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. November 5, 2018

Owner Operated Companies

Alphabet Inc. – Google parent Alphabet reported third quarter results, including an overall revenue increase of 21% to $33.74 billion. Google ad sales contributed 86% of revenue, but growth slowed to 20% from nearly 24% last quarter. Alphabet reported net profit of $9.2 billion, or $13.06 per share, compared with $6.7 billion, or $9.57 per share in the year-ago quarter. That beat the average analyst estimate of $10.45. Earnings were boosted by a lower tax rate and favourable valuation of the firm's investments in start-ups such as Uber Technologies Inc.

Berkshire Hathaway Inc.'s reported quarterly operating profit doubled as its insurance business dodged hurricanes and benefited from lower taxes. Berkshire once again admitted struggling to put its cash pile to work and resorted to buying back $928 million in its own company's stock in the latest quarter. The company has $103.6 billion in cash, short-term treasuries and other similar investments. Operating profit in the third quarter doubled to $6.88 billion from $3.44 billion a year earlier, and higher than the $6.11 billion expected by Wall Street, according to data from Refinitiv US Holdings Inc. Berkshire said third-quarter net income rose more than 355% to $18.5 billion, though that reflected a new accounting rule requiring it to report unrealized investment gains with earnings. Buffett said the rule could lead to "wild and capricious" results and can mislead investors, who should look at operating profit instead.

Facebook, Inc. – The main Facebook service and its Messenger sibling grew monthly users during the third quarter to 2.27 billion, up 10% compared with a year ago but a percentage point below both expectations and last quarter's pace. Average revenue per U.S. and Canadian user grew 6.7% in third quarter compared with the same period last year. Growth for Asian-Pacific users was 4.6%. About 2.6 billion users interact with at least one of Facebook's services each month, up from 2.5 billion when it released the figure for the first time last quarter to emphasize that its potential audience for advertisers is unrivaled in size. Overall third-quarter revenue was $13.7 billion, up 33% from the same period last year and in line with expectations when accounting for currency fluctuations. Quarterly profit of $5.1 billion, or $1.76 per share, was up 9% and above the average per-share estimate of $1.48.

Fortive Corporation reported quarterly adjusted earnings of $0.86 per share. The mean expectation of 17 analysts for the quarter that ended in September was for earnings of $0.87 per share. Revenue rose 9.2% to $1.84 billion from a year ago; analysts expected $1.86 billion. Fortive Corp's Reported EPS for the quarter was $0.64. The Everett, Washington-based company reported quarterly net income of $227.9 million.

The Kraft Heinz Company missed quarterly earnings estimates, as steep commodity costs, other expenses and pricing promotions overshadowed higher-than-expected sales. Consumer goods companies have struggled in recent months to cope with skyrocketing costs for raw materials and transportation, exacerbated by a shortage of truck drivers in the U.S. Chief Financial Officer David Knopf said the company expects profitability to improve "significantly" beginning with the current quarter, with growth continuing into the first half of next year. Excluding items, the company earned $0.78 per share, falling $0.03 short of analysts' average expectations, according to data from Refinitiv. Net sales rose 1.6% to $6.38 billion, topping Wall Street estimates of about $6.31 billion.

Energy Sector

Baytex Energy Corp. reported its third quarter results, which included the following highlights: completed the strategic combination with Raging River Exploration Inc. during the quarter, creating a well-capitalized, light oil company with an attractive free cash flow profile and improved balance sheet; light oil assets generate approximately 80% of Batyex' operating netback; the company generated adjusted funds flow of $171 million ($0.46 per basic share), $32 million in excess of exploration and development capital expenditures of $139 million, which delivered production of 82,412 boe per day (81% oil and natural gas liquids [NGL]) during Q3 2018; Baytex completed two (2.0 net) significant light oil discovery wells in the Pembina area of the East Duvernay Shale; the company reduced its annual guidance for operating expenses by 4% (at mid-point) to $10.50-$10.75/boe, reflecting strong performance year-to-date of $10.54/boe. Baytex secured additional rail capacity, which increases its crude oil volumes delivered to market by rail to 11,000 boe per day (boe/d) (approximately 40% of its heavy oil production) through 2019. Commencing January 1, 2019, approximately 70% of the company's crude by rail commitments are West Texas Intermediate (WTI) based contracts with no Western Canadian Select (WCS) pricing exposure. Baytex expects to generate approximately $900 million of adjusted funds flow, 80% of which is derived from its light oil assets in the Eagle Ford and Viking. With an updated capital program of $700 million (at the mid-point), the company expects to generate $200 million of cash flow above capital expenditures.

