News Highlights

Owners. Operators. And Insightful Investors.

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PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. August 19, 2016

Energy Sector

Crescent Point Energy Corp. – As reported by The Financial Post, Crescent Point Energy struck two deals worth $243 million to buy up land and assets in Saskatchewan. The chief executive officer Scott Saxberg calls the deals a "home run" for Crescent Point, which is already active in the Flat Lake area of Saskatchewan. Crescent Point also announced during its second quarter earnings call that it had sold land and assets in northwestern Alberta that it does not consider part of its core business for $31 million. It said the money raised will be used to pay for a portion of the two acquisitions. The company is marketing a few other land packages in Alberta, which were acquired as byproducts of larger acquisitions focused in Saskatchewan, but Mr. Saxberg says the company has not received bids it will consider for those assets. Mr. Saxberg says, "Selling these assets to redeploy that capital into our core areas makes sense."

Financial Sector

HSBC Holdings Plc bought back 1.45 million shares, repurchasing the London-listed shares at £5.42-£5.50 each, according to statement to London stock exchange Monday. HSBC also bought back 3.02 million shares at average £5.44 Pence each Aug. 17, according to statement to London stock exchange Wednesday.

NN Group of Companies Limited reported Q2 2016 Results: Operating Profit €321million (-34%) versus expectations of €267 million, Net Income €246 million (-39%) versus expectations of €203 million. Normally, we think NN Group's quarterly disclosure has provided good capital management news but disappointing operational news. But this quarter's news was overall very encouraging in our view. The capital management message is huge: a massive beat in capital generation with >250% Solvency 2 ratio, supporting higher than expected dividends to the centre and so higher net cash in the holding company. We think this should support the outlook for dividends and buy-backs. And, for a change, the IFRS operating results beat consensus and offer a glimpse of slightly higher quality from a good, clean Dutch life investment margin and a property & casualty combined ratio which, whilst disappointing at the headline because of the European storms (estimating to have been a 7.3% hit) was nonetheless still ok in our view with a combined ratio of 103.7%. We think NN Group offers an attractive combination of aggressive capital management and potential for operational improvement.

Activist Influenced Companies

Hertz Global Holdings Inc. has announced the appointment of Rick Frecker as the executive vice president and general counsel. Frecker has served as the company's acting general counsel since April. "Rick has performed exceptionally throughout his eight years with the company and is held in high regard throughout our organization," said John Tague, Hertz Global Holdings president and CEO. "Heading our general counsel office over the past several months, Rick has proven himself extremely capable, leading complex transactions, such as the separation of our equipment rental business, while also providing valued counsel to the senior leadership team. I am very pleased to see Rick take this next step at Hertz Global Holdings."Frecker, who joined the company in 2008, previously served as vice president and deputy general counsel. In that role, he was responsible for all corporate securities matters and served as head legal counsel on Treasury and Corporate Development activities together with responsibility for corporate compliance. Additionally, he has had responsibility for legal activities related to the company's franchise agreements.

