News Highlights

Owners. Operators. And Insightful Investors.

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Established in 2007

PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. August 27, 2018

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Owner Operated Companies

Berkshire Hathaway Inc. is reportedly in talks to invest about 20-25 billion rupees ($285.4-356.7 million) in India's One97 Communications Ltd., the parent of digital payments firm Paytm Mobile Solutions Private Limited. Berkshire is said to pick up a 3%-4% stake in Paytm's parent and the deal is being done through a primary subscription of shares, the paper said citing people familiar with the matter. If materialised, it could be the first direct investment in India by Buffett. One of Berkshire's key fund managers, Todd Combs, who is also seen as a potential Chief Investment Officer at the company, is leading the transaction. Berkshire's investment could be clinched in the coming weeks, valuing Paytm at over $10 billion.

Energy Sector

Baytex Energy Corp. announced the closing of the strategic combination with Raging River Exploration Inc. Baytex has emerged through this transaction as a well - capitalized, oil - weighted company with an attractive growth and free cash flow profile provided by its world class assets focused across North America. Current production is approximately 94,000 boed (83% liquids) from a diversified asset portfolio, including Viking, Peace River, Lloydminster and East Duvernay properties in Canada and the Eagle Ford in Texas. Baytex has a deep inventory of drilling prospects that generate top tier returns on invested capital with the capability to deliver meaningful organic production growth. Company's estimates for 2019 include: average annual production of 100,000 to 105,000 boed (85% oil and natural gas liquids), debt adjusted production per share growth of approximately 12%, exploration and development capital program of $750 to $850 million, adjusted funds flow of approximately $900 million, net debt to adjusted funds flow ratio of 2.2x and operating netback of approximately $28/boe. With the closing of the transaction, Baytex established a new $300 million term loan facility that is due June 2020 and is secured by the assets of Raging River. This additional facility, combined with existing facilities of USD $575 million, increases credit capacity to approximately $1.05 billion with approximately $500 million undrawn.

Financial Sector

Canadian Imperial Bank of Commerce (CIBC) reported Q3 2018 core cash EPS of $3.08 vs. consensus $2.94. The beat was attributable to higher revenues (+$0.09), largely from better than expected investment banking revenues and lower Non-Interest expenses (+$0.07). Canadian Personal & Commercial adjusted profits up 16% year/year. Mortgages (average) grew 4% year/year, while credit cards increased 2% and commercial loans rose 10%. PCLs were up 7% year/year. Net Interest Margin (NIM) was up 5bps quarter/quarter. CIBC Bank U.S.A. stand-alone performance looked strong, with 34% earnings growth quarter/quarter, NIM expansion of 4bps quarter/quarter and 37bps year/year. Loan growth of 14% year/year was solid, and deposit growth of 13% year/year through cross border initiatives. Capital Markets earnings up 5% year/year. Provisions for Credit Losses (PCLs) of $241 million compared to $232 million consensus. CIBC's charge-offs were flat year/year at 24 bps. CIBC's CET 1 ratio is now 11.3% and it announced a 2% dividend increase (+$0.03).

JPMorgan Chase & Co., in a bid to lure customers from the discount brokerage industry, said last week it will begin offering free stock trades for self-managed accounts through its Chase mobile banking app starting next week. Shares of Charles Schwab & Co., Inc. and other discount brokerages fell after CNBC reported the offering was imminent. The service will be part of a new suite of investment products called "You Invest" through which customers will get at least 100 free trades of stocks and exchange-traded funds in their first year, a bank spokeswoman said last Tuesday. As part of the "You Invest" offering the bank also plans to launch online managed portfolios early next year, the spokeswoman said. The industry had been anticipating some sort of dramatic move by JPMorgan for several years. In April 2017 Chief Executive Officer Jamie Dimon said in his annual letter that an "inexpensive" self-directed online tool was coming by the end of that year. He also has talked adding free services as part of a bigger consumer package, much like he has seen Amazon.com Inc. do with its Prime service. (Source: Reuters)

