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. November 26, 2018

Owner Operated Companies

Alphabet Inc. – Google will invest almost $700 million in a Danish data centre, the latest investment in the Nordic region which is known for its abundant renewable energy. Google said it would match the new centre's use of energy made from fossil fuels with green energy generated through power purchase agreements. The Nordic countries, which can generate electricity relatively cheaply from renewable sources such as hydropower and wind, have long been a magnet for heavy power-using industries, but are now attracting power-hungry data centres. Google said it is also evaluating investments in a number of onshore and offshore wind and solar energy projects in Denmark. In September, Google signed a 10 year deal to buy renewable energy from three new wind farms being built in Finland that will power one of its data centres. The new data centre in the small city of Fredericia will cost 4.5 billion Danish crowns ($689 million) and employ 150 to 200 staff once completed in 2021, according to the plans. Besides Fredericia, Google bought another plot last year in Aabenraa, Denmark, next to a planned Apple Inc. data centre. Facebook, Inc. has also planned a data centre in Denmark. Denmark is home to a large wind energy sector including turbine maker Vestas Wind Systems A/S and offshore wind farm developer Orsted A/S.

Walgreens Boots Alliance, Inc. – Drugstore owner Walgreens and health insurer Humana Inc. are reportedly in preliminary discussions to take equity stakes in each other. In June, Humana said it would partner with Walgreens, with its unit operating senior-focused primary care clinics inside two Walgreens stores in Kansas. The companies are discussing the possibility of expanding that venture, among other options, according to the WSJ report. The news comes amid widespread consolidation in the healthcare industry, with pharmacy benefits manager CVS Health Corp. set to close its $69 billion purchase of health insurer Aetna Inc.

Energy Sector

Nothing significant to report. .

Financial Sector

Standard Chartered PLC, the emerging markets bank, said its business would no longer be supervised by an independent monitor following the expiration of an agreement with its regulator, the New York Department of Financial Services (DFS). The bank has been under the supervision of a monitor since 2012 after it agreed to settle charges from U.S. authorities in relation to its dealings with entities in Iran and deficiencies in its anti-money laundering controls. The monitorship was extended twice, once in 2014 and again in 2016. "The group is pleased that the DFS has acknowledged the bank's progress in re-mediating and improving its financial crime controls to the point that a monitor is no longer necessary," Standard Chartered said in a statement. (Source: Financial Times)

Standard Chartered is drawing up plans to buy back shares for the first time in a generation as management tries to revive the lender's flagging share price. The buyback plan, which could be announced alongside full-year results at the end of February, represents a significant shift in the direction of the bank, which has raised billions of pounds from investors in the past decade to fund its growth. The proposal is still in its infancy and is contingent on the size of any fine the bank must pay to settle allegations by U.S. authorities that it breached sanctions against Iran, according to several people familiar with the plans. Given the sensitivity of the negotiations over the penalty, management are reluctant to put a figure on the scale of any potential buyback, according to a person briefed on the plans. (Source: Financial Times)

Activist Influenced Companies

Nothing significant to report.

Dividend Payers

Aryzta AG - At expiration of the rights exercise period on November 15, subscription rights for 97.4% of the new registered shares were validly exercised. The listing and first day of trading of the new registered shares took place on November 19. Aryzta reported 0.3% underlying sales growth, made of -0.6% volume and 0.9% price/mix. Assuming €19 million volume losses from insourcing, suggests 2.4% growth, made of 1.5% volume and 0.9% price/mix. Disposals had a negative impact of -5.3%, in line with expectations. Assuming €19 million losses from insourcing, it is estimated 6.4% underlying growth, made of 4.3% volume and 2.1% price/mix. Mid to high single-digit organic EBITDA growth guidance confirmed, implying an EBITDA of €310 million to €325 million. This, despite 'recent flour price increases', next to 'sustained high butter prices'.

