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. December 10, 2018

Owner Operated Companies

Berkshire Hathaway Inc. – Billionaire global investor Warren Buffett's Berkshire Hathaway is looking to pick up a 10% stake in Kotak Mahindra Bank Limited. A stake acquisition by U.S. based Berkshire Hathaway may be conducive to Uday Kotak, the billionaire head of Kotak Mahindra Bank, who has been asked by India's central bank to lower his holding in the private-sector lender to 20% by the end of this year, and to 15% by March 31, 2020. Berkshire Hathaway is likely to invest between $4 billion and $6 billion in the private-sector bank by buying promoter stake or through a preferential allotment. The acquisition of a 5% percent stake or more in an Indian bank requires prior approval from the Reserve Bank of India (RBI). In August, the RBI said the CEO's plan to reduce his stake by issuing non-convertible perpetual non-cumulative preference shares does not meet their promoter holding dilution requirement. Uday Kotak directly held a 29.73% stake in the lender as of September 30, 2018, according to Bombay Stock Exchange data. Earlier this year, Berkshire Hathaway forayed into India's digital payments space by taking a 25 billion Indian Rupee stake in the parent of Paytm. (Source: Thomson Reuters)

Walgreens Boots Alliance Inc. said it would partner with FedEx Corporation to launch a next-day delivery service for prescription drugs nationwide, giving it a leg up as Amazon.com, Inc. threatens to shake-up the sector. In the race to make inroads in the on-demand drug delivery space, Walgreens' move could potentially put it head-to-head with Amazon, which earlier this year said it would buy online pharmacy PillPack, Inc. Amazon's entry in the market would rattle traditional drug retailers and could potentially disrupt major players in the U.S. drug supply chain. Rival CVS Health Corporation launched its own next-day delivery service earlier this year. Walgreens said patients can have qualifying prescriptions delivered to their doorstep as early as the next day for $4.99. Same-day drug delivery is already available in certain markets and will be expanded in 2019, Walgreens said.

Energy Sector

Cardinal Energy Ltd. – Volatility in Canadian oil price differentials, coupled with the recent decline in world oil prices, has caused Cardinal Energy to re-evaluate the current level of its dividend. During the fourth quarter, Canadian oil producers have received embarrassingly low prices due to lack of pipeline egress. The industry is looking to truck and rail solutions to move oil to market instead of transporting it through pipelines, the safest, most cost-effective way. The lack of provincial and federal government leadership and failure to act in getting new export pipelines built are costing, not only Alberta, but all Canadians, significant revenue and future investment in the country. This week's Alberta government announcement is a much needed short-term solution but will not solve the long-term take-away capacity issue facing the industry. Although the company does not think that the current pricing differentials between Canadian barrels and U.S. barrels will be permanent, it is obligated to its shareholders to protect its business and its balance sheet until Canadian prices improve. Cardinal will temporarily reduce its monthly dividend to $0.01 per month ($0.12 per year) commencing with the December 2018, dividend payable on January 15, 2019. The board of directors plans to review the dividend in April 2019, and make adjustments to the dividend rate to reflect changes to price differentials and market conditions at that time. Cardinal has been designed and organized to be a low-decline, dividend-paying company. It works on a daily basis to reduce its operating costs, to run its operations more efficiently and to maintain its peer-leading low-decline rate. The company cannot, however, control differential pricing, especially in a situation that has arisen to the extreme levels experienced in the last 90 days. During the first part of the fourth quarter, Cardinal reached record production of approximately 22,000 boed, well ahead of the company's production guidance of 21,000 to 21,500 boed, driven by a combination of lower-than-forecasted base declines and positive drilling results at Bantry and Elmworth. The company's development drilling inventory has materially expanded, providing Cardinal confidence in both the long-term sustainability of the asset base and the future growth potential of the company. Since then, with widening Canadian oil price differentials, the company began to systematically shut in its higher operating costs properties to avoid cash production losses. As of December 1, approximately 15% of the company's production was shut in. With the Alberta government's announced mandatory production curtailment and the expected pricing improvements in Canadian oil differentials, the company expects to bring back the majority of the shut-in production in January 2019. The company's focus for 2019 will be to maintain the integrity of the company's asset base, reduce long-term debt and undertake capital projects that create long-term reductions in operating costs.

