News Highlights

Owners. Operators. And Insightful Investors.

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PORTLAND INVESTMENT COUNSEL®

Established in 2007

Our views on economic and other events and their expected impact on investments. June 4, 2018

Owner Operated Companies

Berkshire Hathaway Inc. – Warren Buffett had reportedly proposed to invest $3 billion in Uber Technologies Inc. earlier this year, but the talks failed following disagreements over the deal's terms. Buffett's Berkshire Hathaway would have provided a convertible loan to Uber that would have protected Buffett's investment should the Silicon Valley ride-hailing company hit financial crisis. Uber's Chief Executive Officer Dara Khosrowshahi proposed decreasing the size of the deal to $2 billion, giving Buffett a smaller share of the company. The deal reportedly fell after the two sides could not agree on terms. Buffett, who had long shunned the technology sector, has become a top shareholder of Apple Inc., and expressed regret about not investing in Alphabet Inc.'s Google and Amazon.com, Inc. before they became huge. Berkshire has $108.6 billion in cash and equivalents as of the end of March that it is eager to invest. That said, Buffett may view Apple and Uber less as technology companies than strong brands with loyal customers. Khosrowshahi has since his August appointment been trying to improve the image of Uber, which has been rocked by management turmoil and tarnished by revelations about an alleged sexist workplace culture tolerant of chauvinism. The Uber board of directors has committed to a 2019 initial public offering, and Khosrowshahi has not strayed from that timeline. An investment by Buffett would likely have been viewed as a stamp of approval. In the last decade, Buffett has invested billions of Berkshire dollars to support companies, including investments in The Goldman Sachs Group Inc., General Electric Company and Bank of America Corporation during or in the aftermath of the global financial crisis, as well as preferred investments in companies acquired by the 3G Group. Many of these have carried favourable terms for Berkshire, giving it a reputation as a lender of last resort to companies in need. In February, Uber was valued at $72 billion.

Brookfield Asset Management Inc. – India's Reliance Communications Limited (RCom) said it expects to complete its asset sale to Reliance Jio Infocomm Limited and Canada's Brookfield in the coming weeks, after the bankruptcy appeals court halted insolvency proceedings against the debt-laden company. The 181 billion-rupee ($2.7 billion) asset sale by businessman Anil Ambani-controlled RCom includes airwaves, fiber, mobile masts and real estate assets in Delhi and Chennai, the company said in a statement, as it aims to prune its debt pile. Telecom assets such as towers and airwaves will be sold to Jio, RCom has previously said. Brookfield is reportedly involved in a small real estate transaction with RCom.

Energy Sector

Crescent Point Energy Corp. announced Scott Saxberg had left as chief executive officer, as the company looks to turn around its business after staving off a shareholder proposal to make changes to its board. The Calgary, Alberta-based company named former Vice President Craig Bryksa as interim president and CEO replacing Saxberg. Crescent Point's shareholders voted for all of its director nominees earlier this month, defeating activist investor Cation Capital in one of the biggest proxy fights of the Canadian energy sector in about four years. The oil producer is now looking to cut costs, improve its balance sheet in a bid to reduce debt after undergoing heavy losses in the aftermath of the 2014 oil price crash. We expect that the management change will, over time, remove one of the restrictions that has affected the relative stock performance for the company, namely the institutional investors' reluctance to invest in the company because of the former management's communication mishaps.

Source Energy Services Limited : Debt Financing Adds Financial Flexibility For Growth - Source has arranged an additional $50 million Senior note offering and $18 million increase in credit facilities to $88 million – the financing is being used twofold : 1) to enhance working capital requirements of the rapidly expanding business, and 2) to provide greater flexibility for capital program expansion to meet market demand – the next data point will be early July when Source will begin to disclose prior quarterly tonnage sales and may also give some form of outlook - management's tone, as well as that of the pumpers, is that Q2 (Canada) could come in better than expected– we also note that another potential upcoming catalyst is more contract awards, specifically from LNG Canada Development Inc., which would also allow for Source to entertain the potential to expand one of their mines – and then finally, a higher rig count year/year could be another upside catalyst.

