News Highlights

Owners. Operators. And Insightful Investors.

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Established in 2007

Our views on economic and other events and their expected impact on investments. February 19, 2019

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Owner Operated Companies

Fortis Inc., a leader in the North American regulated electric and gas utility industry, released its 2018 fourth-quarter and annual financial results today. 'After considerable acquisition-driven growth in recent years, Fortis is a premier North American utility forging ahead with excellence in operations, sustainability and financial performance,' said Barry Perry, President and Chief Executive Officer, Fortis. 'In 2018 we launched our most ambitious utility capital expenditure plan ever at $17.3 billion for the period 2019 to 2023.' Fortis benefits from its vast geographic and regulatory diversity, low carbon footprint and the move to a cleaner energy future. The company's net earnings for the year were $1,100 million, or $2.59 per common share, compared to $963 million, or $2.32 per common share, for 2017. For the fourth quarter of 2018, net earnings were $261 million, or $0.61 per common share, compared to $134 million, or $0.32 per common share, for the same period in 2017. The increase in annual earnings was driven by growth at both the regulated and non-regulated businesses, as well as lower income tax expense. The lower income tax expense primarily related to a one-time expense in 2017 associated with U.S. tax reform, along with the positive tax impacts of electing to file a consolidated state tax return and designating assets as held for sale in 2018. On an adjusted basis, net earnings attributable to common equity shareholders for 2018 were $1,066 million, or $2.51 per common share, an increase of $0.04 per common share compared to 2017. On an adjusted basis, for the fourth quarter of 2018, net earnings attributable to common equity shareholders were $241 million, or $0.56 per common share, a decrease of $0.02 per common share compared to the same period in 2017.

Energy Sector

Berkshire Hathaway Inc. – Warren Buffett's Berkshire Hathaway Inc. said it had taken a fresh stake in Suncor Energy Inc. for the second time in about six years. Suncor, Canada's biggest oil and gas company, is considered one of the safest Canadian energy companies to invest in, given its integrated structure and diversified business mix. Berkshire's investment puts the Buffett stamp on Suncor and could be seen as a positive for the Canadian energy sector. The move comes at a time when global investors have been pulling away from Canada because of its struggle to approve pipelines. Berkshire said in a filing with the U.S. Securities and Exchange Commission that it has a stake of 10.8 million shares in the company, representing about 0.7% of Suncor's total outstanding shares, according to Eikon data from Refinitiv. The new position comes more than two years after Berkshire sold its stake in Suncor. Berkshire took a position in Suncor in 2013 and exited its stake in 2016.

Financial Sector

Ares Capital Corp.'s Q4 2018 core net investment income per share of $0.45 was above the consensus of $0.41/share. Most items came in higher than expected, but the beat was mainly from structuring fees, as the company had a strong origination quarter and saw gross commitments of approximately $2.7 billion. Book value per share was $0.04/share lower quarter/quarter at $17.12. Ares also announced they would be raising their dividend by $0.01/share a quarter to $0.40/share and also announced a special dividend of $0.08/share to be paid out over the next four quarters. Overall, this was a strong quarter as results beat across the board, with the measured increase in the dividend highlighting the continued positive momentum of the company in our view. Ares had $2.7 billion of new commitments during Q4 2018 of which approx. 72% were in first lien, 22% were in second lien securities, 1% in subordinate certificates, with the remainder in other equity and preferred securities. Against that, Ares had approx. $1.0 billion of exits. The portfolio mix at quarter end was 47% first lien (vs. 44% previously), 29% second lien (vs. 30%), and 5% in certificates of the Senior Direct Lending Program (vs. 6% previously). Overall yield on debt and income producing securities at amortized cost decreased 10 basis points to 10.2%. Balance Sheet Leverage was approx. 0.71x debt to equity, up modestly from the prior quarter. Based on board approvals, Ares can go beyond 1x Debt/Equity cap in June of this year. Management indicated that the goal is to take leverage up at a measured pace over a 2-3 year period (within a new target range of 0.90-1.25 Debt/Equity), investment environment permitting, which should improve the Return On Equity profile over time. Management indicated that the market recovered modestly since the technical sell-off in Q4 2018. However, some retail loan funds continue to experience outflows this year. Management is optimistic that these changes in supply will drive an improvement in pricing and terms in the lending environment.

