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. September 4, 2018

Owner Operated Companies

Berkshire Hathaway Inc. – Warren Buffett said Berkshire Hathaway bought back its own stock for the first time since 2012 and added to its already huge stake in Apple Inc. Buffett also said investors are better off owning a basket of stocks than long-term bonds as a strong U.S. economy bolsters corporate profits, despite higher costs from tariffs. "I don't know when to buy stocks, but I know whether to buy stocks," Buffett, celebrating his 88th birthday, said on CNBC. "Business is good across the board," he added. A buy-back policy announced in July gave Buffett, who has gone 2-1/2 years since a major acquisition, a new way to deploy Berkshire's $111.1 billion of cash and equivalents. Berkshire said the policy frees Buffett and Vice Chairman Charlie Munger to repurchase stock when the price was below Berkshire's "intrinsic value," a determination that would be made "conservatively." The old policy allowed buybacks when Berkshire traded at below 1.2 times book value, but the Omaha, Nebraska-based company's shares have long traded above that level. Buffett said "we've bought back a little" stock since the change, and that he and Munger need "a big enough discount" to ensure that long-term shareholders are better off. Berkshire has also bought "just a little" more Apple stock since June 30, he said, when it had a 252 million share stake now worth more than $56 billion.

Energy Sector

Trans Mountain Pipeline – A Canadian court overturned approval of the Trans Mountain oil pipeline expansion, ruling that Ottawa failed to adequately consider aboriginal concerns, in a blow to Prime Minister Justin Trudeau's efforts to balance environmental and economic issues. Trudeau's government agreed in May to buy the pipeline from Kinder Morgan Canada Limited for CAD$4.5 billion (USD$3.46 billion), betting it would win the court battle and expand Trans Mountain despite fierce political and environmental opposition. The decision also hurts Canada's oil producers, who say the expanded pipeline is needed to address bottlenecks that have sharply reduced prices for their crude. Canada has the option to appeal the ruling to the Supreme Court but Morneau said the government had made no decisions and needs time to study the ruling. An appeal to the higher court would reportedly drag out the project at least another couple of years. The court's ruling is likely to amplify sentiments expressed by oil producers, such as Suncor Energy Inc., that they would hold off on further major investments in Canada's oil patch until regulatory challenges abated. Renewed doubts about Trans Mountain place greater importance for Canada's oil industry on two other pipeline projects. Enbridge Inc. is rebuilding Line 3 from Alberta to a hub in Wisconsin, while TransCanada Corporation is considering construction of Keystone XL from Alberta to Nebraska.

Financial Sector

Bank of Montreal (BMO) reported adj. cash EPS of $2.36 (+16% year/year) vs. consensus of $2.26. This was another strong result in our view led by continued momentum within the U.S. business (Adj. net income (NI) +34% year/year). The U.S. operations now represent 28% of group NI year to date (YTD). Total bank Provisions for Credit Losses (PCLs) were $186 million (19 bps) vs. consensus of $200 million. CET 1 ratio of 11.4% (+10 bps quarter/quarter) benefited from internal capital generation (+32 bps), slightly offset by Risk Weighted Asset (RWA) growth (-12 bps) and share repurchases during the quarter. As expected, BMO maintained its quarterly dividend implying a yield of 3.6%. Canadian P&C Banking: Earnings growth (adj.) was +5% year/year, which should trail peers this quarter. Revenue increased 5% year/year, and expenses grew 4% driving slight positive operating leverage. Loan growth was up 4% year/year (commercial was +11% and personal flat) on limited margin expansion (+1 bp quarter/quarter). U.S. Personal & Commercial (P&C) Banking: Another record in U.S. P&C (81% of U.S. segmented earnings YTD). U.S. P&C adj. NI (in USD) rose 34% year/year on solid revenue growth (+9% year/year) driven by loan growth of 12% year/year (commercial +13% year/year; deposits +8% year/year), and U.S. tax reform. Expenses were controlled generating adj. positive operating leverage of 4.2%. Due to a recovery on performing loans, adj. pre-provision pre-tax earnings was up 15% year/year. Capital Markets: Adj. NI increased 7% year/year. Revenue rose 5% year/year benefiting from higher trading and investment banking activity. Expenses were flat year/year generating significant positive operating leverage (+4%). Wealth Management: Adj. NI was up 6% year/year benefiting from Insurance (+15% year/year). Traditional Wealth increased a modest 3% year/year on Assets Under Management (AUM) growth of 9% year/year.