Financial Sector

Bank of Montreal (BMO) reported Q2 2018 adjusted EPS of $2.20 vs. consensus $2.12. The beat came primarily from lower PCL (approximately +5) with a 3% dividend increase and 20 million share buyback announced. Provisions for Credit Losses (PCL) of $160 million were below our forecast ($202 million consensus) with CET 1 capital ratio of 11.3%. Canadian Property & Casualty (P&C) earnings adjusted up 11% year/year; U.S. P&C reports 50% increase year/year in adjusted net income (USD basis) and; Wealth Management adjusted net income up 12% year/year.

Bank of Nova Scotia (BNS) - BNS reported adjusted cash EPS of $1.71, above consensus at $1.67. Relative to estimates, total revenue (Net interest income) and lower provisions were slightly offset by higher costs. Total bank PCL were $534 million vs. consensus of $583 million. PCL on impaired loans improved 3 bps year/year, as provision reversals on non-impaired loans drove the beat. Overall, credit was good across all client segments in our view. CET 1 ratio of 12.0% (+80 bps quarter/quarter), significantly benefited from moving to Basel II floor (+50 bps; pre-announced) and internal capital generation (+28 bps), slightly offset by Risk Weighted Asset growth (-9 bps). Currently, BNS is in the highest capital position among banks, but we estimate the pre-announced acquisitions will impact their CET1 ratio by approximately 100 bps. BNS also announced a non-recourse issuer bid to repurchase 24 million shares (or 2% of outstanding shares). **Canadian Banking** adjusted net income up 7% year/year. Similar to last quarter, loan growth was 7% year/year (residential mortgage +6% year/year, commercial +14% year/year). **International Banking** adjusted net income up 15% year/year (benefit from alignment reporting from Chile contributed 4% to Net Income growth). Loan growth increased 11% year/year, and 16% in the Pacific Alliance region. **Global Banking and Markets** earnings were down 14% year/year (off a tough comparison last year). Revenue declined 4% year/year from lower income from global equities (i.e. trading), fixed income, and investment banking results. Expenses were high (+13% year/year) due to higher regulatory costs and technology investments.

Bank of Nova Scotia (BNS) announced that they will acquire MD Financial Management Inc. (MD) for $2.585 billion, using a combination of cash and stock. MD is the leading provider of financial services to physicians and their families in Canada, with more than $49 billion in assets under management (AUM). The transaction will strengthen BNS's wealth management position, with Canadian banking AUM set to increase to over $230 billion (post the closing of Jarislowsky, Fraser Limited and MD). Alongside the MD acquisition, BNS and the Canadian Medical Association (CMA) will enter into a 10-year agreement whereby BNS will be the CMA's preferred provider of financial products and services. Based on projected year 3/year 5 post-tax earnings contributions, the purchase price of $2.585 billion implies a P/E multiple of approximately 17x / 10x (three and five years out, respectively). On a price to AUM basis, the multiple stands at 5.3%. On both these metrics the price appears expensive, in our view (with BNS trading at approximately 11x 2018 estimate). The transaction is expected to close in Q4 2018 pending regulatory approval. BNS have covered a portion of the purchase price ($2.585 billion) through a 19.7 million (1.6% dilutive) offering of common shares (at $76.15 per share) on a bought deal basis for gross proceeds of $1.5 billion. The transaction will have an approximately 30 bps impact on BNS's CET 1 ratio. Pro-forma for the MD acquisition, BNS now looks to have the lowest capital ratio of the Big-6 banks at approximately 10.7% in our view.