HSBC Holdings PLC produced a weak set of Q4 2018 numbers. Profit Before Tax Q4 2018 was $3,256 million compared with consensus $4,293 million. Included -$131 million of adjustments. Underlying Profit Before Tax Q4 2018 (incl. bank levy) was $3,387 million or -24% (-$1,055 million) below expectations. The miss was driven predominantly by weaker revenue (Global Banking and Markets & Wealth Management) and Impairments (incl. $165 million Brexit charge), whilst underlying costs came in 2% (+$130 million) better. Pre-provision $4,646 million was -14% (-$778 million) light. Underlying revenue at $12.6 billion was -7% (-$908 million) below consensus. Equates to year/year +1% or quarter/quarter -9%. All divisions looked disappointing except for the Centre in our view. Q4 2018 Net Interest Margin of 1.63% (versus 1.73% in Q3 2018)

was very disappointing given rate environment. Note that includes additional liquidity holdings with Net Interest Income only -2% light. Underlying operating expenses at $7.9 billion, -2% (+$130 million) better than expected, despite a -$76 million Argentina hyperinflation adjustment. Quarter/quarter costs were +2%, which is perhaps a little disappointing in the context of revenue -8%. Q4 2018 year/year cost / income jaws of -5%/+5%. Impairments at $853 million were +34% (-$215 million) worse than expected. Primarily reflects $165 million Brexit-related uncertainty charge. Core Equity Tier 1 - 14.0% is -0.3% below consensus expectations. Tangible Net Asset Value of 701 cents per share was flat on Q3 2018 and -5 cents per share below 706 cents per share consensus. Outlook – they have made a "good start" to the year albeit with some credit softening in the U.K. That said note "despite more challenging market conditions and weaker global economic outlook" they are committed to targets.

RioCan Real Estate Investment Trust - Q4 2018 Funds From Operations (FFO) per unit (excluding gains on marketable securities and lease termination income) was $0.41 (up +2%). Operating results were generally positive in our view. The REIT's major market growth was up 2.2%, while secondary locations were up +1.3%. Management still expects Net Operating Income (NOI) for the total portfolio to range between 2.0% and 3.0% on the back of higher rents and occupancy in 2019. Occupancy improved this quarter, while positive renewal spreads (+5.0%) should ensure NOI growth remains on track. Portfolio Occupancy for Q4 2018 was 97.1% on a committed basis, up 10 basis points quarter/quarter and up 50 basis points year/year. Sears re-leasing continues to progress well: the space is 74% leased at rents 55% above previously in-place rents. Debt to Total Assets as of Q4 2018 stood at 42%. The disclosed interest coverage ratio was 3.63x above management target of 3.00x. The weighted average term of fixed debt was 3.3 years. Debt/EBITDA sits at 7.8x, up slightly from 7.5x a year ago. In terms of liquidity, RioCan has total liquidity of approximately $819.6 million comprised of $647.0 million undrawn on credit lines, $97.9 million undrawn on construction facilities, and $74.5 million of cash and cash equivalents. During the quarter, RioCan continued to sell secondary assets to reposition the portfolio to core urban markets, with eleven dispositions totaling $217.8 million ($974.9 million for the year). While RioCan did not acquire any assets during the quarter, it did purchase a $35.2 million property in Hamilton and the remaining 50% interest in a property in Calgary for $70.4 million post-quarter. Lastly, RioCan estimates that on its first five mixed-use projects (total cost of $574 million), they will yield close to 5.7% on cost. Based on its assessment of market capitalization rates, RioCan believes the assets will trade closer to a 4.2% capitalization rate, creating roughly $231 million in value (approx. $0.75/unit, of which approx. 0.54 has already been reflected in the International Financial Reporting Standards fair value).

