News Highlights

Owners. Operators. And Insightful Investors.

Phone: 1-888-710-4242
Web: www.portlandic.com
Email: info@portlandic.com

PORTLAND INVESTMENT COUNSEL®

Established in 2007

Our views on economic and other events and their expected impact on investments. May 7, 2018

Owner Operated Companies

The Kraft Heinz Company's quarterly profit beat expectations as the company benefited from tax changes in the United States and raised prices to counter higher input costs. Food companies, including Conagra Brands Inc. and General Mills Inc. have flagged higher transportation costs and rising commodities prices in recent months. These companies are also under pressure to boost sales while the struggling retailers they sell products to clamp down on prices and inventory. Kraft Heinz, whose brands include Velveeta cheese and Heinz ketchup, said it raised prices in the United States and in other parts of the world, driving overall pricing up by 1% point. Pricing was positive for the third straight quarter. Net income rose 11.1% to $993 million, or 81 cents per share, primarily reflecting benefits from the biggest overhaul of the U.S. tax code in over 30 years, which slashed the corporate income tax rate to 21% from 35%. Excluding items, earnings were 89 cents per share, beating the average analyst estimate of 82 cents, according to Thomson Reuters. Net sales slipped 0.3% to $6.30 billion in the first quarter ended March 31 as weakening demand for processed foods in the United States more than offset growth in Canada, Europe, the Middle East and Africa. Sales missed expectations of $6.33 billion. To prove to investors that it can grow through innovation, Kraft Heinz has been investing in e-commerce and food and beverage start-ups, joining a growing list of U.S. food companies looking at new ways to spur growth. Finance chief David Knopf said the rise in first-quarter pricing also helped make up for higher expenses from the company's aggressive commercial investment plans.

Energy Sector

Baytex Energy Corp. released first quarter results which were broadly in-line on production and cash-flows. The company posted its best operating net-back since 2014 in Eagle Ford at over $32/boe, however average corporate netback was brought lower by its Canada heavy oil fields' netback at about $8/boe, impacted by the bottlenecking supply out of Western Canada. Eagle Ford's most recent wells (operated by Baytex's partner Marathon Oil) show impressive improvements in deliverability (initial production) of as much as 20%. Likewise, the company's most recent wells at Peace River show promise. Because of the exceptionally high WCS (Western Canada Select crude oil price benchmark) differential during the quarter, Baytex decided to build some inventory instead of selling into the depressed market. Baytex indicated that May's WCS differential has largely normalized so, presumably, they're releasing the previously built inventories, which should improve cash flow for the current quarter. The company's net debt positioned weakened somewhat during the quarter, mostly due to currency effect, which also impacted the net earnings.

Crescent Point Energy Corp.'s first quarter results were slightly below consensus expectations on cash flows, at $429 million ($0.78 per share) vs. $449 million ($0.82 per share), largely driven apparently by the wider differentials because of the bottlenecking in the Western Canadian Sedimentary Basin. Crescent Point is a relatively early reporter in the area, and we suspect most other producers would disappoint somewhat on cash-flows for the quarter. The bottlenecking issues have been substantially taken care of and improving (through shutting in of production by some of the oil sands producers, crude-by-rail and gradual removal of the earlier volume restrictions on the pipelines), with the situation expected to broadly normalize by the third quarter. Production exceeded the company's guidance and the company's drilling program seems to be on track with good results; of interest, the higher growth area of Uinta and the newly acquired lands in East Duvernay. Most notably, for the first time in a very long while, Crescent Point announced $25 million worth of savings in its capital program, with, apparently, no production impact. The company also announced further non-core assets disposal of $225 million at $70,000/flowing boe (fully priced in this environment, we believe), subsequent to the quarter end. The company talked about $1 billion worth of non-core assets on the sale block when we met with them a few weeks ago, so there's more to come.

Shareholders of Crescent Point voted to elect the Canadian energy producer's full slate of directors after a contentious battle with activist investor Cation Capital. The proxy fight, the biggest in the Canadian energy sector in at least about four years, was closely followed by investors and brought to the forefront new activist investor Cation. Crescent Point was Cation's first activist engagement. Alberta-based Cation, which owns a 0.3% stake in Crescent Point, began its public push for change at the company last month. The proxy battle was expected to be close, with Institutional Shareholder Services (ISS) supporting some of the activist's nominees and Glass Lewis supporting the company's choices. Crescent Point lost its "say on pay" vote, as shareholders expressed their continued dissatisfaction with the company's compensation practices.