Canadian Dividend Payers

Brookfield Infrastructure Partners LP – Brookfield Asset Management Inc. has reportedly signed a preliminary contract to buy Brazilian engineering conglomerate Grupo Odebrecht's 70% stake in water and sewage group Odebrecht Ambiental. The source said the deal was done at an equity value of 5.3 billion real ($1.65 billion), which implies an earnings before interest, tax, depreciation and amortisation (EBITDA) multiple of 8.5x. Odebrecht Group will retain the right to develop water concession projects outside Brasil and Brookfield will re-brand Odebrecht Ambiental, which was named Foz until 2012. The deal is expected to be completed by the end of the year. Odebrecht, Latin America's largest engineering group, owns 70% of Odebrecht Ambiental, with Brazilian worker compensation and retirement fund FGTS owning the remaining 30%. It was not immediately clear whether FGTS would also sell its stake to Brookfield. The source said that last winter Odebrecht Ambiental chief executive Fernando Santos-Reis had discussed the possibility of selling a stake in his firm with Antoine Frerot, CEO of French group Veolia, as well as with Jean-Louis Chaussade, CEO of smaller rival Suez. Established in 2008, Odebrecht Ambiental is market leader in Latin America, serving more than 18 million people and several large companies in the steel, petrochemical and pulp and paper industries. Its Aquapolo project, which recycles Sao Paulo's sewage to produce water for a petrochemical complex is rated as the largest industrial water re-use project in the southern hemisphere. One of the world's top 10 water firms, Odebrecht Ambiental does not have a global presence like Veolia and Suez and in 2014 the firm announced plans to list some of its shares in 2015 or 2016 to finance its global expansion. But its parent company Grupo Odebrecht got caught up in a corruption probe at oil producer Petróleo Brasileiro and other state companies. The scandal has curtailed access to capital markets and loan funding for the group's 15 subsidiaries and the company is now selling assets to reduce debt.

Brookfield Property Partners LP – The Toronto Stock Exchange has accepted a notice filed by Brookfield Property Partners LP of its intention to renew its prior normal course issuer bid for a further one-year period. Brookfield Property stated that at times its limited partnership units trade in price ranges that do not fully reflect their value. As a result, from time to time, acquiring limited partnership units represents a desirable use of available funds. The notice provides that Brookfield Property may, during the 12-month period commencing Aug. 18, 2016 and ending Aug. 17, 2017, purchase on the TSX, the New York Stock Exchange and any alternative Canadian trading system, up to 13,097,963 limited partnership units, representing approximately 5% of its issued and outstanding limited partnership units. Under the normal course issuer bid, Brookfield Property may purchase up to 36,782 limited partnership units on the TSX during any trading day, representing approximately 25% of the average daily trading volume of 147,131 on the TSX for the most recently completed six calendar months prior to the TSX's acceptance of the notice of the normal course issuer bid. This limitation does not apply to purchases made pursuant to block purchase exemptions and purchases made on another exchange. All limited partnership units purchased by Brookfield Property under this bid will be promptly cancelled.

Northland Power Inc. announced that the Ontario Electricity Financial Corporation (OEFC) has brought a motion to the Ontario Court of Appeal regarding the retroactive payments found to be owing by OEFC under power purchase agreements to Northland's wholly-owned subsidiary, Iroquois Falls Power Corp., and Northland's managed facilities, Cochrane Power Corporation and Kirkland Lake Power Corporation. The motion seeks to set aside or vary the order of that court dated August 5, 2016, dismissing OEFC's motion for a stay of the portion of the Superior Court's global adjustment decision requiring the OEFC pay the retroactive payments to the Northland Applicants. Northland intends to oppose the motion. As described in Northland's recently issued quarterly financial statements, the OEFC is also seeking leave to appeal the decision in its entirety to the Supreme Court of Canada. Receipt of any retroactive payments will depend on the outcome and timing of the motion and any other appeal rights that OEFC may have. Northland expects to include the retroactive payments in income when received.

Global Dividend Payers

AT&T Inc. is joining Verizon Communications in raising the prices of some of its data plans. As with Verizon, AT&T is going to great lengths to avoid calling the changes a price hike, as the higher prices come with more data, reducing the cost per gigabyte for many customers. Indeed many customers will benefit, and those that won't can keep their existing plans. The price increase underscores how wireless companies see data as a way to boost revenue. Most plans now come with unlimited calls and texts. AT&T customers who want to keep their existing plans don't need to do anything. They can still add lines to their account, but won't be able to change data levels without switching to the new rates. AT&T also said that it would roll out a new data plan that does away with overage fees and reduces data speeds for wireless customers who surpass their data allowance. Customers can choose the new Mobile Share Advantage plan and pay for extra data, if needed, or work with slower data speeds instead of paying for overages, the company said in a statement. Its current plan includes a $5 data overage charge per 300 megabytes on its 300-megabyte plan and $15 per 1 gigabyte on other plans. AT&T and its rivals are locked in an aggressive battle for subscribers in the saturated U.S. wireless market. Data overage charges have long been a gripe for wireless customers who increasingly spend time on their mobile devices watching streaming video services such as Netflix and playing games such as Pokemon Go. The move came after AT&T's bigger rival, Verizon, announced a feature last month called "safety mode" that protects users against data overages and slows down speeds. Moreover, Verizon and AT&T have been reworking their plans as smaller competitors T-Mobile, which eliminated data overage charges in 2014, and Sprint, which offers half-off discounts, are luring customers away to their services. Plans above 10 gigabytes also include unlimited talk and text to Mexico and Canada and no roaming charges in Mexico.