Royal Bank of Canada (RBC): reported adjusted cash EPS of $2.14 (+13% year/year), slightly above consensus of $2.11. A lower tax rate benefited EPS (+$0.09), offset by higher non-interest expenses (-$0.13). Expenses appear elevated from a rise in variable compensation, higher tech spend and increased "Other" costs. RBC also lowered its effective tax rate guidance to the low end of their 21-23% range due to earnings mix shifts (U.S. business growth). Looking at the segments; Canadian banking, Wealth management, and Capital markets earnings were strong, while Insurance and Investor & Treasury Services had negative year/year growth. The dividend increase to $0.98/share (+4%) was above estimates, potentially signifying stronger earnings visibility. Credit was in line and stable. Total bank PCLs were $346 million compared to consensus of $348 million, implying PCLs ratio of 23 bps (+3 bps quarter/quarter) and still at the low-end of their 20-30 bps targeted range. CET 1 ratio of 11.1% (+20 bps quarter/quarter) was in line and driven by strong internal capital generation (+34 bps) and slightly offset by Risk

Weighted Assets (-19 bps). Year to date, RBC has repurchased 12.8 million shares (1.3 million shares in fiscal Q3) for $1.3 billion.

Standard Chartered PLC is in talks to sell its private equity business to Intermediate Capital Group PLC (ICG), a source with direct knowledge of the deal said last week, as part of a broader disposal of its 'principal finance' investment business. Standard Chartered has separately completed the sale of the other half of its principal finance unit, comprising its real estate investment business in Asia, to private equity firm Actis LLP. The U.K.-based bank, whose business is focused in Asia, Africa and the Middle East, did not disclose the size of that deal. Thomson Reuters reported in November the real estate principal finance business has around $700 million in investments across Asia and Africa. A spokesman for the bank confirmed the completion of the Actis deal. Standard Chartered and ICG declined to comment on the prospective ICG deal. (Source: Reuters)

Wells Fargo & Company is laying off more than 600 workers as it grapples with a slowdown in its mortgage business. The fourth-largest U.S. bank has given 60 days notice to 638 mortgage employees across the country, Wells Fargo spokesman Tom Goyda said in an emailed statement, with cuts concentrated in Orlando, Florida; Ranch Cordova, California; Colorado Springs, Colorado, and Charlotte, North Carolina. "After carefully evaluating market conditions and consumer needs, we are reducing to better align with current volumes," Goyda said. Wells Fargo has been making sporadic cuts to its mortgage workforce as part of a bid to rein in costs. These layoffs are the largest so far this year. The home lending business has struggled as rising interest rates hurt refinancing demand. Wells Fargo's mortgage banking income fell 33% in the second quarter from a year earlier. (Source: Reuters)

Activist Influenced Companies

Brookfield Business Partners L.P., together with its institutional partners, and Macquarie Capital, together with its institutional partners, have agreed to sell Quadrant Energy Australia Limited to Santos Ltd. for USD $2.15 billion. In addition to the headline sale price consideration, the agreement includes a contingent payment in relation to the recent significant Dorado-1 oil discovery and a royalty over all other future hydrocarbons produced in Quadrant's Bedout basin tenements. This ensures that Brookfield and Macquarie maintain exposure to the upside in these exploration interests. Following the Dorado-1 oil discovery and given the financial strength of the business, Brookfield and Macquarie determined it to be the appropriate time to transition Quadrant to a long-term owner that is suitably equipped to take it through the next phase of development. With an increasing focus on exploration and development activities, including the assessment and development of the exciting Dorado opportunity, the owners believe Santos is an ideal party to optimize the future prospects of the company. Quadrant Energy is currently held by Brookfield Business Partners and its institutional partners (48.3%), Macquarie Capital (21.8%) and its institutional partners (jointly Australian Energy Consortium), Wesfarmers (13.2%) and AMB Holdings (13.2%). Quadrant management holds the balance (3.4%). The sale is expected to settle in the fourth quarter of calendar year 2018.

