News Highlights

Owners. Operators. And Insightful Investors.

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

Established in 2007

PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. September 10, 2018

Owner Operated Companies

Facebook Inc. said it will invest more than $1 billion to build its first data centre in Asia in Singapore, slated to open in 2022. Facebook's facility will be located in the west of the island, near where Google (Alphabet Inc.) is expanding its Singapore data centres in an $850 million investment as mobile growth, e-commerce and cloud computing demand rise across the region. "This will be our first data centre in Asia," Thomas Furlong, Facebook's Vice President of infrastructure data centres, said at a press conference with local authorities in Singapore. He said the facility was expected to open in 2022 depending on the speed of construction. Facebook said in a statement the 170,000 square metre facility represented an investment of more than SGD$1.4 billion ($1 billion) and would support hundreds of jobs. Facebook has a number of data centres in the United States as well as Ireland and Sweden, and it is building a facility in Denmark. "The data centre isn't country specific to where users are located…it's a dynamic process," said Furlong.

Linamar Corporation – We had the opportunity to re-connect with the management of Linamar at the company's headquarters in Guelph which strengthened our conviction in the company's investment merits. We were advised that despite the significant NAFTA related uncertainty business is continuing as usual, including an increase in work requests in Mexico. The company continues to be laser focused on growth and taking advantage of outsourcing opportunities by the original equipment manufacturers (OEMs) across the globe, driven by digitization, autonomy and electrification. Equally, the management is focused on growth opportunities in the access markets (scissors, booms and telehandlers) as well as in the agricultural equipment sector (via the newly acquired MacDon business). Linamar has seen steady growth in Europe and continues to pursue opportunities in Asia Pacific, gradually diversifying away from North American automotive. We believe there is significant value embedded in a business which has routinely grown its top and bottom line by double digits per annum. We share management's view that most possible outcomes to NAFTA negotiations are desirable to the current state of uncertainty and expect the stock to re-rate significantly subsequent to a trade deal.

Energy Sector

Crescent Point Energy Corp. named Craig Bryksa its new Chief Executive Officer and said it would immediately reduce 17% of its workforce as the Canadian energy producer looks to turn around its business. The company, whose stock has underperformed the broader market in recent years, in May won a proxy fight with activist investor Cation Capital. A widening in the discount at which Canadian oil trades to the U.S. light crude has hurt the company's bottom line, while costs and debt have risen. Crescent Point also said it planned to reduce its debt by more than CAD$1 billion ($759.5 million) by end-2019. The company had a net debt of CAD$4.02 billion, according to its latest earnings report. The company, which had 1,085 full-time permanent employees as of December end, said the workforce reduction is expected to generate annual savings of over $50 million. The company said it would also divest some assets. We see the announcement as an attempt by the company to take a more gradual approach to its transformation subsequent to the reshuffle of its management and board, which may have gone counter, in the short term, with the market's expectations for a more drastic approach.

Financial Sector

Dutch Bank, ING Groep NV, has agreed to pay €775 million in penalties for compliance failures that allowed companies — including a Curacao lingerie company and Russian mobile phone operator — to allegedly launder hundreds of millions of euros and pay bribes over six years. The penalties are the largest ever imposed on a company by the Dutch public prosecution service, which said it found "clients were able to use accounts held with ING for criminal activities for many years, virtually undisturbed" from 2010 to 2016. The bank's failings were unearthed after the Dutch prosecutor probed wrongdoing at four companies that had accounts at ING, including $55 million in bribes paid to the daughter of Uzbekistan's president by a unit of Russian mobile operator VimpelCom. (Source: Financial Times)

Activist Influenced Companies

Brookfield Business Partners LP has appointed Jaspreet Dehl as chief financial officer of Brookfield Business Partners, effective immediately. Ms. Dehl succeeds Craig Laurie, who will take on a new role overseeing capital markets, finance and planning for Brookfield Business Partners and its portfolio company operations as managing partner. "Craig has demonstrated strong financial leadership since the spinoff of Brookfield Business Partners in 2016 and has played a key role in growing the business. We know that Craig will continue to be a significant contributor to the success of Brookfield," said Cyrus Madon, chief executive officer of Brookfield Business Partners. "Jaspreet has been a senior member of our finance team since she joined Brookfield in 2011 and is well known to many of our investors. As Brookfield Business Partners continues to execute its growth strategy, we look forward to benefiting from Jaspreet's leadership and expertise as our chief financial officer."