Crescent Point Energy Corp. reported its third quarter results, which included the following highlights: during the quarter Crescent Point completed the previously announced organizational restructuring, resulting in approximately $50 million of annual cost savings; strong third quarter production with current operations on track to meet or exceed 2018 guidance within capital budget; funds flow from operations totalled $474.7 million during third quarter, or $0.86 per share diluted, including an operating netback of $41.14 per boe; capital expenditures were $416.0 million in the quarter; Crescent Point's 2018 capital expenditures guidance remains unchanged at $1.775 billion, with FCF generation expected to improve in 2019, based on a preliminary capital expenditures budget of $1.55 billion to $1.60 billion. Net debt to funds flow from operations was 2.1 times, with cash and unutilized credit capacity of approximately $1.7 billion. The company had, on average, over 40% of its oil and liquids production, net of royalty interest, hedged through the remainder of 2018 and 2019, at a weighted average market value price of approximately CAD $78.00/bbl. The company's average selling price per barrel of crude oil was CAD $80.11 during third quarter. Despite the recent widening of Canadian oil differentials, Crescent Point expects its realized oil pricing in fourth quarter to be significantly stronger than Canadian index prices as approximately 90% of the company's oil production is either located downstream of recent apportionment points or in the U.S.

Royal Dutch Shell PLC Q3 results - given concerns as to how to bridge the gap between Shell's 2019-2021 cash flow aspirations and the actual cash flow delivered in the first half of the year, a 20% beat to Q3 cash flow forecast was welcome. Part of the strength can be explained by seasonality, but we believe it is also a result of the return of high margin cash barrels in the Gulf of Mexico. The key take-away for us on the post-results call was management confidence in meeting the $25-30 billion FCF ambition for the end of the decade. This reflects more than 600K boe/d of equity volumes over 2018/2019 that come on stream and that appear well on track. These are high margin barrels such as those in Australia, Brazil and North America. Shell's cash flow performance is particularly encouraging in Q3 with underlying cash flow from operations post financing at $13.8 billion. This is the highest quarterly cash flow on our record. Adjusted for capital expenditures (capex) and dividends, cash breakeven is estimated at less than $50/bbl with gearing down 2.3% quarter/quarter. In terms of bridging the gap to the 2020 $25-30 billion FCF aspiration, the company highlighted an additional $7 billion of cash flow from the new projects coming on-stream on a base adjusted for capex and prices of $21 billion. One area that disappointed us was the Integrated Gas performance with earnings 13% behind forecast. This mainly reflects lower than expected integrated gas production and Liquefied Natural Gas (LNG) liquefaction volumes, but we expect volumes to improve next quarter with less maintenance. This combined with seasonality in the LNG and gas market and the time lag effect in pricing should lead to better earnings and cash flow performance in our view.

Whitecap Resources, Inc. delivered another excellent quarter with strong operational and financial results. Production for the third quarter averaged 75,529 boe/d (84% oil and NGLs), approximately 1,000 boe/d higher than the company's internal forecast on lower than expected capital spending of $115 million. Whitecap now expects average annual production to increase to 74,500 boe/d on full year capital spending of approximately $450 million. In the third quarter, Whitecap generated funds flow of $205 million ($0.49/share), invested $115 million to grow production per share and returned $33.8 million in dividends to shareholders, which resulted in $56.2 million of free funds flow. Net debt at the end of the quarter was approximately $1.3 billion on credit capacity of $1.7 billion and net debt to annualized Q3 2018 funds flow ratio was 1.6 times.