The Bank of Nova Scotia (BNS) reported Q3 2018 adjusted EPS of $1.76, below consensus of $1.77. Adjusted EPS this quarter excluded impacts of acquisition-related costs of approximately $320 million after tax ($453 million pre-tax) or $0.21 per share, mainly related to day 1 PCLs on acquired performing financial instruments. BNS increased its quarterly dividend by $0.03 to $0.85. Total revenues of $7,207 million were below forecast of $7,454 million for the quarter mainly driven by lower than expected trading revenues. Non-interest expenses were $3,619 million, below estimates with efficiency cost/income came at 50.2%. International loan growth was +10% year/year (down -1% quarter/quarter) on a constant currency basis.

P&C loan growth was +9% year/year (down -1% quarter/quarter) and +10% year/year (down -2% quarter/quarter) respectively on a constant currency basis. Canadian P&C (excluding wealth management) residential mortgage growth was about +5% year/year (down -1% quarter/quarter), while net interest margins were up 4 bps quarter/quarter to 2.41%. The bank's CET 1 ratio came in at 11.4%, down approximately -60 bps quarter/quarter mainly reflecting the impact of acquisitions (-108 bps) partially offset by a net issuance of capital (+47 bps).

Barclays/BNP Paribas/Cred Ag/Credit Suisse/HSBC/ Royal Bank of Canada/TD Bank - A U.S. judge has dismissed an antitrust lawsuit by investors that accused nine big banks of government bond rigging from 2005 to 2015. In a decision made public on Wednesday, U.S. District Judge Edgardo Ramos in Manhattan said the investors failed to show they were injured by conducting any specific transactions in U.S. dollar-denominated supranational, sub-sovereign and agency bonds that were tainted by the alleged collusion. Investors said the banks used chatrooms and other means to share pricing data and coordinate trading to boost profit, infecting "each and every" transaction. The defendants included Barclays PLC, BNP Paribas SA, Citigroup Inc., Credit Agricole SA, Credit Suisse Group AG, HSBC Holdings PLC, Nomura Holdings, Inc., Royal Bank of Canada and The Toronto-Dominion Bank. Dan Brockett, a lawyer for the investors, said his clients plan to amend their complaint. He also said Ramos' decision, which is dated Aug. 24, does not affect Deutsche Bank AG's and Bank of America Corporation's respective $48.5 million and $17 million settlements in the case in August 2017.

National Bank of Canada (NA) reported adj. cash EPS of $1.53 (+10% year/year), above consensus of $1.51. Relative to consensus expectations, results were generally in line with lower PCLs adding 3c and driving the beat. NA reported a strong CET 1 ratio of 11.6% (20 bps above expectations), positive operating leverage across all segments (+2% year/year overall) and an industry leading ROE of 18.5%. NA reiterated its P&C efficiency cost/income ratio target of 53% by end of 2018. As expected, NA maintained its dividend implying a current yield of 3.8%. P&C Banking adjusted NI was up 6% year/year (vs. 8% last quarter). Volume growth was 5% year/year (personal +3% year/year, commercial +8% year/year) with Net Interest Margin up 2 bps quarter/quarter (+6 bps year/year). Total revenue increased 6% (led by commercial at +10%), while expense growth was 3%, higher provisions were impacted by one single commercial account. On a Pre-provisions / Pre-tax basis, NA rose 10% year/year. Wealth Management NI was up 19% year/year (similar to last quarter) benefiting from strong revenue growth (+10% year/year). Asset growth should continue to be sector leading. Assets Under Administration and AUM were up 16% year/year and 14% year/year, respectively, benefiting from sales momentum in all business lines and from an important client addition at National Bank Independent Network (NBIN) in Q4 last year. Financial Markets earnings increased 8% year/year, which is an above average result vs. peers thus far. U.S. Specialty Finance and International (USSF&I) NI growth of 6% year/year was led by ABA Bank (+31% year/year) as Credigy Solutions Inc. declined 5% year/year due to portfolio maturity and repayment of loans (management signaled this last quarter). ABA continues to expand with 11 new branch openings from last year (+23%) generating solid revenue growth of 47% year/year (loans +56% year/year).