Financial Sector

Bank of Montreal (BMO) reported adjusted cash EPS of $2.32 (+19% year/year) vs. consensus of $2.30. BMO delivered strong results in its core personal & commercial banking business with Canadian earnings (adjusted) +8% year/year and U.S. earnings (adjusted) +31% year/year. Both platforms benefited from solid loan (specifically commercial) and deposit growth generating positive operating leverage; revenue and net income were in line, but better credit provisions generally drove the beat (lower quality). Dividend growth was ahead of expectations with a $0.04 increase to $1.00 per quarter (consensus at +$0.02). Total bank Provisions for Credit Losses (PCLs) were $175 million (18 bps) vs. consensus of $206 million. CET 1 ratio of 11.3% (-10 bps quarter/quarter) was below consensus of 11.5%. The sequential decline mainly related to higher Risk Weighted Asset growth (-23 bps), acquisition of KGS-Alpha Capital Markets, LP (-22 bps), share repurchased (-4 bps; 1 million in quarter), slightly offset by strong internal capital generation (+37 bps).

Activist Influenced Companies

Nothing significant to report.

Dividend Payers

GEA Group AG announced yesterday that investor Groupe Bruxelles Lambert SA (GBL) (Oliver Capital) has raised its stake in the company to 8.5% from 7.3% in September 2018 (DGAP, December 7). In August 2017, GEA had announced that GBL's stake in the company had crossed 3.0%. Additionally, last month, GBL's representative Colin Hall was appointed as a member of the Board at GEA.

Roche Holding AG – Drugmaker Gilead Sciences Inc. named Roche Holding AG's Daniel O'Day as its new chief executive, tapping an industry veteran to fill a management vacuum. O'Day, now head of Roche's pharmaceuticals business, joined the company in 1987 and held various roles in the United States before moving in 1998 to headquarters in Basel, Switzerland. O'Day's hiring comes about four months after Gilead said in July that Chief Executive John Milligan and Chairman John Martin would step down at the end of the year. At Roche, O'Day was a champion of bi-specific antibodies that are under development as a potentially less expensive, less complicated alternative to CAR-T therapy where T cells must be taken out of the body, re-engineered and re-infused. Roche said William Anderson, current CEO of its Genentech business, would replace O'Day next year. Anderson joined Roche in 2006, leading the immunology business unit in Genentech, and then took charge of oncology sales and marketing. In 2013, he became head of global product strategy based in Basel before assuming his current role at Genentech in 2017.

Roche - Kadcyla is an antibody-drug conjugate (ADC) engineered to deliver potent chemotherapy directly to HER2+ cancer cells, potentially limiting damage to healthy tissues. Kadcyla is already approved in 2L late (metastatic) breast cancer. Kadcyla cuts the risk of disease recurring by half compared to Herceptin in patients with HER2+ early breast cancer (eBC) with residual disease after neoadjuvant treatment, i.e. adjuvant treatment in high-risk patients (HR 0.5, p<0.0001). In other words, at three years, 88.3% of patients treated with Kadcyla did not have their breast cancer return compared to 77.0% treated with Herceptin. Patients with eBC can undergo surgery directly followed by adjuvant therapy (APHINITY regimen). If patients opt for neo-adjuvant therapy ahead of surgery and have no residual disease, they may undergo adjuvant therapy (APHINITY regimen). If, though, patients have residual disease following neo-adjuvant therapy and surgery (approximately 20% of all adjuvant patients), KATHERINE is their new treatment option which, in analysts' view, materially increases probability of success for regulatory approval. Also, the Food & Drug Administration approved the Tecentriq + Avastin + chemotherapy in the 1L setting for patients with non-squamous metastatic NSCLC as well as in the 2L setting for patients with metastatic NSCLC with ALK or EGFR mutations that progressed following targeted therapy. Approval of Tecentriq as tested in IMpower150 is good - but was expected.

Economic Conditions

Statistics Canada outlined that Canada created 94,100 jobs on stronger full-time hiring and said the jobless rate had fallen to 5.6%. Analysts in a Reuters poll had forecast 11,000 new positions. Reuters notes that Friday's jobs report will provide some relief for Bank of Canada Governor Stephen Poloz, who said last Thursday that economic data since October had been disappointing. The 94,100 increase in the number of jobs created - a 0.5% month/month jump - is the largest on record, eclipsing 94,000 in March 2012. On a year/year basis employment rose by 218,800 jobs, or 1.2%. The six-month average for employment gains increased to 33,800 from 16,900 in October.