BHP Billiton Plc's 2016 results were above consensus. The company reported underlying EBITDA of US$12.3 billion compared with company-collated consensus of US$11.9 billion (range US$11.4-12.8 billion). Last year the company reported US$21.9 billion. Petroleum EBITDA came in line at US$3.7 billion versus consensus of US$3.7 billion. Copper was the strongest division relative to forecasts with EBITDA of US$2.6 billion for 2016 versus consensus at US$2.0 billion. This was mainly driven by Escondida where there were higher recoveries from the bioleach pad extension, and due to absolute costs coming in 7% lower than guidance due to cost initiatives. Iron ore came in at US$5.6 billion in line with consensus at US$5.6 billion. Coal came in slightly ahead at US$0.6 billion vs. expectations of US$0.4 billion. Underlying attributable profit was US$1.2 billion versus consensus of US$1.1 billion and US$6.4 billion in 2015. Underlying basic earnings per share (EPS) was US$23/share compared with US$121 in 2015. In line with its new dividend policy (minimum of 50% of underlying attributable profit at every reporting period) the company declared a final dividend of US$14/share,

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making a full year payment of US$30 per share versus consensus of US$34/share. Period-end net debt was US$26.1 billion, still elevated from the US$24.4 billion reported at the end of 2015. The company made productivity gains of over US$400 million in the period and remains on target for US$2.2 billion of gains through 2017. Capital and exploration expenditure was US$6.4 billion, lower than the US$7.0 billion guidance. The company has maintained its capital and exploration guidance at US$5.0 billion for 2017, and has set a further productivity target for 2017 of US$1.8 billion.

Néstle SA reported sales much as expected (organic growth 3.5% in 1st half compared to consensus expecting +3.7%); with margins up 30bps (consensus had +20bps); outlook unchanged. The implied Q2 organic growth of +3.1% was about the lowest quarter Nestlé has ever reported. It may have been the lowest quarterly growth this century from Nestlé, but the whole industry has been struggling with top line and +3.1% for Q2 in the circumstances is in our view par for the sector. Mondelez International Inc. and Kraft Heinz Company reported negative volume growth. Nestlé highlights price at only 0.5% in Q2 with a number of areas negative - Europe, Asia, Water and "Other". The group expects pricing to pick up in the coming months and so retains its expectation of organic growth of close to last year's 4.2% (implies +4.8% H2). The margin, however, is a touch better than expected with again a big gross margin increase (+130bps on top of a similar increase last year) – allowing re-investment (marketing +90bps), but still an operating margin up 30bps. Again, the message from Nestlé looks much as we have seen elsewhere, that no input cost inflation leads to little pricing but gross margins are very strong.

Economic Conditions

U.S. – The National Association of Home Builders' (NAHB) housing market index advanced a couple of points in August, to 60, in line with the expectations, showing increased conviction in the strength of the US home building by the home builders themselves. **U.S. Housing starts unexpectedly rose 2.1% in July to 1.21 million** units (annualized) following an upwardly-revised 5.1% leap in June. The increase was spread across three of the four major geographical zones. It was led by the more volatile multiple-units sector, but single-family construction still rose modestly in the month and in the past year. While homebuilder confidence remains elevated, starts could pull back near term given the lower level of building permits, which inched down to 1.15 million after recent solid gains.

