News Highlights

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PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. February 13, 2017

Energy Sector

U.S. land rig count increased by 12 rigs week/week to 712 rigs, up 83 rigs in the last four weeks and is up 92% off the May 2016 trough. The rig count is up on average 28% Quarter To Date quarter/quarter. Gains in Horizontal Oil (+9), Directional Oil (+2), Horizontal Gas (+2), and Directional Gas (+1) were slightly offset by declines in Vertical Oil (-2), while Vertical Gas remained flat week/week. Total horizontal land rig count is down 56% since the peak in November 2014 (See Fig. 1). The Permian currently makes up 53% of all oil rigs.

U.S. horizontal oil land rigs increased by 9 rigs week/week to 488, up 60 rigs in the last four weeks and is up 98% off the May 2016 trough, as gains in the Permian (+5), Eagle Ford (+5), "Other" (+2), and Mississippian (+1) were partially offset by declines in Woodford (-4), while Williston, DJ-Niobrara, and Granite Wash remained flat week/week.

Canadian rig count increased by 8 rigs week/week and is up 60% from the level this time last year.

U.S. Gulf of Mexico offshore rig count decreased by 1 rig week/week to 20 and is down 63% since June 2014.

BP PLC Q4 Results - Break-even point to cover capex and dividends is now $60/barrel by the end of 2017, up from the previous $50-$55/barrel. This reflects increased spending associated with the acquisitions made in December. Whilst we understand the rationale behind each of the acquisitions on its own it does appear that this represents a change in priorities. At the operating level, adjusted Earnings Before Interest, Tax and Amortisation (EBITA) of $856 million was 27% below consensus. The miss was driven mainly by a weaker than expected contribution from Downstream, but there was also a higher corporate charge. This was partly offset by a stronger than expected upstream contribution which at $400 million was over $1 billion better than a year ago and more than double consensus levels. In the upstream its estimated net income per barrel, excluding Rosneft, of $1.2/barrel of oil equivalent (boe). This is up $3.2/boe from a year ago compared to the $6.7/boe increase in the Brent oil price – an impressive capture ratio in our view. Downstream reported operating income of $877 million, disappointing relative to forecast of $1,288 million of profit. This was mainly driven by a weaker performance of the fuel business which was negatively impacted by a particularly large turnaround at the Whiting refinery and weak supply and trading performance. Headline cash flow from operations of $2.4 billion was down 58% year/year with a $2 billion release of working capital and was negatively impacted by $2 billion of Macondo payments. With cash dividends of $1.2 billion, there was a negative free cash flow post capital expenditure and dividends of $3.6 billion. Net debt of $35.5 billion at the end of Q4 2016 was 10% higher quarter/quarter. Hence, gearing (net debt to capital) of 26.8% was up 1% point quarter/quarter. Divestments in 2017 to be $4.5-$5.5 billion. Reserve replacement ratio estimated at 109% (including the impact of the Abu Dhabi renewal). Dividend unchanged at 10 cents/share flat quarter/quarter. CEO Bob Dudley and CFO Brian Gilvary hosted the post Q4 results call and were keen to highlight the progress made in 2016, particularly on the cost reduction side where the group achieved its 2017 target of reducing costs by $7 billion a year ahead of schedule. The focus from the questions was on the decision to make acquisitions that have the impact of increasing the cash break-even of the group to $60/barrel by the end of 2017 from the previous $50-$55/barrel. The management team did say that the confidence to do the transactions came from the underlying progress on costs and efficiency made together with the strong outlook for projects and maintained that once rebalancing achieved then will look to offset dilution from the scrip at the first opportunity. Ultimately whilst the delay in the rebalancing point by a year is unwelcome, we do understand the logic of the acquisitions in terms of adding long term value, and we should still see a material increase in cashflow into 2017 that supports the dividend.

Total SA - Adjusted net income of $2,407 million was 9% ahead of the company compiled consensus estimate. Upstream production of 2,452kboe/d (thousands of barrels of oil per day equivalent) was up 4% year /year and flat on last quarter. Q4 dividend increased 1.6% to €0.62/Share. 2017 cashflow break-even is expected to be $40/barrel pre-dividend. $50/barrel break-even including cash part of the dividend with the group planning to end scrip dividend at a $60/barrel oil price. Headline cashflow from operations of $7 billion was up 45% year/year with a $1.9 billion release of working capital. Net debt of $27.1 billion at the end of Q4 2016 was 11% lower quarter/quarter. Hence, gearing (net debt to equity) of 27.1% was down 3.5% quarter/quarter. The group reported reserve replacement rate of 136% at constant prices. Downstream expected to generate operating cash flow of $7 billion per year. $10 billion asset sales program over 2015-17 is about 80% complete.

