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. June 18, 2018

Owner Operated Companies

Alphabet Inc. – Google will invest $550 million in Chinese e-commerce powerhouse JD.com, Inc., part of the U.S. internet giant's efforts to expand its presence in fast-growing Asian markets and battle rivals including Amazon.com, Inc. The two companies described the investment as one piece of a broader partnership that will include the promotion of JD.com products on Google's shopping service. This could help JD.com expand beyond its base in China and Southeast Asia and establish a meaningful presence in U.S. and European markets. Company officials said the agreement initially would not involve any major new Google initiatives in China, where the company's main services are blocked over its refusal to censor search results in line with local laws. JD.com's investors include Chinese social media powerhouse Tencent Holdings Limited, the arch-rival of Chinese e-commerce leader Alibaba Group Holding Limited, and Wal-Mart Stores, Inc. Google is stepping up its investments across Asia, where a rapidly growing middle class and a lack of infrastructure in retail, finance and other areas have made it a battleground for U.S. and Chinese internet giants. Google recently took a stake in Indonesian ride-hailing firm GO-JEK, and sources have told Reuters that it may also invest in Indian e-commerce upstart Flipkart Online Services Pvt. Ltd. JD.com's company officials said the deal would marry Google's market reach and strength in analytics with JD.com's expertise in logistics and inventory management.

Energy Sector

Baytex Energy Corp. and Raging River Exploration Inc. have agreed to a strategic combination of the two companies. The combined organization will be a well-capitalized, oil-weighted company with an attractive growth and free cash flow profile provided by its world class assets across North America. The combined organization will have an enterprise value of approximately $5 billion and operate under the Baytex name. We see the transaction as a de facto acquisition of Raging River by Baytex in an all stock deal. If completed, the transaction has the ability to be a transformative deal for Baytex, further diversifying the company's exposure to crude oil markets through the addition of meaningful exposure to the emerging East Shale Duvernay oil field and, perhaps more significantly, meaningfully reducing the company's financial leverage, in the neighbourhood of 1.8x net debt to cash flows. We believe there are significant thresholds to be met in order to complete the transaction, in particular meeting the 66% support from the current shareholders of Raging River, which may not perceive the initial 10% premium offered for Raging River's share as attractive enough and/or be convinced of the benefits of the combined entity for the same. Should the deal be completed, the combined entity would be in position to produce between 100,000 to 105,000 boed (85% oil and natural gas liquids) by spending between $750 million to $850 million of development capital. This would lead to roughly $1 billion of adjusted cash flow in the current pricing environment, upwards of $400 million of free cash flow as well as a significant reduction in the financial leverage, as mentioned.

Financial Sector

Citigroup Inc.'s investment bank has suggested that it will shed up to half of its 20,000 technology and operations staff in the next five years, as machines supplant humans at a faster pace. The forecast by Jamie Forese, president of Citi and chief executive of the bank's institutional clients group, was the starkest among investment banking bosses in a series of Financial Times interviews to mark the 10th anniversary of the financial crisis. Mr. Forese said the operational positions, which make up almost two-fifths of investment bank employees at Citi, were "most fertile for machine processing". "We've got 20,000 operational roles. Over the next five years could you make it 10,000?" he added, in comments that had echoes of former Deutsche Bank Chief Executive John Cryan's claim that up to half of the German bank's workforce could be replaced by technology. (Source: Financial Times)

ING Groep N.V. is teaming up with France's AXA SA to develop a new type of digital insurance that will rebuild the Dutch bank's insurance activities two years after it was forced to sell out of the sector. The partnership between two of Europe's largest financial groups, is designed to provide a new form of digital insurance to 13 million of the Dutch bank's customers in six countries. The deal comes just over two years after ING sold the last chunk of its stake in NN Group N.V., the biggest insurer in the Netherlands. The Dutch bank was forced to dismantle its bancassurance strategy by disposing of NN to comply with EU state aid rules after being bailed out by its government in the 2008 financial crisis. "We are not going back into the insurance business as an owner," Ralph Hamers, Chief Executive of ING, told the Financial Times. "We have never left the insurance business as a vehicle to distribute it." The bank still sells NN products to its Dutch and Belgian customers. The countries covered are six Challenger markets (Germany, Australia, Italy, France, Czech and Austria). The products covered are: P&C, health and protection insurance. In our view the partnership fits ING's strategy: (1) leveraging ING sizeable platform and digital customer base; (2) increasing importance of mobile channels; (3) ING ambition to grow fees (Source: Financial Times)

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

Standard Chartered PLC - Is in the "comfortable position" where it doesn't have to do any deals, but can if an attractive opportunity arises, CEO Bill Winters says in an interview with Handelsblatt last week. An Asian bank serving private clients would be a "natural addition" to the business. Winters says StanChart is an attractive target for many bigger banks due to its geographic footprint. Bank is focusing its strategy on emerging markets with a solid presence in Europe. Winters says regulation and the fear of taxpayer-funded bailouts hinder larger consolidation in Europe.