Royal Bank of Scotland Group PLC - Profit Before Tax in Q4 2018 was £572 million, +54% ahead of consensus £371 million. However, excluding one-offs it was £536 million, 44% ahead of consensus so bottom line miles ahead but all driven by impairment and litigation costs. Pre-provision earnings excluding strategic and litigation costs of £1,000 million were -6% below – mainly in costs, which was about £50 million too high. Guiding next year on cost being £300 million lower than last year but that's still about £100 million higher than consensus. Net Interest Margin in the fourth quarter was 1.95% in line with management guidance. Special dividend was good at 7.5 pence per share versus 3 pence per share consensus. Paying 3.5 pence per share final. Core Equity Tier 1 16.2% versus 16.5% consensus but difference mainly due to special dividend although Risk Weighted Assets did come in 2% lower so still would have expected capital a little better. Cost income was guided to below 50% for 2020 which RBS now say will be a challenge although consensus at 53%. Tangible Net Asset Value per share of 286 pence.

Activist Influenced Companies

Brookfield Business Partners L.P. (BBU) reported financial results for the quarter ended December 31, 2018. "We had another successful year in 2018, with strong growth in funds from operations reflecting contributions from recent acquisitions, as well as improvements and organic growth within our operations. During the year, we invested approximately $500 million in high quality businesses across our sectors and geographies and generated $1.5 billion from monetization activities," said Cyrus Madon, CEO of Brookfield Business Partners. "We are focused on integrating and executing operational plans for our recent acquisitions, including Westinghouse, and on closing the acquisition of a leading global battery manufacturing business from Johnson Controls." Brookfield Business Partners reported Company FFO for the year ended December 31, 2018 of $733 million, or $5.67 per unit (excluding incentive distribution), compared to $252 million, or $2.22 per unit in 2017. Company FFO for the year benefited from significantly improved results in our industrials segment and the incremental contributions of companies acquired during the year which included One Toronto, Schoeller Allibert Holding B.V. and Westinghouse Electric Company LLC. Net income attributable to unitholders for the year was $422 million compared to $24 million in 2017. Net income per limited partnership unit was $1.11. In November 2018, together with institutional partners, BBU reached a definitive agreement to acquire 100% of Johnson Controls Inc.'s Power Solutions business for a purchase price of approximately $13.2 billion (approximately $750 million of equity to be funded by BBU). In January 2019, together with institutional partners, BBU signed a definitive agreement to acquire up to a 100% controlling interest in Healthscope Group for a purchase price of approximately $4.1 billion. Healthscope Group is Australia's second largest private hospital operator and the largest pathology services provider in New Zealand.

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Barrick Gold Corp. reported adjusted EPS of 6 cents per share, in line with consensus of 6 cents per share. Q4 2018 gold and copper production was pre-announced. **2019 gold production** guidance of 5.1 to 5.6 million ounces. The midpoint of guidance (5.35 million ounces) is approximately 5% below 2018 pro forma production. The lower production is largely driven by lower production from Barrick Nevada. Cash costs are expected to be higher at $650-700/oz, approx. 13% higher at the midpoint than 2018 of approx. $600/oz and analysts' estimate of $606/oz. Management notes that 2019 cash costs are affected by the planned completion of mining at the comparatively high-grade, low-cost, Cortez Hills open pit in the first half of 2019, partially offset by lower costs at Turquoise Ridge, as well as the addition of lower cost production from Loulo-Gounkoto and Kibali. Management expects higher grades, improved efficiencies, and cost discipline to reverse this trend over the next two to three years. 2019 copper guidance is for 375-430 million pounds. The midpoint is approx. 5% higher than 2018 production of 383 million pounds. Copper C1 cash costs are expected to improve to $1.70-$2.00/lb, as compared to $1.97/lb in 2018. Attributable 2019 capex is forecast at $1.4 to 1.7 billion. 2019 general and administrative expenses (G&A) (ex-stock compensation) is forecast at approx. $160 million and reflects the recent G&A cost reductions. Barrick's year end 2018 gold reserves were 62.3 million ounces, down from 64.4 million ounces at year end 2017. Randgold Resources Ltd. year end 2018 reserves were 13 million ounces, down from 14 million ounces at year end 2017. Barrick's reserves were estimated using a $1,200/oz gold price (unchanged) while Randgold continued to use $1,000/oz. During 2019, reserves and resources of newly acquired Randgold will be combined with Barrick's on the basis of common calculation criteria and will be reported on that basis at the end of the year. At its recent investor day, management noted that the common criteria would be approx. $1,000/oz.