Source Energy Services Ltd. reported Q1 2018 revenue that handily beat $89.5 million estimates, with headline EBITDA of $20.5 million that was beat consensus EBITDA of approx. $18.5 million. Despite facing significant CN rail disruptions through February, improved unit train flow by early March allowed Source to sell 642,773 tonnes of proppant in Q1 2018. This figure was up 15% sequentially and above estimates of 575,000 tonnes. Only 9% of these volumes were sold at the mine gate in Q1 2018 (versus approx. 30% in Q4 2017), which drove improved average revenue per tonne of $135.17 (up 18% sequentially). Source generated a Q1 2018 cash gross margin of $43.08/tonne on its WCS basin (or "in-basin") volumes, which was up 30% sequentially but below estimates of $47.00. A significant driver of this shortfall was relatively higher-cost legacy inventory related to Source's 2017 acquisition (which the company depleted in Q1 2018); on a normalized basis Source reported its Q1 2018 gross margin on in-basin volumes was $45.98/tonne. Source exited Q1 2018 with net debt of $147.4 million (1.5x 2018E EBITDA) which was approx. $15 million above estimates due primarily to a higher-than-expected working capital draw. The company did not provide an update on its previously announced 2018 capital program (of between $50 and $65 million).

Whitecap Resources, Inc. reported first quarter results which were broadly in line with the expectations in term of both production and cash flows. The period was the most active quarter for the company since inception with development capital spending of $182.4 million. The strong capital efficiencies achieved with its capital program during the quarter resulted in record production of 73,120 boed (85% oil and NGLs – natural gas liquids) and funds flow of $166.5 million ($0.40/share) in Q1 2018. The company also reported the acquisition of a complementary working interest in Whitecap's core southwest Saskatchewan area for $56.8 million. The acquisition includes current production of approximately 1,000 boed (95% oil) and 60 (46.9 net) low risk, top tier drilling locations. Whitecap achieved record production of 73,120 boed in Q1 2018 compared to 55,886 boed in Q1 2017, an increase of 31% (16% per share). The company generated funds flow for the quarter of $166.5 million ($0.40 per share) compared to $124.6 million ($0.34 per share) in Q1 2017, an increase of 34% (18% per share). Whitecap repurchased 1.3 million shares for $11.5 million in the first quarter (2.5 million shares repurchased to date for $22 million) which reduces annual dividend payments by approximately $370,000. The company is confident that it is on track to meet its full year guidance of 73,600 - 74,800 boed. With estimated production of 74,000 boed in 2018, and with WTI currently above US$65.00/bbl, it anticipates generating in excess of $180 million in free funds flow after investing $430 - $450 million of development capital, growing production per share by 14% and returning $133 million in dividends to shareholders. With the strong operational results to date, combined with significantly higher crude oil prices, the company undertook a further 5% increase to the monthly dividend to $0.027 per share ($0.324 per share annualized) from $0.0257 per share ($0.3084 per share annualized) effective for the June 2018 dividend.

Financial Sector

Ares Capital Corporation reported Q1 2018 core net investment income per share of $0.39, roughly in-line with the consensus of $0.38/share. Dividend income came in higher than expectations but was partially offset by Interest income that was modestly lower than estimates while capital structuring fees were in-line. Book value per share was $0.19/share higher quarter/quarter at $16.84, boosted by approx. $0.23/share of net realized and unrealized gains on the quarter. Net-net, this appears to be a solid quarter for Ares in our view. The company has covered its dividend with core Net interest income and generated positive book value growth over the last two quarters. Ares had $1,792 million of new commitments during Q1, of which approx. 49% were in first lien, 18% were in second lien securities, 20% were in senior subordinated loans, 3% in subordinate notes of the secondary debt lending program (SDLP), with the remainder in other equity and preferred securities. Against that, Ares had $1,342 million of exits. The portfolio mix at quarter end was 42% first lien (vs. 44% previously), 30% second lien (vs. 32%), and 4% in certificates of the SDLP (vs. 4% previously). Overall yield on debt and income producing securities increased 40bps to 10.1%. Leverage of approx. 0.71x debt to equity, up slightly from the prior quarter of 0.68x.