Financial Sector

BNP Paribas SA reported Q4 2016 beat of 5% pre-exceptionals & 6% Profit Before Tax beat excluding Corp Centre and exceptional. However, in our view it looks a low quality beat with retail miss (restructuring) and Corporate & Investment Banking (CIB) beat mainly on costs not revenues. Headline revenues, costs & Operating profit are in line. Provision are 8% above consensus, leaving about a 10% net miss versus consensus at €1442 million given the restructuring charges, goodwill write down etc. On a reported basis, 14% miss in retail (€144 million restructuring costs), 27% beat in CIB though cost driven not revenues (Fixed Income, Currency and Commodity revenues €838 million (-22.5% quarter/quarter). French retail revenues -3.7% year/year versus -3.1% in Q3 2016. Core Equity Tier 1 11.5% was about in line with expectations with Dividend per share of €2.70, a bit shy of expectations. Management guided to a more subdued 2020 plan targeting 10% Return On Equity which may disappoint some but looks more realistic in our view.

Brookfield Asset Management Inc. released its financial results for the year ended Dec. 31, 2016. Net income for 2016 totaled $3.3 billion or $1.55 per Brookfield share, compared with $4.7 billion or $2.26 per Brookfield share in the prior year. Funds from operations (FFO) increased by 26% due to strong growth in asset management revenues and carried interests, although fair value changes declined relative to the prior year which led to an overall reduction in net income. The increase in FFO includes a 64% increase from the company's asset management business, which is a result of the continued growth in the company's fee-bearing capital, including capital raised in the company's private funds and the increased capitalization of the company's listed issuers. Operating FFO from invested capital increased by 22% as a result of the contribution from acquisitions and operational improvements throughout the company's businesses, including the commencement of leases and commissioning of development projects. Current-year FFO also included realized disposition gains of $923 million, compared with $842 million in the prior year, as the company continued to monetize assets as part of its continuing capital recycling program. The board declared a quarterly dividend of 14 cents per share (representing 56 cents per annum). This represents an 8% increase over the prior year. Fundraising of $30 billion in private funds has driven significant growth in the company's fee base and scale of its asset management business. Fee-bearing capital increased by 16% to $110 billion during 2016, driven largely by an increase of 44% in private funds. The company made solid progress in capital deployment, investing or committing $18 billion, putting capital to work for the company's clients, and progressing toward the next series of funds.

Fifth Street Senior Floating Rate (FSFR) reported core earnings of $0.20/share, and so under-earned the quarterly dividend of $0.225/share. NAV decreased 1.2% quarter/quarter to $10.86/share. Leverage fell slightly below the low end of the target range at 0.79x Debt /Equity (previously at 0.90x), but was expected since management noted last quarter that it should fall due to anticipated net repayments. On the dividend side, there were a couple of moving parts with FSFR cutting the dividend by about 16%, while also moving to a quarterly distribution going forward. FSFR declared $0.04/share monthly dividend for March 2017 or effectively $0.19/share for Q2 2017 ($0.075 monthly dividends previously declared for January and February 2017) and also announced a $0.19/share quarterly distribution for Q3 2017. Overall, the quarter's results were negative as core earnings missed estimates, and it's pretty apparent that FSFR's earnings power was insufficient to support the previous dividend so they had to cut to a more achievable level.

IGM Financial Inc. announced earnings results for the fourth quarter of 2016 and for the year ended Dec. 31, 2016. Net earnings available to common shareholders for the three months ended Dec. 31, 2016 were $233.0 million or 97 cents per share compared to net earnings available to common shareholders of $173.9 million or 71 cents per share for the comparative period in 2015. Operating earnings available to common shareholders, excluding other items, for the three months ended Dec.31, 2016 were $199.0 million or 83 cents per share compared to operating earnings available to common shareholders, excluding other items, of $198.2 million or 81 cents per share in 2015. Net earnings available to common shareholders for the year ended Dec. 31, 2016 were $770.5 million or $3.19 per share compared to net earnings available to common shareholders of $771.7 million or $3.11 per share for the comparative period in 2015. Operating earnings available to common shareholders, excluding other items, for the year ended Dec. 31, 2016 were $736.5 million or $3.05 per share compared to operating earnings available to common shareholders, excluding other items, of $796.0 million or $3.21 per share in 2015. Revenues for the three months ended Dec. 31, 2016 were $801.2 million compared to $752.1 million a year ago. Revenues for the year ended Dec. 31, 2016 were $3.04 billion compared to $3.03 billion a year ago. Expenses were $542.5 million for the fourth quarter of 2016 compared to $532.6 million a year ago and $2.10 billion for the year ended Dec. 31, 2016 compared to $2.04 billion a year ago. Total assets under management at Dec. 31, 2016 were $141.8 billion compared to $133.6 billion at Dec. 31, 2015. Mutual fund assets under management at Dec. 31, 2016 were $137.1 billion compared to $127.5 billion at Dec. 31, 2015.