Barclays PLC is tightening its lending criteria to a U.K. economy that is lagging behind the rest of the world. Chief executive Jes Staley says Brexit uncertainty was helping to stunt economic growth and that was something the bank could not ignore. Speaking exclusively to the BBC he said "we have to be mindful of weaknesses in the economy and we have protect the integrity of the bank". That meant tightening some lending criteria, "just to be prudent". "In no way do we pull back in a radical fashion - but we will look at our credit exposures and see whether that's proper given the direction of the economy," Mr. Staley said. "We can at the margin tighten some of our underwriting criteria and credit standards just to be prudent for the stability of the bank." Mr. Staley said measures might include looking at how big a loan Barclays would be prepared to provide as a percentage of the value of a residential property - the so called loan to value ratio - particularly in London and the South East. (Source: BBC)

National Bank of Canada reported adjusted cash EPS of $1.45, which beat consensus of $1.39. The beat came from lower taxes (approximately +4), better than expected net trading revenues (approximately +2) offset by higher PCL (approximately -2) with a 3% dividend increase and 8 million share buy-back plan. PCL of $91 million were above our consensus) $83 million forecast. CET 1 capital ratio of 11.3% was up quarter/quarter . Furthermore, the bank extended its moratorium on International acquisitions to 2020 from 2018. Canadian P&C posts 8% year/year earnings growth; Wealth Management net income up 19% year/year; Capital Markets earnings up 11% year/year and U.S. Specialty Finance & International earnings up 57% year/year.

Royal Bank of Scotland Group PLC (RBS) - Britain could sell a 10% stake in RBS very soon, Sky News reported on Monday. The British government still holds a 71% stake in the bank after stepping in with a taxpayer bailout during the financial crisis. Sky reported that bankers expected Britain to announce the disposal of a stake worth at least £3 billion ($4 billion), but added that any share sale could be delayed by market conditions or ministers' concerns about value for money for taxpayers. Given the £5.02 the government paid for the bank shares, the Treasury stands to lose billions of pounds on the sale. The British government pumped £45.5 billion into RBS in the depths of the financial crisis, and efforts since then to recoup the money have been stymied by the plunge in the bank's share price, regulatory probes in the United States and Brexit. (Source: Reuters)

RBS - Chief Financial Officer Ewen Stevenson resigned to pursue another opportunity. The search for a successor will commence immediately, RBS said in a statement last Wednesday. Stevenson will remain in his position to ensure an orderly handover. "The board and I are sorry to learn that Ewen has decided to move elsewhere," Chairman Howard Davies said in the statement. "He will go with our thanks for a job well done and our good wishes."

Activist Influenced Companies

Nomad Foods Limited announced it would buy British frozen foods maker Aunt Bessie's Limited from William Jackson & Son Limited for €240 million. Aunt Bessie's, known for its Yorkshire puddings and frozen potatoes, will expand Nomad's footprint in the U.K. adding to its Birds Eye brand. The acquisition is Nomad's second this year, following the company's €225 million acquisition of Goodfella's Pizza which it completed in April. Aunt Bessie's is expected to immediately add to Nomad's earnings and will expand its presence within the potatoes category, one of the largest segments in frozen food, the company said. Credit Suisse Group AG acted as financial adviser and Norton Rose Fulbright acted as legal adviser to Nomad Foods on the transaction while Stamford Partners LLP acted as financial adviser and Addleshaw Goddard LLP acted as legal adviser to William Jackson & Son.

Dividend Payers

Dufry AG – Q1 2018 with organic growth of +7.1% and EBITDA margin +100 bps. Outlook with further margin improvements in 2018/2019. Dufry has the leading position in global travel retail market and geographical well diversified portfolio of concessions.