Dufry AG signed a contract with P&O Ferries Limited to operate stores on 15 ships which serve several routes from/to the U.K. (Dover-Calais, Europoort-Hull, Zeebrugge-Hull and in the Irish Sea). It will use its World Duty Free brand and it will take over the retail space in April/May 2019. This contract will add 19 shops

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with a total of 3,600 square metres. This will be a strong expansion for the Dufry Cruise Services (established in August 2017) which had until now 27 ships. At the end of 2017, there were 17 ships and sales were +64% in fiscal year 2017. Already at the end of May 2018, Dufry announced another 10 new ships (2,740 square metres) with contract from Holland America Line Inc. (subsidiary of Carnival Corporation, 8 ships). The global cruise business has seen continuous growth of +5% per annum with Carnival, Royal Caribbean Cruises Ltd., Norwegian Cruise Line Holdings Ltd. and MSC Cruises SA being the leaders. The new contract with P&O Ferries gives a push to the Dufry Cruise Services business, which has just been started, and it strengthens its position in the cruise retailing market, where Starboard Cruise Services, Inc. (owned by LVMH Moet Hennessy Louis Vuitton SE) is number one, Harding Retail (owned by Flemingo International Ltd.) number two and Dufry number three but expanding the business strongly. Cruise ship/seaports make 3% of sales. It will add 0.8% to the group wide retail space but will add 35% more ships to its portfolio.

GEA Group AG announced an adjusted outlook for its cash flow guidance for 2018 and also some more cautious comments around 2019, which is disappointing given that Q3 2018 results were reported less than a month ago. We also view the timing of the comments on 2019 as unusual given that no formal 2019 guidance has been issued and this may reflect GEA aiming to give new Chief Executive Officer Stefan Klebert a more realistic base which he can work from to start to turn the company around when he formally starts as CEO in February 2019. In terms of the magnitude of cash impact, analysts believe GEA's revised 7% to 7.5% (from approximately 8.5%) cash flow driver margin guidance implies working capital will end the year in the range of €840 million to €925 million. This is €50 million to €125 million worse than previously guided (2% of market capitalization at the mid-point) and also compares to €674 million at the end of 2017. The higher level of working capital is attributed to a worse development in October than anticipated due to the higher volume levels in the business. In terms of EBITDA impact GEA is highlighting that the €595 million of consensus EBITDA for 2019 estimates could be challenging to achieve (2018 estimate guidance is still for €540 million). GEA sees €40 million wage inflation (already well understood by the market) but is also commenting on €30mn negative impact to operational EBITDA driven by exceptional IT costs from 2018 estimates becoming operational costs in 2019 as these are not rolling off. As longer-term investors we continue to hold the stock but this announcement is a reminder of the near-term volatility caused by a fairly lengthy management change process. At the point of management change in February 2019 we see scope for a number of changes that can unlock value including accelerated restructuring and a potential broader portfolio review and resulting disposals. Analysts see more board support for change given that on November 16 GEA announced Colin Hall (Head of Investments at Groupe Bruxelles Lambert (GBL)) would join the supervisory board. GBL currently holds 5.5% of GEA shares.

Pattern Energy Group Inc. has acquired a 35-megawatt (MW) owned interest in the Stillwater wind facility from Pattern Energy Group 2 LP. Stillwater commenced commercial operations in late October and is located in Stillwater County, Montana. The cash purchase price for Pattern Energy's 35 MW owned interest in Stillwater is approximately $23 million, which represents less than a 10x multiple of the five year average cash available for distribution. The acquisition increases Pattern Energy's operating portfolio to nearly 4 gigawatts (GW) of gross capacity, with more than 2.8 GW of owned capacity, across 24 projects. Stillwater has a 25 year power purchase agreement for 100% of the energy produced. Stillwater is utilizing a total of 31 Siemens Gamesa wind turbines comprised of five 2.3 MW turbines with 108 meter rotors and 26 2.625 MW turbines with 120 meter rotors. During each year of operations, the 80 MW facility will generate energy equal to the needs of more than 23,000 Montana homes.

Economic Conditions

Canada – Retail sales in Canada advanced slightly ahead of the expectations for the month of September, up 0.2%, driven chiefly by a strong month of auto sales. The core figure, which excludes sales of vehicles and parts fell short of the expectations, up only 0.1% relative to 0.3%; though retail categories such as clothing, general merchandise and food stores saw solid numbers in the month, they were offset by lower sales of furniture and building materials.

