long expressed a preference that Berkshire own whole companies instead of individual stocks. The Omaha, Nebraska-based company has close to 90 operating units including the BNSF railway, Dairy Queen ice cream and Geico insurance. Wells Fargo & Company remained Berkshire's biggest stock holding, worth roughly $24.1 billion, followed by Kraft Heinz Company at $23 billion. Among other changes in the quarter, Berkshire increased its investments in cable TV operator Charter Communications and automaker General Motors Company. It reported a 59.32 million share stake in AT&T Inc., which bought Berkshire investment DirecTV during the quarter.

JPMorgan Chase & Co. expects faster growth in transaction and private banking activities in Brazil following the exit of HSBC Holdings Plc, the bank's top executive in the country said on Friday. A challenging outlook for banks in Brazil stemming from high borrowing costs, the deepest recession in a quarter century and mounting political turmoil, could pave the way for growing market share in private banking, said José Berenguer, JPMorgan's president in Brazil. "The biggest opportunity at this point is in private banking. Some shops and banks are retreating, which hands us good opportunities," Berenguer said at a São Paulo event. (Source: Reuters)

Nordea Bank AB has a duty to pay its excess capital back to shareholders in form of dividends, CEO Casper von Koskull tells newspaper Borsen. Nordea will keep plan to increase dividend payments for 2015 compared to 2014 when the payout was 70% of profit. Nevertheless, "risks have increased" on a much higher 2015 dividend von Koskull admitted. This comes after Jesper Berg, director general of Denmark's financial watchdog says payout ratios are unsustainable and earnings expectations are also out of whack. "In terms of setting expectations for the long run, these need to be talked down," Berg said in an interview at the FSA's Copenhagen headquarters last week.

Prudential plc reported a solid Q3 Interim Management Statement. While new business sales (APE) missed consensus by 2%, the value of new business (the key metric in our view) beat consensus by about 10% - in all regions (US, Asia, UK) due to better margins, although APE missed consensus in both Asia and UK, with only US beating. M&G also had a second quarter of significant outflows (-£2.3 billion), due to outflows at its flagship optimal income fund. APE in Asia, Prudential's growth engine, missed consensus by 5%, although still grew +20% year-over-year (YoY) in a tough quarter. Hong Kong continued its impressive growth (+55% YoY), but this was offset by weak results in Indonesia (-20% YoY) and a slowdown in growth in China, albeit still positive at +4%. Excluding Hong Kong's impressive sales growth, the rest of Asia actually declined 2% YoY, although this was all due to Indonesia. That said, value of the new business in Asia increased 11% YoY and beat consensus by 4%, as better margins more than offset the weaker sales. US sales beat consensus estimates 8%, with Variable Annuity sales (+8% YoY) in line with first half sales. No update on Solvency '2' requirements (as expected), but the company confirmed it has received approval to use the Marching Adjustment and expects Solvency 2 to confirm Prudential as "a strongly capitalized group". Prudential will update the market on its Solvency 2 position at its investor conference on 19th January 2016, the first UK life company likely to give details of its Solvency 2 position.

Royal Bank of Scotland plc (RBS) completed the sale of all of its remaining 110,461,782 shares of **Citizens Financial Group, Inc.** common stock (20.9%) at a price of $23.38 per share. Post the sale, Robert Gillespie, (RBS's board representative) resigned from Citizen's Board of Directors. The Citizens' Board appointed Christine Cumming to the board.

The Toronto-Dominion Bank (TD) announced several changes to its senior executive team. Specifically, Tim Hockey, who has been serving as the Group Head, Canadian Banking and Wealth Management, will be leaving to become President of TD Ameritrade, effective January 2, 2016; he will become President and CEO of TD Ameritrade on September 30, 2016. In conjunction with this change, TD also announced some additional executive changes effective January 2, 2016, as follows: Colleen Johnston, currently CFO, becomes Group Head Direct Channels, Technology, Marketing and Real Estate; Riaz Ahmed, currently Group Head Insurance, Credit Cards, and Enterprise Strategy, becomes CFO; and Teri Currie, currently Group Head Direct Channels, Technology, Marketing and People Strategies, becomes Group Head Canadian Personal Banking and Credit Cards. The above-mentioned three executives will be joined by nine others as direct reports of the CEO. We are not expecting any changes to strategy at TD as a result of these executive appointments.