Financial Sector

Ares Capital Corporation (ARCC) reported core earnings of $0.45/share that was above consensus ($0.40/share). ARCC posted another strong quarter as it continues to benefit from LIBOR increases and portfolio rotation from the ACAS acquisition. The beat this quarter can be traced to higher than expected fee income, though interest income and NAV were strong as well. NAV increased to $17.16 per share (from $17.05 last quarter), while leverage remained at 0.62x debt-to-equity. Post Q3, ARCC expanded its secured facility in order to take advantage of the reduced asset coverage requirements, which should take effect for ARCC on June 21, 2019. In addition, ARCC was also upgraded to investment grade by Moody's, making it the only business development company with an Investment Grade rating from the 3 major bureaus. Management noted that it is near the end of its portfolio rotation post-ACAS which, combined with the prospect of increased leverage and additional tailwind from higher rates, should help to drive future earnings power. Overall, this was another positive quarter from ARCC, in our view, when it more than covered its recently raised dividend, and should be in a strong position to generate additional value for shareholders going forward. Management noted that ARCC amended its revolver to allow for the new 150% asset coverage requirement when this goes into effect in June of next year.

Barclays PLC has chosen veteran Rothschild banker Nigel Higgins to be its next chairman, as the U.K. lender navigates a series of challenges, including a campaign for disposals by an activist investor. Higgins is due to take the chair at Britain's third-largest bank by market value in May, after the company's annual meeting. His appointment, which must be approved by the Prudential Regulation Authority and Financial Conduct Authority, comes at a challenging time for Barclays and the wider European banking sector. Edward Bramson, the activist investor, acquired a large stake in Barclays this year and has since agitated for the group to jettison parts of its investment bank. (Source: Financial Times)

BNP Paribas SA - core business Profit Before Tax (PBT) of €2,944 million but 5% below consensus, excluding the Corporate Center and non-recurring with 2% Operating earnings beat. Reported PBT below Consensus for Domestic Markets and for International Financial Services (IFS) whereas 6% above consensus for Corporate

& Institutional Banking (CIB). In Domestic Markets, the delta came from Italy (-18% vs consensus) & French retail (-8.8% vs consensus). For IFS, the underlying results came below consensus for Personal Finance, EuroMed, and Wealth & Asset Management. Fixed Income, currency and commodities revenues were down 15% year/year, while Equities revenues were up 4% year/year. Group revenues were 1.3% below consensus, with costs and risk provisions in line (although supported by reversals in CIB). Risk Weighted Assets were down 2% quarter/quarter, leading the CET 1 to be at 11.7% vs 11.5% end Q2 2018.

Citigroup Inc. has been granted a license to set up a branch of Citibank at Abu Dhabi Global Market (ADGAM), a financial center in Abu Dhabi, it said last Tuesday. The new branch will provide liquidity management to Citi's clients looking to establish regional treasury centers in the United Arab Emirates, as well as offering institutional banking services to its global clients, it said. Citi is expanding in the United Arab Emirates where it has provided wholesale and retail banking since 1964, and in neighboring Saudi Arabia where it plans to apply for a full banking license. (Source: Reuters)

DNB ASA - Overall DNB's PBT of NOK 7.1 billion was 3% below consensus. This was a weaker quarter on income primarily in DNB markets where fees overall down 4% at NOK 12.5 billion, whilst costs were 1% weaker at NOK 5.3 billion; however, impairment was substantially better at -NOK 11 million beating by NOK 311 million. On the balance sheet, volumes continued to track well growing 1% finishing at NOK 1,564 billion (after adjusting for FX the group is at the top of the 3-4% targeted range annualized YTD). Capital remained solid in the quarter with CET 1 ratio of 16.5% up 30bps quarter/quarter (cons: 16.4%).

HSBC Holdings PLC reported a jump in quarterly profits thanks to a tighter grip on costs, fuelling hopes that its new chief executive John Flint can return the bank to growth without resorting to runaway spending. The lender's ability to quickly expand in Asia while keeping a lid on expenses has become a focal point for investors deciding whether to back a turnround plan led by Mr. Flint, who was appointed in February. HSBC reported revenue of $13.8 billion in the third quarter, an 8.8% increase compared with a year ago, which it attributed in part to tighter monetary policy in the U.S. Mr. Flint said a "normalisation of monetary policy, especially in the dollar area" had helped the bank expand its net interest margin — the difference between what it pays on deposits and earns on loans. (Source: Financial Times)