Dividend Payers

Novartis AG announced it will sell its Sandoz U.S. dermatology business and generic U.S. oral solids portfolio to Aurobindo for $900 million plus $100 million in potential milestones. The deal is expected to close in 2019.The divested portfolio generated approx.$620 million with a core operating income of approx.$180 million in the first half of 2018. The deal covers approximately 300 products (70% oral solids and 30% dermatology), and additional development products. Additionally, 750 employees and field reps, manufacturing facilities, and Sandoz's dermatology development centre will be transferred to Aurobindo on completion. The gross proceeds represent a 0.8x multiple of assumed fiscal year 2018 revenues ($1.2 billion). This price paid appears cheap but dermatology and small molecule generics are significantly under pressure in the U.S. from an increasingly competitive market environment. In Q2, Sandoz net sales were impacted by 9 percentage points of price erosion, mostly coming from the U.S. This divestment is in line with previous comments that Sandoz would focus on higher growth areas and business optimisation. Sandoz's focus in the U.S. will be on complex generics, and biosimilars, which are less competitive areas in our view. Global sales of Biopharmaceuticals in Sandoz were the key driver of growth in in Q2 2018 (+34%cc year/year). We continue to believe that biosimilars will be a significant driver of margin expansion as they mature.

Economic Conditions

Canadian employment slumped 52,000 in August according to the Labour Force Survey, disappointing consensus which was looking for a small increase. The participation rate fell one tick to 65.3% (from 63.4%) but that didn't prevent the unemployment rate from shooting up to 6%, courtesy of the large job losses. There were job declines in both public (-38K) and private sectors (-31K), which dwarfed the 17K increase in the ranks of the self-employeds. Employment in the goods sector fell 30K with declines in manufacturing, construction, resources and agriculture more than offsetting small gains in utilities. Services-producing industries saw a 21K drop in employment with sharp losses in professional services, trade, finance/real estate and information sectors dwarfing gains in transportation, education and accommodation services. Full time employment was up 40K but that was more than offset by the 92K net purge in part-time positions. Hourly earnings were up 2.9% year/year, dropping from 3.2% the prior month.

U.S. Nonfarm payrolls topped headline expectations, rising 201,000 in August, but this was more than offset by downward revisions tallying 50,000 in the previous two months. The three-month average of 185,000 is down modestly from the past year norm of 194,000, implying slower momentum, likely due to labour shortages. Manufacturing fell for the first time in over a year, and retail remained weak. Healthcare, construction and professional/business services stayed strong. Household survey employment plunged 423,000, more than retracing the prior month's gain, reducing the employment rate slightly to 60.3%, little higher than a year ago. If not for a two-tenths drop in the participation rate to 62.7%, a tick below the past-year average, the jobless rate would have risen instead of remaining flat at 3.9% (3.853%, so still flirting with 18-year low).

Financial Conditions

The Bank of Canada (BoC) left the overnight rate unchanged at 1.50% last week. The central bank acknowledged the economy's strong performance last quarter recall Q2 real GDP growth in Canada was 2.9% but said the economy is evolving "closely in line" with its earlier projections. The BoC downplayed the fact that headline inflation is above target, blaming gasoline and the airfare component of the consumer price index (CPI), and saying it expects inflation to move back towards 2% in early 2019 as the effects of earlier increases in pump prices dissipate. The central bank emphasized the core measures of inflation (which remain close to 2%) and the fact that "wage growth remains moderate". The central bank was encouraged that "the rotation of demand towards business investment and exports is proceeding" and that the housing market is "beginning to stabilize as households adjust to higher interest rates and changes in housing policies". The BoC says the data "reinforce Governing Council's assessment that higher interest rates will be warranted to achieve the inflation target". However, it warned that it is paying close attention to NAFTA negotiations. The central bank also noted the intensification of financial stresses in certain emerging economies which, for now, had limited spillovers.

The Reserve Bank of Australia (RBA) held its official cash rate (OCR) at 1.5%, extending a record run of policy inaction stretching back to August 2016. It remains clear that the RBA is in no hurry to raise interest rates. The bank has emphasized that, whilst the next move will likely be up, there is no rush to hike given wage growth and inflation remain uncomfortably low. Fears of a global trade war and strains in emerging markets have only reinforced our view that rates will stay low for a long time to come.

The U.S. 2 year/10 year treasury spread is now 0.24% and the U.K.'s 2 year/10 year treasury spread is 0.70% - 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 4.54% (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 14.51 (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.

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

PIC18-054-E(09/18)