Dividend Payers

BHP Billiton PLC reported a decent set of fiscal year 2018 results in our view: EBITDA came in 1% light of consensus, while EPS was 1% ahead of consensus. Underlying cash flow performance was strong with net debt declining $4.5 billion in the second half of 2018 to reach $10.9 billion versus estimate of $11.5 billion. As such net debt moved towards the bottom of BHP's target $10-15 billion net debt range, where it is guided to stay while commodity prices remain strong. The fiscal year 2018 dividend was in line with expectations (+4% versus consensus) for a payout ratio of 70%. Capital expenditures guidance was broadly reiterated at $7.7 billion in fiscal year 2019 for continuing operations and less than $8 billion in fiscal year 2020. The only area of softness in the result was that BHP halved its $2 billion productivity target to $1 billion (all to be delivered in fiscal year 2019) reflecting $200 million lost from U.S. onshore and Cerro Colorado disposals and $700 million higher costs in Q-Coal during fiscal year 2018. We suspect the market will not be particularly concerned by this, but it does mean upgrades are unlikely post these results with fiscal year 2019 guidance calling for 7% higher unit costs at Escondida, +3% at Q-Coal, +9% in conventional oil and -2% in iron ore (all USD basis at AUD/USD=0.75). There was relatively little in these numbers to change the investment case. We continue to see BHP as having a number of interesting potential catalysts (cash return post shale sale, further activist-driven changes at board level, additional asset sales and restructuring potential) which could drive meaningful outperformance if they crystallise although there are risks around each. The broader sector backdrop continues to look challenging given strong USD & tightening U.S. liquidity impacting Emerging Market asset prices & demand: BHP traditionally outperforms in this environment. On spot, BHP trades on FCF yields of 9.4% and 9.6% for 2018-2019 respectively. Enterprise Value/EBITDA multiples for BHP are 5.8x and 5.6x.

Novartis AG - BYL719, an alpha-specific PI3K inhibitor, met the primary endpoint (PFS) in the phase 3 SOLAR study in patients with HR+/HER2- metastatic breast cancer with PIK3CA mutation that progressed on initial treatment. SOLAR-1 evaluated BYL719 in combination with fulvestrant compared to fulvestrant alone in postmenopausal patients with HR+/HER2- PIK3CA-mutant metastatic breast cancer that progressed on or following aromatase inhibitor treatment with or without a CDK4/6 inhibitor. While meeting the primary endpoint is good news in our view, Novartis wording was cautious and so we'll need to understand the data better to understand the potential of this drug when the full results are to be

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discussed with regulators globally and presented at an upcoming medical meeting.

Pattern Energy Group Inc. has completed the sale of the company's operations in Chile, which principally consist of its 81-megawatt (MW) owned interest in the 115 MW El Arrayan wind project to affiliates of Arroyo Energy Investment Partners LLC Investors for which Pattern Energy received a cash consideration of $70.5 million before transaction-related expenses of approximately $2.0 million. This price represents a cash available for distribution (CAFD) multiple that is greater than the CAFD multiple for projects the company has acquired in the past. "This is an excellent result that underscores the value of our portfolio and demonstrates a key part of our strategy, which is to recycle non-strategic holdings and use the capital to reinvest in accretive assets, repurchase stock or make other beneficial investments," said Mike Garland, Chief Executive Officer of Pattern Energy. "Due to changes in the Chilean power market, we felt it was better for the company to focus on its core business areas and reduce overhead. We continue to see excellent growth opportunities in the United States, Canada, Mexico and Japan."

Economic Conditions

U.S. existing home sales ignored expectations for a rebound in July; instead, sales fell for the fourth consecutive month. The 0.7% headline drop took sales down to 5.34 million units annualized, the lowest in 2½ years, or since February 2016. But the market is still very tight, with months' supply at just 4.3, well below normal of around 5-6'ish.

The Eurozone passed an important milestone on August 20th. The date marked the formal end of the bailout of Greece. It is the final country to be receiving emergency loans in the wake of Europe's financial crisis. The last payment has been made and the Greek government will have to finance its spending through taxes or by borrowing in the financial markets, though it will be decades before it is all repaid. Five countries received bailout loans - Greece, Ireland, Portugal, Spain and Cyprus - and at the most intense points of the crisis there were genuine doubts about whether the Eurozone would survive, or at the very least whether some countries would drop out. It has been a long haul for the Eurozone, it has been eight years since the first bailout for Greece was agreed. (Source: BBC)

Financial Conditions

The U.S. 2 year/10 year treasury spread is now 0.20% and the U.K.'s 2 year/10 year treasury spread is 0.55% - 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. Also, the narrowing gap between yields on the two-year and 10-year Treasuries is of concern given its historical track record that when shorter term rates exceed longer dated ones, such inversion is usually an early warning of an economic slowdown.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 4.51% (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 12.31 (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 bodes well for quality equities.

And finally......

U.S. stocks have now achieved the longest-ever bull run, making the post-financial crisis rally the longest stretch of rising prices without a 20% drop, the level typically associated with a bear market. The rally has continued despite rising global tensions, protectionist policies and the Federal Reserve raising interest rates.

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 www.portlandic.com/prices

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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