RioCan Real Estate Investment Trust reported Funds from Operations (FFO) per diluted unit of $0.47. FFO per unit was up 2.5% year/year and ahead of consensus of $0.44. The increase was primarily driven by same-property Net Operating Income growth of 1.6% year/year, and the continued aggressive use of the buyback to offset the dilutive impact of asset sales. The pace of asset sales appears to have moderated, as the value of properties sold or under conditional agreement to be sold, is now $1.3 billion, as compared to $1.2 billion the prior quarter. Management asserted on the conference call that they remain on track to divest a total of $2.0 billion of non-core properties and expects to reach $1.5 billion by year-end 2018. In 2019, the pace may be slower than originally hoped for as rising interest rates as well as slowing demand for properties in secondary markets are factors. As selling higher-yielding properties can be extremely dilutive, management of RioCan is taking advantage of its undervalued equity to repurchase units with a large amount of the proceeds of asset sales. Over the past year, RioCan has repurchased 20.5 million units, including 5.5 million units in Q3 2018, for a total of $502.0 million. We view these purchases extremely positively as they are accretive to NAV. In fact, the repurchases in Q3 were completed at, on average, an 11.4% discount to NAV per unit estimates (of circa $27.86).

Royal Bank of Scotland Group PLC: has implemented several profit-hitting measures to prepare for the fallout from a disorderly Brexit. The bank took a £100 million impairment charge to steel itself against an expected rise in customers defaulting on their loans due to what it described as a "more uncertain economic outlook". It also took steps to hoard liquidity rather than lending it out in a move that led to a larger-than-expected drop in its net interest margin — the difference between what it pays on deposits and earns from loans. The moves, were announced alongside third-quarter results. (Source: Financial Times)

Standard Chartered PLC (China) has become the first foreign bank to be granted a license to provide custody services to domestic funds and asset managers in China, the bank said last Monday, as Beijing took another step towards opening its capital markets. Since 2017, a handful of foreign asset managers have been permitted to set up onshore operations and sell investment products in China, but custody, holding clients' securities for safekeeping, has, until now, been restricted to local players. This new license, granted by the China Securities Regulatory Commission, will allow Standard Chartered to provide custody services to these foreign asset managers operating in China, as well as domestic players. "This is a big step forward in the further opening up of China's domestic financial markets," said Jerry Zhang, chief executive and executive vice-chairwoman of Standard Chartered China, in a statement. (Source: Reuters)

Activist Influenced Companies

Pershing Square Holdings, Ltd. (PSH) – Billionaire investor Bill Ackman has taken a stake in hotel operator Hilton Worldwide Holdings Inc. for the second time in two years after earning a 32% profit on his investment in 2017. Ackman's Pershing Square Capital Management hedge fund owns 10.9 million shares, or 3.7% of the company. Pershing Square, which invests $8.4 billion, said the 10.9

million Hilton shares purchased represent about 13.9% of the net asset value of Pershing Square Holdings, the firm's publicly traded hedge fund. Ackman, one of the industry's most closely watched activist investors, originally started buying Hilton stock in 2016 and exited the position in 2017, he told investors last year. The size of that position was never disclosed, but a source familiar with the matter said it was smaller than the current position. Ackman is one of a few activist investors delivering top returns this year, with results up by double digits before this month's market sell-off.

Pershing Square Holdings noted that on October 25, 2018, Pershing Square Capital Management, L.P. CEO Bill Ackman purchased a total of 7,165,000 PSH Public Shares at a price of $14.96 per share, and PSH Board Member Nick Botta purchased a total of 335,000 PSH Public Shares at a price of $14.96 per share.

Dividend Payers

BHP Billiton PLC - Following last week's completion of the sale of BHP's U.S. Onshore assets to BP PLC and Merit Energy Company, BHP has announced the return of $10.4 billion net proceeds to shareholders (gross proceeds were $10.8 billion, net of $0.4 billion tax and transaction costs). This will be distributed to shareholders via a combination of a USD $5.2 billion off-market buyback in Australia commencing immediately and a USD $5.2 billion special dividend to be paid in January 2019.