Standard Chartered PLC may face another fine for sanctions breach, Bloomberg reports. Standard Chartered has already paid a painful penalty for secretly moving billions of dollars through the U.S. on behalf of Iranian clients, in violation of sanctions. But a sweeping investigation has found evidence suggesting that the bank's Iranian business was more extensive than it admitted. Now U.S. authorities are understood to be weighing a criminal penalty against Standard Chartered and individual employees. Authorities may impose an even bigger fine than the $667 million the bank paid in 2012 to penalize it for what they view as concealment, though specific numbers had not yet been discussed in negotiations as of early August. In securities filings, the bank has said it could face a range of civil and criminal penalties stemming from the case, "including substantial monetary penalties." Standard Chartered hasn't set aside specific reserves for this matter.

The Toronto-Dominion Bank (TD) reported adj. cash EPS of $1.66 (+10% year/year), above consensus of $1.63. TD displayed higher revenue, lower expenses and provisions. By segment: Canadian retail performance has tracked peers thus far (NI +7% year/year), U.S. retail platform remains solid (adj. NI +31% year/year), while Capital markets was weak (NI -24% year/year; due to lower trading-related revenue related to the revaluation of short-term trading deposits). TD reported a CET 1 ratio of 11.7% (-10 bps quarter/quarter). The sequential decline was related to completion of its share buyback (-35 bps), organic RWA increase (-24 bps), slightly offset by internal capital generated (43 bps). TD's capital ratio remains at the high-end vs. peers. Total bank PCLs were $561 million vs. consensus of $595 million driven by Canadian retail. Similar to peers, TD cites the current credit environment as stable remaining at cyclically low levels.

Activist Influenced Companies

Brookfield Business Partners L.P., together with institutional partners, has entered an agreement to acquire a 55% controlling interest in Ouro Verde Locacao E Sevicos SA, a leading Brazilian heavy equipment and light vehicle fleet management company for approximately $170 million (660 million Brazilian reals). Ouro Verde leases more than 25,000 heavy equipment and light vehicles under multiyear contracts and provides related maintenance, operations and other services to a diversified base of leading Brazilian and global corporate clients. Brookfield Business Partners will commit to finance up to $70 million of the equity on closing using existing liquidity. Prior to or following closing, a portion of Brookfield Business Partners' investment may be syndicated to other institutional partners. Closing of the transaction is subject to customary approvals and is expected to occur before the end of the year.

Pershing Square Holdings, Ltd. (PSH) – Pershing Square Capital Management (PSCM) CEO Bill Ackman, Pershing Square Holdings board member Nick Botta, members of PSCM investment team, and others affiliated with the companies have bought more than 6.5 million PSH public shares since July 10, 2018. Ackman and his affiliates bought 5.75 million shares at an average price of $15.51 per share for a total additional investment of $89.2 million. Botta purchased 600,000 public shares at an average price of $15.25 per share for an additional investment of $9.2 million. If all PSH management shares were converted to public shares, Ackman would own about 14.6% of the company on a fully diluted basis; in total, the PSCM affiliates would own about 16.4% of the company. PSCM affiliates increased their investment in PSH because they continue to believe that PSH is “substantially undervalued”.

Dividend Payers

Bunzl PLC - 1st half results reported constant currency revenue growth: 12% vs. estimated 10.5% with 1st half organic growth of 5.2%. 1st half EBITA: £285 million with EBITA margins: 6.6%. EPS: 59.4p and Dividend per Share 15.2p. EBITA beat is mainly a result of a slightly higher contribution from acquisitions with constant currency growth being 12% rather than the 11% stated in the pre-close statement. EBITA in North America was 4% below estimates due to operating cost inflation, which was mentioned at the full year results. Some cost cutting initiatives have been launched to help offset this and we would expect further efforts to push through price increase. The UK & Ireland was stronger on revenue but lower on margin than we expected. This is likely to be due to the continued ramp up contract with Compass. Europe and, in particular, the Rest of the World segments surprised positively. It remains a quiet year for acquisitions with total committed spend of £132 million this year versus the average spend of approx. £250 million (excluding the extraordinary 2017). We don’t see any change to the acquisition situation, it is a matter of timing. The shares are trading on approx. 18x 2019E PE and approx. 14x EV/EBITA, with a 2.2% dividend yield and a approx. 5% FCF yield.