Activist Influenced Companies

Nothing significant to report.

Dividend Payers

AT&T Inc. closed its $85 billion deal to acquire media company Time Warner Inc. after U.S. antitrust regulators indicated they would not seek a delay. The deal, first announced in October 2016, was opposed by President Donald Trump. AT&T was sued by the Justice Department, but won approval from a judge to move forward with the deal following a six-week trial. The Justice Department still has 60 days to appeal the decision by U.S. District Judge Richard Leon, even though the deal has closed. In its lawsuit aimed at stopping the deal, filed in November 2017, the Justice Department said that AT&T's ownership of both DirecTV and Time Warner, especially its Turner subsidiary, would give AT&T unfair leverage against rival pay TV providers that relied on content like CNN and HBO's "Game of Thrones." The AT&T ruling is expected to trigger a wave of mergers in the media sector, which has been upended by companies like Netflix, Inc. and Alphabet Inc.'s Google. AT&T had been worried about closing its deal ahead of a June 21 deadline if the government won a stay pending an appeal. Any stay could take the deal beyond a June 21 deadline for completing the merger, which could allow Time Warner to walk away or renegotiate the proposed transaction with AT&T. The merger, including debt, would be the fourth largest deal ever attempted in the global telecom, media and entertainment space, according to Thomson Reuters data. It would also be the 12th largest deal in any sector, the data showed.

Novartis AG today announced for its eye care division Alcon that new data showing significantly improved near and intermediate distance vision with the AcrySof IQ PanOptix intraocular lens (IOL) compared to the ZEISS AT LISA tri 839MP IOL. These findings further strengthen the value of Alcon's PanOptix IOL ENLIGHTEN optical technology, to provide enhanced image quality and more comfortable near to intermediate vision (while its performance for distance vision is comparable to that of the ZEISS product). These results are setting the AcrySof IQ PanOptix IOL apart from other trifocal IOLs. Results from a head-to-head study involving 180 patients were presented today at the World Ophthalmology Congress (WOC), held June 16-18, 2018 in Barcelona, Spain. With such data, as now presented at the WOC in Barcelona, Novartis can further claim Alcon's leadership in certain areas of eye care as shown here for this intraocular lens that allows to treat cataracts and correct presbyopia in a single surgery, with superiority vs. the ZEISS product shown for vision at short to medium distance as needed for reading and using a computer.

South32 Limited has announced an agreed deal to acquire the remaining 83% of Arizona Mining Inc. it doesn't own for US$1.341 billion in cash. The CAD $6.20/share offer price is a 50% premium to last close and values Arizona at USD $1.6 billion on 100% basis. Arizona's key asset is the Taylor deposit in the U.S., a high-grade underground polymetallic orebody (silver-lead-zinc) with a M&I resource of 101 million short tons at 10.4% zinc equivalent. It has potential to become a low cost, long life asset similar in profile to Cannington. Based on the AZ pre-feasibility study it is estimated the project has a net present value of $1.98 billion, which implies a Price/NPV of 0.73x based on S32's $1445 million total acquisition cost. There is potential for the NPV to rise further as drilling continues to expand the resource. Overall we would see this as a judicious use of surplus capital in a commodity the company knows well and adding a growth option to an otherwise ex-growth portfolio. In addition to the Eagle Downs acquisition, the company now has two greenfield growth projects to deliver.

Tesco PLC – U.K. Like for Like (LfL) growth of +2.1% consistent with previous periods and a slight beat to consensus (+1.9%). Tesco has now posted 5 quarters of LfL growth in the 2%-range – a step-up largely driven by inflation. The elements of growth remain a key topic, with inflation (and implicitly, volume) a topic that none of the companies want to address explicitly given the competitive sensitivity. Tesco did, however, comment that market inflation is between 1.8% to 2.4%. In our view this forms the bulk of Tesco's U.K. and RoI LfLs even as they 'try to minimize it'. More explicitly, management highlighted price cuts near the end of the quarter (focused on fresh food) and that they felt comfortable with their overall relative price positioning. The company commented that it was the combination of service level improvements (an ongoing focus) and business wins (more one-off) that contributed to the strong performance at Booker (+14.3% LfL). Growth was broad-based, as compared to last year where growth was driven by lower-margin drinks categories. Tesco also noted that there have been no price cuts in the Booker offer yet and the first conversations with suppliers only happened in March. Top-line in Asia (-9.0%) remains weak. Price cuts in fresh food is pushing deflation of approximately 2%, but the majority of the decline was the continuation of the decline in bulk selling in Thailand. Online home delivery growing modestly. Growth was approximately 4%, although basket size and subscription levels are both increasing, which will help profitability in our view.

Transalta Renewables Inc. announced a $150 million offering of its common shares through a bought deal. The net proceeds of the offering will be used to partially repay drawn amounts under the company's credit facility, which were drawn in order to fund recent acquisitions. The additional liquidity under the credit facility will be used for general corporate purposes, including ongoing construction costs associated with such acquisitions.