Roche Holding AG announced that the Phase III IMpower130 study met its co-primary endpoints of overall survival (OS) and progression-free survival (PFS). The combination of Tecentriq (atezolizumab) plus chemotherapy (carboplatin and Abraxane [albumin-bound paclitaxel; nab-paclitaxel]) helped people live significantly longer compared to chemotherapy alone in the initial (first-line) treatment of advanced, i.e. stage IV, non-squamous non-small cell lung cancer (NSCLC). In addition, the Tecentriq combination reduced the risk of disease worsening or death (progression-free survival; PFS) compared with chemotherapy alone. Safety for the Tecentriq and chemotherapy combination appeared consistent with the known safety profile of the individual medicines, and no new safety signals were identified with the combination. Furthermore, the company notes that it currently has eight Phase III lung cancer studies underway evaluating Tecentriq alone or in combination with other medicines. This is the third positive Phase III study evaluating Tecentriq alone or in combination to demonstrate an OS benefit for people with NSCLC. Based on these positive top-line data on Tecentriq in a further study in non-squamous non-small cell lung cancer (NSCLC), here in combination with chemotherapy vs. chemotherapy alone, we can be confident that Roche is defending its number 2 position in the field of checkpoint inhibition in lung cancer. How close Tecentriq's survival data then actually come to those of number 1, Merck & Co.'s Keytruda, can only be judged, when Roche will publish the numerical outcome data at an upcoming conference (we assume in 2H18, possibly at European Society for Medical Oncology (ESMO) 2018, Munich/Germany, October 19 - 23).

Economic Conditions

Canada's GDP expanded at an annualized pace of just 1.3% in the first quarter of 2018, well below the 1.8% expected by consensus. But there were upward revisions to Q2 and Q3 of last year, pushing up slightly the growth for 2017 as a whole to 3.05% (from 3.00%). For Q1 2018, trade was an expected drag on the economy as imports grew faster than exports. But that was offset by gains for domestic demand as growth for government spending, business investment and consumption more than made up for the drag from residential investment. Inventories chopped a tenth of a percentage point from growth. Nominal GDP grew 2.6% in Q1, a ninth consecutive increase and hence a positive for public finances. Real household disposable income grew just 0.9%, the weakest in four quarters, while the household savings rate fell to 4.4%.

U.S. non-farm payrolls rose 223,000 in May. Adding to the good news were upward revisions to prior months which added a net 15,000 to payrolls. The private sector added 218,000 jobs in May buoyed by cyclical sectors like construction (+25,000) and manufacturing (+18,000) which lifted goods sector payrolls by 47,000. Services-producing industries in the private sector added 171,000 net new jobs thanks to strength in trade/transportation, retailing, business services, education/health and leisure/hospitality. Government added 4,000 jobs as gains at the state/local levels more than made up for cuts at the federal level. Average hourly earnings rose 0.3% in the month, pushing the year/year print to 2.7%. The private sector diffusion index jumped to 67.6, the highest in three months. The household survey printed 293,000 new jobs (all full time), which, alongside a dip in the participation rate (given steady leakage from retiring baby boomers), trimmed the jobless rate to 3.8%.

Italian politics - The Italian President has approved a new government supported by Five Star and The League. The government were sworn in last Friday afternoon and face a confidence vote in Parliament this week. The leaders of the two parties, Di Maio and Salvini, will be Vice-Prime Ministers, as well as Ministers of Labour / Economic Development and of the Interior, respectively. However, most other key members of government are arguably technocrats, such as Giuseppe Conte as Prime Minister, Giovanni Tria in Finance (known for some eurosceptic positions), Paolo Savona in EU Affairs (despite being controversially blocked by the President from the Finance role last Sunday) and EnzoMoavero Milanesi as Foreign Minister (former Minister in the Monti and Letta cabinets). Political instability will decrease in the short term, which might be well received by the market. However, this is an unstable government with conflicting interests between both the two parties and the President in our view and we foresee problems to emerge particularly around budget discussions and EU decisions.

Financial Conditions

Bank of Canada left the overnight rate unchanged at 1.25% last week. The central bank acknowledged Q1 Canadian GDP growth was probably higher than the 1.3% it had forecasted back in April thanks to more robust exports and investment. The Bank of Canada also said that because of rising gasoline prices, it now expects inflation to be a bit higher in the near term than what was forecasted back in April. While there are uncertainties about trade policy and housing (amidst the ongoing adjustment to new mortgage guidelines), the central bank nonetheless concluded that "developments since April further reinforce Governing Council's view that higher interest rates will be warranted to keep inflation near target".

The U.S. 2 year/10 year treasury spread is now .42% and the U.K.'s 2 year/10 year treasury spread is .63% - 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 4.56% (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 4.0 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 13.39 (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.

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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.

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