Global Banks – Financial Times reports Global banks must raise up to €1.1 trillion in special debt by 2022. The Financial Stability Board (FSB) confirms its final proposals for Total Loss Absorbing Capacity (TLAC) for global systemically important banks, which will be put before the G20 later this month. The FSB recommends a buffer of 16% of a banking group's assets by 2019, rising to 18% of risk-weighted assets by January 2022. It adds that the requirements for emerging market banks are the same, but the implementation will be delayed by 6 years. The Financial Times highlights that the proposals mean that banks may have to raise as little as €42 billion and as much as €1.1 trillion by 2022 in special debt to prevent taxpayer bailouts of lenders although much of this requirement will be filled by rolling over existing debt into new instruments that are eligible for TLAC, estimated to be priced at 0.30% more expensive.

Activist Influenced Companies

Nothing new to report.

Canadian Dividend Payers

Northland Power Inc. – posted third quarter results, which handily beat expectations, in large part due to a settlement payment with Ontario Electricity Financial Corporation (OEFC). Adjusted earnings before interest, taxes, depreciation and amortization (EBITDA) was $119 million, compared to consensus of $94 million, while FCF/share was $0.37, compared to expectations for $0.21/share. Northland has made good progress at Gemini, a North Sea offshore wind farm project contracted with Dutch clients, with all 150 monopiles in-place and the transition pieces installed, ready to receive the turbines next year; this part was delivered ahead of schedule (109 days versus 180 days budgeted). The two jackets for the two offshore sub-stations are also in place. Nordsee's, the company German North See offshore windfarm project, components are being produced and the process is on target. The company updated its adjusted EBITDA guidance for 2015 to $395 - $405 million, from $380 - $400 million, while the dividend payout ratio guidance was lowered to 95%-105% from 110% to 115%.

Global Dividend Payers

Barry Callebaut acquired the commercial beverages vending activities from FrieslandCampina Kievit. The transaction includes a long –term contract manufacturing agreement. The acquisition will add roughly 20,000 tonnes p.a., representing 1% of group's volume. The business has sales of CHF 55 million (0.9% of group's sales). The acquisition should help Barry to leverage the Petra acquisition. Beverages mix using cocoa powder, which is expected to grow over proportionally in the coming years. Cocoa powder consumption as an ingredient is expected to grow at 3.4% over the coming five years, and accelerate to 4.3% in the 2020/25 period (based on Olam research). This announcement follows the acquisitions of AM Foods in 2004 (CHF 50 million sales) and Eurogran in 2009 (CHF 40 million) in the Vending mix segment.

BHP Billiton plc - there was a tragic incident at the Samarco Mineração S.A (Samarco) iron ore operation in Minas Gerais, Brazil on Thursday, November 5, 2015. Each of BHP Billiton and Vale holds a 50% interest in Samarco. Samarco has advised that, at this stage, there are nine fatalities. Samarco has also advised that four people previously unaccounted for have been found and 19 people remain unaccounted for. We offer our deepest sympathies to the families and friends of those who have died as a result of this tragic incident. BHP Billiton's immediate priority is the welfare of the Samarco workforce and the community. The local authorities have advised that through the emergency response, 637 people have been evacuated and temporary accommodation has been provided. Samarco and authorities are providing water and food aid to affected communities. BHP Billiton and Vale have pledged to support Samarco in establishing an emergency fund for community support and rebuilding works. Minimising the environmental impact of this incident is also a priority and an Environmental Recovery Plan is to be developed by Samarco with the support of an external expert. At this stage, the tailings extend 440 kilometres downstream and 11 communities have been affected. Samarco has put in place a water monitoring program for the ongoing analysis of the water quality of the Gualaxo do Norte, Carmo and Doce Rivers. Samarco is working with relevant authorities to manage river water quality and ensure availability of potable water. Samarco employees have been put on paid leave and options are being considered by Samarco for managing the workforce longer term. Samarco is continuing to monitor the impacted tailings facilities, including the Germano dam. In conjunction with independent experts, Samarco is developing a plan to reinforce the dam structures and stabilise the area. Samarco operations were immediately stopped following the incident and Samarco's operating licence has been suspended. The Samarco operations will remain suspended as authorities commence investigations and rectification work plans are developed. Samarco and representatives of BHP Billiton and Vale are meeting with lead insurers in Brazil this week.