Royal Bank of Scotland Group PLC - Numerous reports over the weekend on cost saves at Royal Bank of Scotland (RBS). Bloomberg says RBS is preparing to cut more than £1 billion of annual operating costs by eliminating jobs and closing branches as it seeks to bolster profitability. The Financial Times mentions £800 million of cost saves. RBS has said it will unveil fresh plans to meet profit targets alongside annual results on Feb. 24. The Sunday Times, citing an analyst it didn't identify, said RBS needed to cut 15,000 jobs, close branches and seek to save £1 billion-£1.5 billion and move to automation. RBS previously targeted a Cost /Income ratio of 55% in medium term and 50% in the long term (5 year horizon out to 2019). We think RBS would be unlikely to be able to deliver this amount of cost saves without further restructuring charges coming through, which would impact capital.

Activist Influenced Companies

Restaurant Brands International Inc., the owner of Burger King and Tim Hortons, reported a higher-than-expected quarterly profit as comparable sales at its burger chain topped estimates and costs fell.

Total comparable sales at Burger King rose 2.8% in the fourth quarter ended Dec. 31. Total costs at Restaurant Brands fell about 16% to $619.8 million, while total comparable sales at Tim Hortons, which operates mainly in Canada, rose 0.2% in the quarter. The company's net profit attributable to shareholders more than doubled to $118.4 million, or 50 cents per share, from a year ago, when it took a $37 million charge for the merger of Burger King and Tim Hortons. On an adjusted basis, Restaurant Brands earned 44 cents per share, beating the average analysts' estimate of 42 cents per share, according to Thomson Reuters. The Oakville, Ontario-based company's total revenue rose about 5% to $1.11 billion and was nearly in line with estimates.

Hertz Global Holdings Inc. – The new CEO, Kathryn V. Marinello, announced structural changes in North America. Jeffrey T. Foland has decided to step down as senior executive vice president and chief revenue officer of company.

Canadian Dividend Payers

Brookfield Infrastructure Partners LP – A Brazilian federal court suspended the $5.2 billion sale of state-controlled Petróleo Brasileiro SA's natural gas pipeline unit to a group of investors led by Canada's Brookfield Asset Management Inc. The Sergipe state-based court ruled the transaction, which was to be closed within weeks, be halted because of discrepancies in the way Petrobras proceeded with the sale. Petrobras said that it had been informed about the court's decision and that it planned to take "appropriate judicial measures" regarding the case, indicating it would appeal. The sale of the natural gas transportation system, called NTS (Nova Transportadora do Sudeste), was the main item of Petrobras' 2015-2016 divestiture program.

Global Dividend Payers

ABB Ltd. - The Serious Fraud Office in Britain confirmed on Friday that it has started an investigation into the activities of ABB's UK subsidiaries, their officers, employees and agents for suspected bribery and corruption, related to Monaco-based engineering and construction group Unaoil. The statement comes after ABB said in a Wednesday filing that it had 'self-reported to the Securities and Exchange Commission and the Department of Justice in the United States as well as to the SFO in the United Kingdom concerning certain of its past dealings with Unaoil and its subsidiaries, including alleged improper payments made by these entities to third parties.' It is worth highlighting that Unaoil has been linked to bribery cases with Samsung, Rolls-Royce, Halliburton, Siemens, L&T and Australia's own Leighton Holdings.

GEA Group AG's Q4 results came in largely as expected following the Q3 profit warning. GEA reported Q4 order intake of €1.22 billion came in some 3% ahead of consensus' €1.18 billion. That's still down 3% organically on last year, more importantly base orders are flat organically. On the 2017 guidance, the company says it aims to generate "moderate revenue growth" from the €4.5 billion level seen in 2016 and operating EBITDA is €620-€670 million. That's in line with forecast. The €450 million buyback program announced last week also largely as we expected going into the quarter. This will amount to 11.8 million shares (based on a share price of €38.2) and correspond to 6.1% of shares outstanding.