Berkshire Hathaway Inc.'s annual meeting: Berkshire's 49% increase in Q1 2018 operating EPS to $3,215 per A share ($2.14 per B share) was 10% above estimates, driven primarily by stronger-than-expected pre-tax earnings in Insurance and BNSF divisions, partially offset by lower-than-projected earnings in Berkshire Hathaway Energy. Net Q1 EPS was a loss of $0.46 per B share driven by net unrealized investment losses from equity investments. In Q1, pre-tax Insurance earnings increased to $1.7 billion from $750 million a year ago, driven by improved underwriting results as well as growth in investment income. BNSF railroad Q1 earnings increased 12% year/year. The Manufacturing, Service and Retail segment's earnings increased 23% year/year. BH Energy segment earnings decreased 17% year/year including weaker-than-expected results at PacifiCorp. The Finance & Financial Products segment earnings increased 10% year/year. In Q1, linked-quarter book value per share declined 0.3% (consistent with our projection) at $211,184 per A share ($140.79 per B share) including mark-to-market equity investment losses. And so Berkshire shares are currently priced at about at 1.39x book value. From the meeting it seems: Berkshire remains open to targeting a large acquisition (a year ago, management said it could target an all cash deal up to $150 billion) primarily in the U.S., but also in other developed nations; Warren Buffett dismissed the idea of a special dividend to return excess capital to shareholders, and he did not update his views on raising the share buyback threshold (currently up to 1.2x book value); Buffett believes Berkshire would still be viewed as an acquirer of choice when he is no longer with the company based on Berkshire's long-term track record of successful deals; and Buffett affirmed that reinsurance is among Berkshire's core businesses, and he sounded a warning on cyber insurance. Berkshire now has around $85 billion of immediately deployable cash available for accretive acquisitions to supplement organic growth.

BNP Paribas S.A. released its Q2 2018 Results. Beat on net income despite a large miss in Corporate & Investment Banking with weaker

Fixed Income Currency and Commodities (FICC) where revenues are down 31% on Q1 2017. FICC in Q1 last year was very strong, so the comparison was high. Equities showed decent progression, up 19% year/year, broadly in line with U.S. peers. Other business lines are fine in our view; domestic markets (retail) €659 million +5% vs. estimates, international financial services +4%. Provisions were €200 million better, group costs inline. CET 1 capital ratio 11.6% is a bit lower than expected mostly due to higher Risk Weighted Assets.

HSBC Holdings PLC - Q1 2018 results underlying profit before tax (PBT) was $6,033 million or 1% better than expectations. The key variations were Income 1% better, costs however were 6% worse with impairment significant better -70%. Volumes grew well, +2% quarter/quarter at $981 billion with guidance of mid-single digit growth for the year. Amongst the divisions Commercial banking was the standout performer whilst Markets had a tough start finishing -10% on revenues. Tangible Net Asset Value was $7.29 in-line, whilst CET 1 capital ratio was in-line at 14.4% (fully loaded for IFRS 9). A $2 billion buyback is earlier than expected but should be taken well.

Standard Chartered PLC beat expectations with a 20% rise in first quarter pre-tax profit, but disappointing income showed the long road ahead for its returns to meet targets after years of restructuring. PBT for Standard Chartered, which focuses on Asia, Africa and the Middle East, rose to $1.26 billion in the quarter to the end of March, from $1.05 billion in the same period a year ago, helped by improvements in asset quality. However, revenues (excluding improving impairments) fell short of market expectations at $3.9 billion, despite being the bank's best since the second quarter of 2015. Underlying profit of $1,257 million was in line with expectations +1%/ $7 million but with a weak mix. Income growth after being flagged as "broad-based double-digit year/year growth" at full year results slowed in March finishing 2% light at $3,873 million up 7% year/year (5% constant currency). Combined with 1% better costs saw pre-provision miss by 3%. Impairment was 21% better at $215 million bringing underlying in line. After $70 million of restructuring, statutory PBT was 2% light at $1,187 million. CET 1 ratio was up 26bps quarter/quarter to 13.9% with model changes now not expected to be material. Guidance of 5-7% income growth is reiterated.

Activist Influenced Companies

Nothing significant to report.

Dividend Payers

Nestlé SA acquires the rights to market Starbucks consumer and foodservice products globally, outside the coffee shops and excluding ready-to-drink (RTD) products. The business has CHF 2 billion sales with strong leadership in North American premium and portioned coffee categories. Together with Nescafé (CHF 10 billion sales) and Nespresso (CHF 5 billion), Nestlé strengthens its position as leading provider of coffee solutions. Nestlé is making an upfront payment of US$7.15 billion in cash (3.6x Enterprise Value/sales, 15x EV/EBITDA), and then logically royalty payments. Nestlé has surprised the market with this unexpected transaction. However, coffee is one of the key growth pillars in the CEO's strategy; the deal with Starbucks allows Nestlé to keep the privately owned JAB Holding Company at a distance, which moreover will be busy integrating Dr. Pepper Snapple Group; finally, it allows Nestlé to gain scale in the U.S., a weak spot so far. Based on multiples, the price might appear expensive, but given the returns, the deal could exceed the cost of capital within 3-4 years.