BHP Billiton PLC released earnings for the first half of 2019. Underlying Net Profit After Tax was US$4 billion whereas consensus was US$4.21 billion, Underlying EBITDA US$10.5 billion (CS US$10.65 billion, consensus US$10.63 billion) – all on a continuing operations basis. Interim dividend 55 pence per share – a 75% payout (first half 2018 payout 72%, first half 2017 66%). Dec. 31 net debt was US$9.9 billion (consensus US$9.7 billion). Commodity prices clearly driving near term sentiment but BHP have no changes in mind to alter output in Iron Ore with steady capacity creep still the path being trodden. No doubt a stronger second half 2019 is required (consensus forecasts roughly an approximately 40/60 first half 2019/second half 2019 skew), so achieving guidance and ideally putting first half 2019 operational challenges behind them a focus for the next 6 months.

Nestle S.A. – Fiscal Year 2018 organic sales grew by 3.0% (3.7% in Q4 2018 benefitting from an easier comparator and strong performances in infant nutrition, pet care and confectionery) of which 0.5% represented price. Consensus expectations were 3.0% and 0.6% respectively. Developed markets 1.6%, Emerging Markets 4.9%. Changes in scope (+0.7%) and a 1.6% Foreign Exchange headwind led to a 2.1% increase in reported sales to SFr 91.44 billion. Underlying margins increased 50 basis points to 17.0% (consensus 17.0%). Gross margin +50 basis points, Distribution -30 basis points (higher freight costs), Administration, Marketing, R&D +30 basis points. A 13% increase in underlying EPS to SFr 4.02 (a 14% increase in constant currencies). Consensus SFr 3.89. A lower tax charge (23.8%) explains 5% of the increase and the SFr 7 billion buyback another 2%. Year End net debt of SFr 30.3 billion (cash flow helped by a further improvement in working capital), representing 1.6x Fiscal Year 2018 EBITDA. CEO Ulf Mark Schneider is targeting "continued improvement" in organic sales growth and "an underlying margin improvement towards our 2020 target". The Herta meat business (sales SFr 0.7 billion) has been placed under strategic review. The SFr 20 billion buyback is now scheduled to complete by end of 2019 (6 months earlier).

Newell Brands Inc. just reported Q4 2018 Core EPS of $0.71, which compares to consensus $0.66 due to a lower tax rate being offset by a difference in discontinued operations. Core sales were down -1.2% with outperformance in Food & Appliances offsetting a slower recovery in Learning & Development. Gross margins were up +180 bps and Operating margins were up +80 basis points. But guidance is disappointing. Though the change to "normalization practice" and effective restatement of prior "normalized" EPS to now include many costs previously deemed one-time in nature is an important headline, the weaker outlook is much more driven by fundamental performance. Recall that in late November, the company named a new CFO, Chris Peterson, who is quickly making his mark on financial reporting. In terms of 2019 guidance, "normalized" EPS of $1.50-1.65 is more than 25% below current consensus. We believe approximately 6% is due to a new lower 2018 base, 4% is from lower core sales growth than previously expected and the balance reflects less operating margin expansion. Notably, with the outlook calling for just 20-60 basis points of operating margin expansion, we'd think that prior 2020 guidance for post-transformation plan margin structure is now off the table.