Inflation in Canada, as measured by changes in the CPI, picked up in October, reaching a 2.4% annualized value relative to 2.2% in the month prior for its headline reading. The core inflation, which excludes the effect of the most volatile price series, including food and energy, was up one tenth to 1.6%.

The U.S. housing market - Housing starts largely matched market expectations, rising 1.5% to 1.228 million annualized in October following upward revisions the prior two months. All of the increase was in the lumpy multiples segment, up 10.3%, while singles fell for a second straight month, by 1.8%. Starts plunged 34% in the Northeast and fell 5% in the West, but spiked 33% higher in the Midwest and rose 5% in the hurricane-ravaged South (despite the second rainiest October in 34 years of national data). Permits slipped 0.6%, though the decent level of 1.263 million flags some further improvement in starts in the final two months of the year in our view. Still, despite the end of hurricane season, any increase in construction will be limited given the third largest decline on record in the National Association of Home Builders index in November. The underlying trend in housing starts (especially singles) remains weak in our view, pointing to a fourth consecutive quarterly decline in residential construction. That's one reason real GDP growth will likely moderate in Q4 from the near 4% average pace of the prior two quarters.

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U.S. existing home sales rose 1.4% in October, beating the consensus call, to 5.22 million units annualized. But this is only a two-month high and it follows six consecutive monthly declines and sales are still 5.1% below last year's levels, the weakest since August 2014. Still very low inventory levels continue to hold sales back; the number of homes for sale fell for the fourth month in a row, keeping the months' supply at a tight 4.3, off the lows but still well below normal. Prices are not rising as quickly as they once were but they are rising (approx..4% year/year) and, coupled with climbing interest rates, are hurting affordability. This particularly impacts first-time homebuyers ; the share of sales to first-time homebuyers edged down to 31% from 32% in the prior month, still in the range that has prevailed over the past year. In summary, the six month losing streak in existing home sales has finally ended but higher rates and prices will limit the gains.

U.S. – Durable goods orders in the U.S. retreated more than initially expected, down 4.4% in October relative to expectations for a 2.5% pullback. The notoriously bulky transportation orders were a drag on the headline figure in the month. However, even when excluding transportation, the 0.1% advance fell short of a 0.4% expected improvement. Some of the categories which contributed to growth in the month included computers and electronics, communications and electrical appliances.

The **U.S. consumer sentiment**, as captured by the University of Michigan, retreated in November to 97.5 index points from 98.3 index points in October, below the expectations for a 98.3 index points read. Both the "current conditions" and the "expectations" components of the composite index retreated in the month.

U.K. Brexit - All eyes on the British Government and Parliament's vote due December 12 after the E.U. agreed to the U.K. Brexit treaty. Debate rages on as to what happens when and if, as it seems likely, it gets voted down in Parliament. Labour hinting at another referendum in a people's vote, the Democratic Unionist Party vowing to vote the deal down and more contrasting headlines on the idea as Financial Times says "mistaken assertion that a no-deal Brexit is impossible on the grounds there is no majority for it in the House of Commons."

Financial Conditions

The U.K. deficit rose to £8.8 billion from £7.2 billion last year, marking the biggest October figure for three years, and well above the £6.1 billion forecast. However, the amount borrowed so far this financial year is the lowest for 13 years. The figures come after the Chancellor said austerity was coming to an end. The Office for National Statistics said the current year-to-date borrowing was £26.7 billion, which is £11.2 billion less than the same period last year and the lowest since 2005. During his budget announcement the Chancellor also said borrowing is likely to fall over the next five years. A Treasury spokesperson said it was the government's best year-to-date performance since 2005, adding "our balanced approach is getting debt falling while supporting our vital public services, keeping taxes low, and investing in Britain's future". (Source: BBC)

Italy - Bloomberg reported Lega's Salvini signals a possible budget offer to the E.U. suggesting the 2.4% deficit target is not set in stone, with his economic adviser Armando Siri saying a little fine-tuning is possible. Prime Minister Conte's working dinner with European Commission President Juncker over the weekend failed to break ground but Salvini and Deputy Prime Minister Di Maio are due to meet Conte November 26.

The U.S. 2 year/10 year treasury spread is now 0.23% and the U.K.'s 2 year/10 year treasury spread is 0.64% - 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 4.81% (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 20.02 (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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