U.S. nonfarm payrolls rose 155,000 in November following downward revisions totaling an insignificant 12,000 in the prior two months. The November gain followed a still-strong 237,000 increase in October and is below this year's average (206,200), but it's still a decent figure considering widespread labour shortages. As well, the lingering impact of hurricanes might have clipped payrolls, as an above-normal number of people reported missing work due to bad weather. Payroll gains were widespread across industries. Household employment stayed strong, up 233,000 after a 600,000 spike in October. This kept the jobless rate at a near 49-year low of 3.7% amid a stable participation rate. Average hourly earnings rose 0.2% following a downwardly-revised 0.1% increase the prior month, holding the yearly rate at 3.1%. While the latter is near nine-year highs, it's not fast enough to spur inflation in our view.

U.S. nonmanufacturing ISM unexpectedly rose in November, up 0.4% to a 2-month high of 60.7% (similar to its manufacturing cousin), or just 1.3% away from the record high. **New orders** are up 1% to a 5-month high of 62.5% (although this could reflect some pulling forward of orders ahead of the anticipated rise in tariffs), and

business activity is up 2.7% to match September's 15-year high of 65.2%. **Employment** slipped 1.3% to a 3-month low of 58.4% but this could be a factor of the inability to find qualified workers. **Supplier deliveries** were less delayed, which is not a bad thing but it did hold the headline back. For the third consecutive month, all but 1 of the 18 industries surveyed reported growth, and their comments were upbeat, in our view, but there were clearly concerns about trade and the labor supply.

Britain's exports of financial services to the E.U. could fall by almost 60% as a result of leaving the single market, marking a "sea change" in the services sector that drives the U.K. economy, according to new research by the Centre for European Reform. The think-tank sought to assess the impact of new trading barriers on the key areas of services where Britain currently has a comparative advantage — finance, insurance, law and accountancy. It estimates, in a paper published last week, that exports of financial services, minus insurance and pensions, would drop from their level of £23.6 billion in 2013 to £9.8 billion — a decline of 59% — if Brexit led to the U.K. and E.U. trading services under the provisions of a free trade agreement, rather than as a member of the single market. (Source: Financial Times)

Financial Conditions

The Bank of Canada (BoC) held its overnight rate at 1.75% as expected. The BoC statement was less hawkish than the one released last October. That was expected in light of the deterioration in the global economic picture and slumping commodity prices. However, the BoC's statement was silent about market volatility and instead focused on economic fundamentals. On that note, the central bank is unsure about how much slack there is in the economy, more so after downward GDP revisions. It seems the Bank is less confident about the economic outlook. It indeed added the oil price shock, the evolution of business investment, and the assessment of the output gap (slack) to the list of factors that would determine the pace of policy normalization. Based on the statement, the BoC seems to be considering downgrading its 2019 Canadian GDP growth forecast in the upcoming Monetary Policy Report. So, while the central bank did not entirely close the door to a January rate hike, odds of such a hike being delivered have, in our view, dropped.

The Reserve Bank of Australia held its official cash rate at 1.5% at its last meeting for the year. The concluding paragraph of last week's accompanying statement was exactly the same as the one in November, with the central bank saying that: "The low level of interest rates is continuing to support the Australian economy. Further progress in reducing unemployment and having inflation return to target is expected, although this progress is likely to be gradual. Taking account of the available information, the Board judged that holding the stance of monetary policy unchanged at this meeting would be consistent with sustainable growth in the economy and achieving the inflation target over time".

Reserve Bank of India (RBI) kept its benchmark repo rate and reverse repo rate at 6.50% and 6.25% respectively last week, as expected. This was the second straight month that the central bank had stayed on hold as growth slows and inflation moderates, while the government is getting the RBI to ease the credit crunch leading into the election next year. The rebound in Indian Rupee from its record low in October has also taken pressure off further tightening at this meeting. In its policy statement, the RBI said that the rate decision is consistent with the stance of "calibrated tightening" of monetary policy which it has adopted in October from "neutral" previously. While the decision on keeping the policy rate unchanged was unanimous, the RBI said that one member had voted to change the stance to "neutral", suggesting a more dovish outlook. The next monetary policy meeting will be on February 5-7, 2019.

The U.S. 2 year/10 year treasury spread is now 0.12% and the U.K.'s 2 year/10 year treasury spread is 0.52% - 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 4.75% (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 23.47 (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.

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

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.

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

PIC18-082-E(12/18)