U.S. factories, mines and utilities increased production in July, adding backbone to the economy's recent revival following a soggy first half of the year. **Industrial output jumped 0.7%**, the most in 1½ years. While June's pace was scaled back to a 0.4% advance, this marked the first back-to-back gains in a year. Manufacturing output rose 0.5%, the most in a year, following a 0.3% increase the prior month. The strength was broadly based, with solid advances in consumer goods (autos, computers and other durable goods), construction supplies and, notably, business equipment. The latter could signal a much welcomed upturn in capital expenditure. Also, the decline in oil drilling has abated, helping to lift overall mining output 0.7% in the month (though it's still down 10% year/year). Oil and gas well drilling rose for a second month in a row following nine consecutive declines. Meantime, the heat wave across much of the country had air conditioners running flat out, juicing utilities demand for a second straight month. The spurt in industrial output lifted the capacity utilization rate to a nine-month high of 75.9%. But that's still well below inflation-threatening levels of above 80%. Hence, the still subdued inflation picture in our view.

Consumer prices were unchanged in July, as expected, trimming the yearly rate to 0.8%. A renewed slide in gasoline prices and flat food and clothing prices were offset by rising medical care costs and rents. The latter two are now at yearly rates of 4.0% and 3.3%, respectively, while food, clothing and new motor vehicle prices are virtually unchanged in the past year. Core prices edged up 0.1% in the month, shaving the yearly rate to 2.2%, bang on the average for 2016 though up from 1.8% in 2015.

Canada – Canadian retail sales retreated by 0.1% in June, surprising analysts which were expecting a 0.5% advance in the month and adding to the weakness experienced in June. Core retail sales, which excludes the impact of vehicles and parts transactions, were weaker still, down 0.8%, as other retail categories, such as building materials, clothing and general merchandising suffered in the month (the unusually warm weather might have played a role).

Canadian inflation, meanwhile, retreated a couple of tenths, as expected, to 1.3%, dragged lower by cheaper gasoline mostly. The core inflation reading, of 2.1% year on year rate of change, was flat and in line with the expectations.

Japan continued to record another month of trade surplus of JPY513.5bn in July (easing from JPY693.1 billion in June) **even as exports contracted for the 10th straight month at -14%year/year in July** (much worse from the -7.4% year/year decline in June but in line with the Bloomberg forecast of -13.7%), **while the contraction of imports worsened further to -24.7% year/year in July** (a further deterioration from the 18.8% in June and much worse than the Bloomberg median forecasts of -20%), the 19th straight month of decline, and the worst monthly contraction so far this year and also the steepest drop since October 2009. On an adjusted basis, the trade surplus was a much smaller JPY317.6 billion, a slight easing from JPY335 billion surplus in June.

Financial Conditions

The U.S. 2 year/10 year treasury spread is now .83% and the UK's 2 year/10 year treasury spread is .44% - 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 their costs of capital.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 3.43% (was 3.31% end of November 2012, the lowest rate since the Federal Reserve began tracking rates in 1971). Existing US housing inventory is at 4.7 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 finally supporting the housing market with housing inventory well off its peak of 9.4 months and we believe now in a more normal range of 4-7 months.

The VIX (volatility index) is 12.15 (compares to a post-recession low of 10.7 achieved in early June) and while, by its characteristics, the VIX will remain volatile, we believe a VIX level below 25 augurs well for quality equities.

Mutual Funds

Portland Investment Counsel Inc. currently offers 7 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

Private/Alternative Products

Portland also currently offers private/alternative products:

- Portland Focused Plus Fund LP
- Portland Focused Plus Fund
- Portland Private Income Fund
- Portland Global Energy Efficiency and Renewable Energy Fund LP
- Portland Advantage Plus Funds
- Portland Private Growth Fund
- Portland Global Aristocrats Plus Fund

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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