Dufry AG - Overall organic growth reached +3.1% after 9 months and -0.7% in Q3, which was in line with expectations. Like-for-like in Q3 was -0.9% and new concessions had a much smaller impact in the first half (+0.2%). Southern Europe was organic. -2.1% (9 million) and -5.2% in Q3 due to Spain (lower spend/pax); U.K./Central Europe -0.7% (excluding Geneva closure +3.6%) and +0.2% in Q3 (acceleration due to UK). Eastern Europe, Asia +15.2% after 9M and 3Q +4.4% (strong comparisons), Latin America -2.8% in 9 million but -11% in Q3 (foreign exchange in Brazil/Argentina); North America continued (9 months +7.5%, Q3 +7.1%). Gross profit was +50bp to 59.9% (Q3 +80bp) and EBITDA margin +50bp to 12.3% (Q3 +30bp). Equity FCF +59% to CHF 430 million. October saw a gradual improvement (org. close to +1%) and therefore Dufry expects full year organic growth of +2-3% (old +5-7%) and an EBITDA margin of 12.0-12.3%.

Roche Holding AG - The Food & Drug Administration (FDA) has approved Xofluza for the treatment of acute, uncomplicated influenza (flu), in people 12 years of age and older. This is the first novel proposed mechanism of action to treat the flu in nearly 20 years and also the first single-dose oral drug approved to treat the flu. This approval comes slightly ahead of the scheduled date on December 24. Xofluza is a new class of antivirals (cap-dependent endonuclease protein inhibitor) that inhibits an enzyme essential for viral replication. Xofluza has demonstrated efficacy against a wide range of influenza viruses, including Tamiflu-resistant strains and avian strains. Xofluza also reduced the time that virus was released (phase 3 CAPSTONE-2: 48 hours vs 96 hours for placebo + Tamiflu; $p<0.0001$). Xofluza was discovered and developed by Shionogi. In February 2016, Roche entered into a worldwide (ex-Japan/Taiwan) licensing agreement with Shionogi for the development and commercialization of its anti-influenza drug. Shionogi received an undisclosed upfront payment and will be eligible to milestone payments and royalties. Xofluza will allow replacing some of the lost Tamiflu sales due to genericization. Estimates are for CHF 265 million peak sales, of which CHF 53 million will be paid to Shionogi as royalties (20% rate). Due to the reduced time to cessation of viral shedding, the drug has the potential to play a role in pandemic preparedness as currently Tamiflu (generic!) does.

Economic Conditions

Friday's (November 2) October U.S. labor market report exceeded expectations as job creation (as indicated by the non-farm payrolls or NFP) came in strongly at 250,000 (well above Bloomberg's median forecast of 200,000). There was no net change to the preceding two months of jobs creation as September's dip to 118,000 (from the preliminary 134,000 and most likely due to the extreme weather that had an adverse - albeit temporary effect - on job creation in the hurricane-impacted regions, such as South Carolina in September) was completely offset by the upward revision to August job creation, to 286,000 from 270,000. Overall, the job creation in the last 3 months averaged 218,000 per month. Meanwhile, the unemployment rate stayed unchanged at 3.7% in Oct, the lowest level since December 1969. The most eye-catching part of Friday's report was the strength of U.S. wage growth which came in at 0.2% month/month, 3.1% year/year (from 0.3% month/month, 2.8% year/year in September and in line with market expectations) while the August wage growth was revised higher to 3.0% year/year (from 2.9% year/year previously). The last time wage growth exceeded 3% was nearly a decade ago, since April 2009. The U.S. labor force participation climbed higher to 62.9% in October (from 62.7% in September).

Financial Conditions

European Central Bank (ECB) decided last week that its Interest rates and the forward guidance on rates would be maintained. Rates will "remain at their present levels at least through the summer of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term": Refi rate at 0.00%; Marginal lending facility at 0.25% and Deposit facility at -0.40%. The ECB will continue making asset purchases of €15 billion per month until the end of December 2018. Of course, all of the above is datadependent, or in their words, "subject to incoming data confirming the medium-term inflation outlook".

The **Bank of England stayed on hold** last week, with all 9 members of the Monetary Policy Committee voting to keep the Bank Rate at 0.75%, and for the Asset Purchase Facility to stay at £435 billion. The Bank felt that the current stance was "appropriate", and that "ongoing tightening over the forecast period" (which extends to the end of 2021) would also be "appropriate". The pace, of course, will remain "gradual" and to a "limited extent".

The **outlook for GDP growth** was described as "uneven" but is little changed over the forecast period: next year was trimmed a bit to 1.7% (was 1.8% in August), while 2020 was left at 1.7%.

The U.S. 2 year/10 year treasury spread is now 0.29% 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 4.83% (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 20.09 (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
- ITM AG Investment 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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