Syngenta AG - Strong full year free cash flow generation and fourth quarter sales of $12.8 billion: 2% lower at constant exchange rates but up 1% excluding Brazil sales terms change and 2015 corn trait royalty, with Q4 regional sales up 7% excluding corn trait royalty. Earnings before interest tax depreciation and amortisation $2.7 billion: margin 20.8% (2015: 20.7%) – a 1.3% improvement excluding corn trait royalty. $320 million savings from Accelerating Operational Leverage (AOL) program. Reported earnings per share $17.03 (2015: $17.78) and free cash flow $1.4 billion (2015: $0.8 billion). China National Chemical Corporation (ChemChina) transaction expected to close in second quarter of 2017.

Economic Conditions

U.S. – The U.S. consumer seems to be catching a breather, as indicated by a modestly tempered consumer sentiment index, as measure by the University of Michigan, which, for the month of February, pulled back to 95.7 index points from January's 98.1 reading and short of the expectations for a 97.9 print. Both the 'current conditions' and the 'expectations' components of this composite index contributed to the move lower. U.S. consumer credit also grew by a less than expected $14.16 billion in December, compared to an anticipated $20 billion and November's $25.21 billion advance.

Canada – Canadian economy added 48,300 new jobs in January, surprising on the upside, as 15, 800 full-time and 32,400 part-time positions were added during the month, in particular in services areas such as finance, real estate and insurance, building services and transportation. The headline unemployment rate moved one notch lower, to 6.8% from 6.9% for the month of December.

Canada's merchandise trade surplus came in at $0.92 billion in December, higher than what consensus was looking for ($0.3 billion). There were revisions dating back to the start of 2016, but note that November's $0.5 billion surplus is now doubled to $1.0 billion. That's back-to-back surpluses totalling just under $2 billion, the most in nearly three years. Exports fell 1% despite the weak CAD, while imports rose for the first time in three months (up 1.6%) despite the weak CAD. Higher oil prices helped widened the energy surplus to $6.4 billion, the highest since October 2014. In real terms, the surplus narrowed at the end of the year but for all of Q4, there was a sharp widening, suggesting that net exports added to trade in the last three months of the year. However, the report won't likely change Bank of Canada's Governor Poloz' view that a "rate cut is still on the table". Real

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exports fell, and non-energy exports dropped 1.1% in December, the 4th decline in the past five months. Then there was a separate report showing a sharp 6.6% drop in December building permits, with across-the-board weakness by sector (residential -4.1%, non-residential -11.4%) and by province (only Manitoba saw a rise in permits).

Japan's 4th Quarter 2016 Gross Domestic Product grew by 0.25% quarter/quarter, the fourth straight quarter of sequential expansion. Compared to the same period one year ago, the Japanese economy grew by an impressive 1.7% year/year in Q4 from +1.1% in 3Q and +0.9% year/year in Q1, the strongest growth since the revised 2.1% year/year in Q3 2015. The full year growth came in at 1.0% in 2016 from 1.2% in 2015.

Financial Conditions

U.S. Federal Reserve Regulatory Point Man, Daniel Tarulla to resign: "The Federal Reserve's lead architect of post-crisis financial regulations plans to resign this spring, giving President Donald Trump more freedom to remake the central bank and to accelerate a deregulatory agenda by putting his own appointees in charge of overseeing Wall Street reports Wall Street Journal. Daniel Tarullo, the Federal Reserve official who spearheaded the push to make banks safer after the 2008 financial crisis, plans to step down in early April, amplifying President Donald Trump's ability to reshape the central bank's oversight of Wall Street and monetary policy. Tarullo's departure means Trump will soon get to fill three of the Fed's seven board positions, as there are two existing vacancies. All governors have votes on the Federal Open Market Committee that sets U.S. interest rates. In addition, Janet Yellen's term as chair expires in February 2018, followed by Stanley Fischer's term as vice chair in June of next year. The openings give Trump the chance to significantly put his stamp on the world's most powerful central bank. (Source: Bloomberg)

Reserve Bank of Australia left rates unchanged at 1.5% overnight repeating that a rising AUD will complicate the adjustment of the economy and that inflation will remain low for some time despite optimistic growth for the economy.

The U.S. 2 year/10 year treasury spread is now 1.23% and the U.K.'s 2 year/10 year treasury spread is 1.18% - 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 4.17% (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 11.28 (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

Individual Discretionary Managed Account Models - SMA

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