GEA Group AG – We met with GEA's management last week, as we revisited the investment thesis and took a deeper dive into the company's most recent business developments. GEA is the largest global provider of equipment and process technology to the food industry. The company's business is driven by a number of trends and market structure characteristics. As urbanization trends are expected to continue, leading to 75% of the world's population living in cities by 2050, so is the need for continued food processing. Industry has also defensive characteristics as consumers tend to cut back on discretionary spending before affecting their foods expenditure. Moreover, even if consumers trade down to less expensive brands, food processing is still required. Increased food regulation, in particular in emerging markets in the wake of some resounding food scandals, is providing impetus for GEA equipment and processes, as the company is known for its unsurpassed quality standards. This is underlined by a company's own survey revealing that machine quality and performance far outstrips price considerations in its clients' purchase criteria. The launch of new product categories, such as Greek yoghurt, craft brews and cranberry juice, also demand re-tooling or increasing industry capacity. Lastly, GEA's highly fragmented industry base affords little negotiation leverage to its clients. The company is in the midst of a new stage of its transformation, from an industrial conglomerate some ten years ago to a food focused company. Its 'Fit for 2020' restructuring program aims to simplify the company's organizational structure, while lowering its overhead and improving its cross-selling opportunities. The company's balance sheet is under-levered at present, as the proceeds from the divesting of its heat exchange business are still to be re-allocated in a number of bolt-on acquisitions and/or used for share repurchases by the end of 2016.

National Grid plc - 1st Half 2016 Results a very strong UK interconnector & property performance – "Others" Earnings Before Interest and Taxation of £288 million is already well ahead of full year £239 million consensus –and helped deliver 1st Half 2016 Adjusted Earnings per Share of 28.4 pence, up approx. 22% on 1st Half 2015 and about 14% ahead of consensus. UK and US regulated businesses remain on track to deliver fiscal year 2016 performance in line with previous guidance. National Grid guide to Full Year 2016 Group Return on Equity similar to fiscal year 2015 11.8%, with asset growth of 4-5% expected for the full year. The company also announced their intention to sell a majority stake in their £8.5 billion RAV (regulated assets value) UK Gas Distribution (GD) business, with the sale process expected to take about1 year. National Grid is primarily pursuing the sale to optimize their portfolio over the medium term, with the sale of the relatively lower-growth/higher-leverage business to lift its portfolio's asset growth profile from approx. 5%/annum to nearer 7%, plus strengthen the group's balance sheet

Syngenta AG – The world's largest agrichemicals company, Syngenta, has reportedly rejected a $42 billion takeover offer by state-owned China National Chemical Corporation (ChemChina). Syngenta is under pressure to boost shareholder returns after turning down a $47 billion takeover offer from Monsanto Company this year. Its chief executive stepped down two months later. Bloomberg reports that the Swiss-based company is still in talks with ChemChina as well as other suitors, and that a deal could be reached within weeks. ChemChina has a 5% share of the global crop chemicals through its ownership of Israeli generic pesticides maker Adama Agricultural Solutions Ltd. Syngenta's 19% market share would catapult it to the industry leader position. Acquiring Syngenta would help ChemChina further its international expansion ambitions and help to enhance the technological know-how of China. Monsanto in August abandoned a revised cash-and-stock deal proposal that was worth 470 Swiss francs per share. To appease shareholders, Syngenta announced plans in September to buy back more than $2 billion of stock, funding the measure by selling its vegetable seeds business.

Economic Conditions

Terrorist attacks that took place in Paris late Friday, as well as **air strikes** by France on Syria that started on Sunday, are clearly causing some flight to safety today. With these new attacks fresh in mind, the **G20 summit in Turkey** switched its focus to security issues and terrorism. (Quite likely soft economic growth in emerging markets and the upcoming Federal Reserve rate hike was top of mind before Friday.) The group vocalized their support for France, while the US and Russia agreed on the need for "a Syrian-led and Syrian-owned political transition". (Source: Reuters)

US consumer sentiment, as measured by the University of Michigan, unexpectedly improved in the month of November, to 93.10 index points compared to the expected 91.50 index points and October's 92.10 index points, as both the 'current conditions' and the 'expectations' components of this composite index improved over the surveyed period.