Novartis AG announced that Sandoz had received a complete-response letter from the FDA (Food & Drug Administration) regarding its rituximab biosimiliar filing. Sandoz's rituximab biosimilar is one of two biosimilars launched in Europe, with the other being Celltrion's Truxima. While Sandoz do not disclose sales for its individual biosimilar drug, at 1Q Sandoz reported that they were pleased with the launch of the product. They were also confident in their ability to supply key markets. Clearly the Complete Response Letter comes as a positive to Roche. Credit Suisse analysts assume that if no biosimilars are launched in 2019 and sales remain flat relative to their 2018 estimates that Roche could generate $664m in incremental sales. At a 60% contribution margin this would be a positive of approx. 2% to group EBITA in 2019.

Economic Conditions

Canada's real GDP rose 0.4% in February, more than making up for January's contraction and topping consensus which was expecting a +0.3% print. That's the biggest monthly increase since May last year. Of the 20 industrial sectors, 15 saw higher output during February. Services-producing industries saw a 0.1% increase in output courtesy of solid contributions from retail, finance/insurance which offset declines in wholesale and real estate. Goods sector output surged 1.2% thanks to gains in manufacturing, oil & gas, construction, mining and agriculture which dwarfed declines in utilities. As a result, industrial production jumped 1.4%, the biggest increase since May last year.

U.S. Nonfarm payrolls rose 164,000 in April, missing to the downside for a second straight month, though the prior month's advance was revised up to 135,000 (from 103,000 previously). While the pace of hiring has downshifted in the past two months, the average so far this year (200,000) is still above last year's mean (182,000). Rather than reflecting a weaker economy, the recent slippage in job creation likely reflects the growing challenge of finding workers, as well as concerns about trade protectionism. Most industries continued to generate jobs in April, with manufacturing still punching above its weight with a 24,000 gain. Household-survey jobs were also soft for a second straight month (up just 3,000). Nonetheless, the **jobless rate plumbed its second lowest**

Phone: 1-888-710-4242
Web: www.portlandic.com
Email: info@portlandic.com

level (3.9%) in the past 48 years, down two tenths as a dip in the participation rate slashed labour force participation. The growing labour shortages mean that wages should be rising faster. But, outside of a modest upward drift that largely reflects firmer productivity, **wages remain unusually calm** (likely due to advanced automation). **Average hourly earnings rose slightly, keeping the yearly rate at 2.6%** (the latter was revised lower the prior month). While this is still close to the top end of the cycle range, it implies little to no upward pressure on inflation once accounting for a pickup in productivity (1.3% year/year in Q1). In our view, wages and inflation should likely remain in check provided that the jobless rate stays above 3½%.

Financial Conditions

The U.S. 2 year/10 year treasury spread is now .45% and the U.K.'s 2 year/10 year treasury spread is .62% - 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 costs of capital.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 4.55% (was 3.31% end of November 2012, the lowest rate since the Federal Reserve began tracking rates in 1971). Existing U.S. housing inventory is at 3.6 months supply of existing houses. So the combined effects of low mortgage rates, near record high affordability, economic recovery, job creation, and low prices are still supporting the housing market with housing inventory well off its peak of 9.4 months and we believe now at the low end of a more normal range of 4-7 months.

The VIX (volatility index) is 15.10 (compares to a post-recession low of 9.52 achieved in early November) 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 8 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
- Portland 15 of 15 Fund

Private/Alternative Products

Portland also currently manages the following private/alternative products:

- Bay & Scollard Development Trust
- Portland Advantage Plus - Everest and McKinley Funds
- Portland Focused Plus Fund LP
- Portland Focused Plus Fund
- Portland Global Aristocrats Plus Fund
- Portland Global Energy Efficiency and Renewable Energy Fund LP
- Portland Global Sustainable Evergreen Fund
- Portland Global Sustainable Evergreen LP
- Portland Private Growth Fund
- Portland Private Income Fund
- Portland Special Opportunities Fund
- Portland Value Plus Fund

Individual Discretionary Managed Account Models - SMA

Net Asset Value:

The Net Asset Values (NAV) of our investment funds are published on our Portland website at http://www.portlandic.com/prices/default.aspx

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.

Glossary of Terms: 'boe' barrel of oil equivalent, a measurement of a unit of energy, 'boed' refers to barrel of oil equivalent per day, 'CET' core equity tier, 'EBITDA' earnings before interest, taxes, depreciation and amortization, 'EPS' earnings per share, 'FCF' free cash flow, 'ROE' return on equity, 'ROTE' return on common equity.

Portland Investment Counsel Inc., 1375 Kerns Road, Suite 100, Burlington, Ontario L7P 4V7 Tel.:1-888-710-4242 • www.portlandic.com • info@portlandic.com

PIC18-032-E(05/18)