Economic Conditions

U.S. retail sales were very weak in December. The headline 1.2% drop was the largest since September 2009. Although a sharp drop in pump prices held back the headline, as expected, other categories piled on: cars, furniture, groceries, health and personal care. Only sales of building/garden equipment and cars rose in December. Every other category was down. The pullback in discretionary areas such as food/drink services, and sporting goods/hobby stores and E-commerce are areas that consumers, if they are worried, will step

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back from first. Those consumer confidence figures (Conference Board, University of Michigan) that are near/at 2-year lows were quite telling in our view. If the jobs data weren't still strong, this might have been weaker. For the purposes of Q4 2018 GDP, Core retail sales (which strip out autos, gas and building materials) fell 1.7%, the largest drop since January 2000, which was a weak hand-off to the new year. One has to wonder, given the big miss by consensus, if the quality of the report was compromised by the shutdown and the rush to get the report out. Maybe there will be revisions in coming months. The market meltdown in December may have also played a role in consumer psychology. Meantime, this suggests that the word "patience" will be in the Fed's vernacular for some time.

Germany's economy just about avoided falling into recession during the final three months of last year. The German economy registered zero growth during the fourth quarter of 2018, the country's Federal Statistics Office said. That means it avoided two consecutive quarters of contraction, which is the usual definition of a recession. A weak trade performance dragged on the economy, and consumer spending remained subdued. The zero growth recorded in the October-to-December period followed a 0.2% contraction in the previous quarter. Reasons for slower growth last year include a slowdown in the global economy and a weaker car sector, with German consumers less willing to buy new cars amid confusion over new emission standards. In addition, low water levels, particularly in the Rhine, affected growth by holding back movement of some goods. (Source: BBC)

Japan's preliminary Q4 2018 GDP saw growth rebounding 0.3% quarter/quarter (1.4% annualized rate) from an downwardly revised contraction of -0.7% quarter/quarter (-2.6% annualized rate) in Q3 2018, more or less in line with market expectations. When compared to the same period one year ago, Japan's Q4 2018 GDP recorded a marginal -0.01% year/year decline (from 0.1%year/year in Q3 2018), the first year/year decline since Q4 2014. The growth rebound in Japan's fourth quarter was solely due to domestic demand (0.6 percent) which more than offset the fall in external demand (-0.3 percent). Within domestic demand, the pillars of support came from private spending which grew 0.6% quarter/quarter (from -0.2% quarter/quarter in Q3 2018 but slightly missing the Bloomberg median forecast of a 0.7% increase) and public spending too (0.8% quarter/quarter in Q4 2018) while capital expenditure (capex) staged an unexpectedly strong rebound of 2.4% quarter/quarter (from -2.7% in Q3 2018 and well above the projected +1.8% increase). Another bright spot was a 1.1% quarter/quarter increase in housing investment in Q4 2018 (from 0.6% in Q3 2018), although again, it did not have much of a material impact on headline growth. Public fixed investment took another dive, albeit contracting by a smaller -1.2% quarter/quarter in Q4 2018 (from -0.6% in Q2 2018 and -2.1% in Q3 2018) while the fall in private inventories shaved another -0.2% off headline growth. As for external demand weakness, Q4 2018 exports rebounded by 0.9% quarter/quarter (from -1.4% in Q3 2018) but that was more than offset by a 2.7% quarter/quarter jump in imports, resulting in a net -0.3% contribution of external demand.

Financial Conditions

The U.S. 2 year/10 year treasury spread is now 0.15% and the U.K.'s 2 year/10 year treasury spread is 0.43% 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 2-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 4.37% (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 3.9 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 16.16 (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:

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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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