US retail sales rose just 0.1% in October, missing expectations. Oddly, car sales actually fell in the month, despite unit sales hitting decade-highs for four months in a row. Excluding autos, sales were up 0.2%. And, for both components — total and excluding autos — August and September were revised lower. Those are the headline numbers and they will feed concerns about the strength of the US consumer, particularly this week after some negative earnings results seen in recent days.

Canada – New house prices have only increased modestly in September, up by 0.1%, a slowdown from Augusts' 0.3% advance and barely missing the consensus expectations, which were calling for a 0.2% improvement.

UK unemployment hits 7-year low in 3rd quarter 2015.

Japan becomes the first Major Economy to Enter into Technical Recession in 2015: In the third quarter, Real Gross Domestic Product fell 0.8% annualized in Q3, while Q2's 1.2% decline was revised to -0.7% and Q1's 4.5% jump was a smidgen higher to +4.6%. Granted, the details could've been worse as the entire decline was due to the drop in inventories and weaker business expenditures, while personal spending was fairly solid. Nonetheless, this is frustrating to Japanese officials as stronger growth continues to remain out of reach despite Prime Minister Abe's policies to generate stronger economic activity.

Portugal - Anti-austerity lawmakers forced Portugal's centre-right government to resign last Tuesday by rejecting its policy proposals at the start of what was supposed to be a second consecutive term in office - and four more years of cutbacks and economic reforms. The government's dramatic collapse came less than two weeks after it was sworn in and raised questions about debt-heavy Portugal's commitment to the fiscal discipline demanded of countries sharing the euro currency. The moderate Socialist Party forged an unprecedented alliance with the Communist Party and the radical Left Bloc to get a 122-seat majority in the 230-seat Parliament, which it used to vote down the proposals. The defeat brought the government's automatic resignation. President Silva must now decide who will lead the government. Options include appointing Socialist Party leader Costa or a caretaker government.

Financial Conditions

US Federal Reserve policymakers remain determined to signal that although Quantitative Easing has stopped, the stimulus remains via keeping rates at present low until earliest December 2015. The US 2 year/10 year treasury spread is now 1.42% and the UK's 2 year/10 year treasury spread is 1.30% - meaning investment banks remain constrained from profiting from a steep yield curve and instead are seeking operational efficiencies, including job cuts and lower compensation, to maintain acceptable levels of profit, i.e. above their costs of capital. It seems the top tier 6-9 investment banks will continue to command their market and possibly increase their share – as barriers to entry for newcomers have in our view been raised.

Influenced by the withdrawal of quantitative easing, the US 30 year mortgage market rate has increased to 3.98% (was 3.31% end of November 2012, the lowest rate since the Federal Reserve began tracking rates in 1971), as the Federal Reserve effectively continues to give priority to incentivising home ownership. Existing US housing inventory is at 5.0 months supply of existing houses. So the combined effects of low mortgage rates, near record high affordability, a more promising economic recovery, job creation, and low prices are finally supporting the housing market with housing inventory well off its peak of 9.4 months and we believe now in a more normal range of 4-7 months.

The VIX (volatility index) is 20.08 (compares to a post-recession low of 10.7 achieved in early June) and while, by its characteristics, the VIX will remain volatile, we believe a VIX level below 25 augurs well for quality equities.

Mutual Funds

Portland Investment Counsel Inc. currently offers 7 Mutual Funds:

- Portland Advantage Fund
- Portland Canadian Balanced Fund
- Portland Canadian Focused Fund
- Portland Global Income Fund
- Portland Global Banks Fund
- Portland Global Dividend Fund
- Portland Value Fund

Private/Alternative Products

Portland also currently offers private/alternative products:

- Portland Focused Plus Fund LP
- Portland Private Income Fund
- Portland Global Energy Efficiency and Renewable Energy Fund LP
- Portland Advantage Plus Funds
- Portland Private Growth Fund

We want to share our insights with you and welcome your feedback. Our website has the latest, as well as archived videos, company profiles, and press articles. Please visit us at www.portlandic.com.

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