Economic Conditions

U.S. consumer prices: Slowly but surely, inflation in the U.S. is creeping higher in response to tightening labour markets and some tariff pass-through to consumers. U.S. consumer prices rose 0.2% in May with and without food and energy costs, as expected. This lifted the annual headline rate three notches to a more than six-year high of 2.8%, and the core rate slightly to 2.2%, the highest since early last year. While the latter is up from last summer's low point of 1.7%, part of the increase reflects the dropping out of big declines in cell phone service charges and physician service fees. Still, there's no disputing a gradual upward drift, as the six-month annualized rate has been hovering around 2.5% all this year. In May, unchanged prices for food, clothing and recreation, and another hefty decline in airline fares, were more than offset by ongoing pressure on rents (0.3% month/month and 3.4% year/year) and prescription drugs (1.4% and 3.7%). New vehicle prices also showed some spark, up 0.3%, possibly due to pass-through of rising steel and aluminum costs owing to tariffs, though they are still down 1.1% from a year ago. The cost of driving was also lifted by gasoline prices jumping another 1.7%, taking their yearly gain to 21.8%. While the Fed's preferred measure of underlying inflation, the core personal consumption expenditures (PCE), remains shy of the 2% target (at 1.8%), it's bound to drift higher, too in our view.

U.S. Retail sales increased 0.8% in May, doubling market expectations and rising the most in six months, following an upwardly-revised 0.4% advance in the prior month. The gains were spread among 10 of 13 major categories, led by increases in clothing, restaurants and even beleaguered department store items. Combined with the solid rebound in personal spending in the prior two months, the strength in May retail sales suggests that Q1's downshift to 1.0% from 4.0% in Q4 was merely a brief pause in a lengthy spending spree.

U.S. Industrial production unexpectedly dropped 0.1% on May. Manufacturing, particularly autos, was hit hard. Motor vehicles & parts took a 6.5% dive, the largest monthly drop in seven years, or in April 2011. In that instance, it was related to Japan's tsunami (a certain pigment was produced in Japan, so there was a shortage of a certain paint colour). This time around, it was due to a roughly 2-week shutdown from Ford Motor Company. The automaker suspended production of the F-150 on a parts shutdown after a fire at one of its supplier's facilities. Excluding autos & parts, production rose 0.3%.

U.S. / China - escalating global trade war, with the U.S. following through with tariffs on China's goods (effective July 6), China retaliating with equal force announcing reciprocal tariffs on is $50 billion of U.S. products, and President Trump threatening to re-retaliate. The damage from already-specified tariffs and possible duties on automotive products is mounting and threatening to slow U.S. GDP growth by an estimated over one-half percentage point.

Financial Conditions

U.S. interest rates - as expected, the Federal Reserve Open Markets Committee (FOMC) lifted the target range for the federal funds rate by 25 bps to 1.75% to 2.00%, with the 1.875% midpoint finally rising above core PCE inflation (currently 1.8% year/year) for the first time since March 2008. This marks the end of a decade-long era of negative real policy rates. The statement described the economy in a more upbeat tone. Growth was now "solid" compared to "moderate" before, and it acknowledged the new cycle low in the jobless rate and that household spending had "picked up" from its Q1 pace. While the FOMC still plans on "further gradual increases in the target range for the federal funds rate" they now appear more determined to get to the longer-run neutral policy rate (2.75% to 3.00%). They dropped the previous reference to policy rates remaining "for some time, below levels that are expected to prevail in the longer-run". The median forecast for the 2018-end fed funds rate shifted to 2.375% from 2.125%, implying two more rate hikes for this year (as we expected). The forecasts for 2019 also shifted to 3.125% from 2.875%, implying still three rate hikes in total next year but now there's only one in 2020 to 3.375%. While the forecast profile for the unemployment rate was lowered 2/10s for this year and 1/10 for the out years (3.6%, 3.5% and 3.5%, respectively), the longer-run level remained unchanged at 4.5%. This suggests a bit more urgency for the Fed to get back to a neutral policy rate.

European Central Bank (ECB) The ECB announced the end of quantitative easing (QE). The ECB said it would taper another €15 Billion in bond purchases from September to December and then end any further new purchases of bonds after that. The ECB though will continue to re-invest dividends and maturities. In addition, the ECB signaled that it did not expect to raise rates after the summer of 2018.

The Bank of Japan (BOJ) left rates unchanged as widely expected but downgraded their inflation forecasts. The BOJ said year/year core inflation should fall "in the range of 0.5-1.0%" versus "around 1%" previously. Central bank divergence is clearly underway especially off the back of the latest Fed hike. USD/JPY traded higher but ran into sellers ahead of the 111 level.

The U.S. 2 year/10 year treasury spread is now .36% and the U.K.'s 2 year/10 year treasury spread is .60% - 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 4.62% (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 13.24 (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.

Portland Investment Counsel Inc. | portlandinvestmentcounsel | Portland Investment Counsel Inc. | @PortlandCounsel

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

PIC18-042-E(06/18)