Novartis AG with its USD$8.7 billion acquisition of AveXis (May-18), Novartis received: the late-stage gene therapy AVXS-101 for spinal muscular atrophy (SMA), a launch-ready gene therapy manufacturing site, a platform technology for gene therapy, know-how, and earlier stage assets. This is clearly in line with Novartis’ goal of becoming a leader in gene therapy in our view. A ph1 trial of AVXS-101 showed impressive motor and survival benefits for type 1 (i.e. severe) patients. A confirmatory ph3 trial is ongoing; Novartis plans to file in second half of 2018/2019 (U.S./E.U.). Trials are also ongoing for less severe SMA (type 2/3) -much larger population. We recognize AVXS-101’s groundbreaking clinical potential, and AveXis’ clear fit for Novartis’ new strategy. However, we believe it will take more than AVXS-101 to materialize the “multi-billion potential” of the acquisition. We look forward further to seeing developments from the AVeXis platform.

WPP PLC - Mark Read has been appointed as CEO of WPP. He was the leading internal candidate and his appointment will not come as a surprise to investors. Mark Read was head of Wunderman from 2015, one of WPP’s main digital agencies with over 10,000 employees. He was also head of WPP Digital and led the move to acquire 24/7 Real Media and the creation of the digital agency POSSIBLE. In April 2018 he was appointed co-COO of WPP. He is clearly already close to the business which will enable him to take swifter action than an external CEO, although it is possible an external hire would have been more radical in shaping the business for the longer term. WPP’s 1st Half 2018 results were more or less in line with expectations: Headline profit before interest and taxes (PBIT) declined 6.9% to £821 million, 4% below consensus estimates. Below PBIT, net interest, tax and minorities all decreased by 3%, 5% and 12%, respectively. Headline NI declined 8% resulting in diluted headline EPS of 42.6p, down 6.2% against 1H17 but in line with consensus estimates. Full Year guidance is in line at the net sales level but equates to a slight margin downgrade and first strategic pointers state that priority will be top line growth (“focus will be on invigorating our company and returning the business to stronger, sustainable growth”). WPP has re-iterated long-term targets of 0.0-0.3-point annual margin improvement in PBIT but is guiding to a 0.4 point decrease this year because of the “mix of performance by geography and function and a decision to invest in the growing areas of our business” So far YTD WPP has won or retained slightly more business than we expected given the management uncertainty. The wins include Adidas, Hilton, Mondelez and T-Mobile (Essence assistance in some digital in-housing). The retentions/consolidations include Mars, Shell, Nestle (US). The losses/resignations include HSBC, Revlon and Kimberly Clark. GSK and Ford (global creative) are still in review. The company estimates first half net new business billings at USD$3.2 billion.

Economic Conditions

U.S. – Personal income advanced 0.3% in the U.S. in July, in line with the consensus expectations. At the same time, personal consumption expenditures were up 0.2% in the month. The core personal consumer expenditures (PCE) price index, the U.S. Fed favourite inflation gage, arrived at a 2% year/year rate of change, in line with the expectations.

The Case Shiller home price index for 20 U.S. metropolitan areas was up 6.3% for the month of June (year/year rate of change), falling behind the expected 6.5% improvement. Pending home sales, meanwhile, were down 0.7% for the same month, relative to the expectations for a 0.3% increase.

Canada's GDP expanded at an annualized pace of 2.9% in the second quarter of 2018. That was below the 3.1% expected by consensus but close to the Bank of Canada's estimate of 2.8%. Trade contributed to growth for the first time in a year thanks to surging exports. Domestic demand was also well supported courtesy of a healthy contribution from consumption spending, as well as gains for residential investment, government expenditures and business investment. Inventories subtracted from growth. Nominal GDP surged 5.1% annualized. Monthly GDP data showed output remaining unchanged in June (i.e. zero growth). There was a 0.2% decline for goods output (gains in manufacturing were dwarfed by declines in all other categories) which offset a 0.1% increase in services-producing industries (driven by accommodation, real estate, health and education which more than offset declines elsewhere).

Financial Conditions

The U.S. 2 year/10 year treasury spread is now 0.25% and the U.K.'s 2 year/10 year treasury spread is 0.68% - 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 4.52% (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 13.79 (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.

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.

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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