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. March 04, 2019

Owner Operated Companies

Danaher Corp. didn't wait long to begin financing its pending acquisition of General Electric Co.'s biopharma business. The company commenced concurrent $1.35 billion common stock and $1.35 billion 3-yr mandatory convertible preferred stock offerings to fund a portion of the $21 billion purchase price. Danaher could raise just shy of $3 billion if full overallotment options are exercised for both offerings. When the acquisition was announced, Danaher said it expected to finance part of the all-cash transaction with approximately $3 billion of proceeds from an equity offering, including potential mandatory convertible. The GE biopharma business transaction will not close until the fourth quarter, pending regulatory approvals. Barclays and Goldman Sachs are leading the offerings. The convertible offering is being marketed with a dividend yield of 5.25%-5.75% and a conversion premium of 17.5%-22.5%.

Energy Sector

Cardinal Energy Ltd. announced its base operating budget for 2019 that will focus on a sustainable dividend, long-term operating cost reduction initiatives, debt repayment and maintaining its production volumes at 2018 levels. Operating cost reduction initiatives are targeting an 8% reduction in operating costs within 2019. Cardinal forecasts debt repayment of 10% to 15% of total debt by year-end. Low corporate decline rate allows for a conservative capital program to maintain production levels which are currently curtailed by the Alberta government. Pursuant to the company's normal course issuer bid announced in December 2018, Cardinal confirmed that in 2019, it has purchased and cancelled the maximum allowable of 10% of the outstanding balance of debentures, below par redemption value, saving approximately $0.3 million of future interest and redemption costs. Cardinal's 2019 base budget is expected to produce adjusted funds flow of approximately $90 to $100 million, assuming a royalty rate of 17%, a West Texas Intermediate ("WTI") oil price of US$55/barrel, US/CAD exchange rate of 0.76 and a $1.47 per thousand cubic feet AECO (Alberta Energy Company) natural gas price. With the company's operating cost reduction initiatives, Cardinal is forecasting to reduce operating costs per barrel throughout 2019 by approximately 8% comparing first quarter to fourth quarter 2019 estimated operating expenses. Cardinal's base capital program includes the drilling of six (6.0 net) oil wells in the company's Bantry, Alberta area to take advantage of a land earning farm-in opportunity. Cardinal also expects to drill two (1.5 net) wells in its Midale, Saskatchewan area where provincially mandated production curtailments are not in place.

Whitecap Resources Inc. delivered another year of double-digit production per debt-adjusted share growth of 16% to achieve record annual production of 74,415 barrels of oil equivalent per day (boe/d) in 2018 along with solid funds flow per fully diluted share of $1.67 per boe, an increase of 23% from the prior year. Expenditures on property, plant and equipment (PP&E) in 2018 of $440.5 million was approximately $10-million lower than projected as the company limited capital expenditures late in the fourth quarter in response to the wide crude oil price differentials. The capital program included the drilling of 261 (216.3 net) wells and was the largest in the company's history allowing it to once again deliver on its business model of self-financed growth including dividends despite the volatility in commodity prices. In 2018, the company generated funds flow of $704.4 million, invested $440.5 million for organic production growth and made dividend payments of $132.3 million which resulted in $131.6 million of free funds flow. Shareholder returns were enhanced in 2018 as the company increased the monthly dividend by 5% to 2.7 cents per share (32.4 cents per share annualized) from 2.57 cents per share (30.84 cents per share annualized) and reduced its common shares outstanding by 6.3 million shares through Whitecap's normal course issuer bid.

Financial Sector

Bank of Montreal (BMO) reported adjusted cash EPS of $2.32 (+10% Year/Year) well above consensus of $2.23 with the beat mainly related to lower provisions (+10 cents; large consumer recovery in US) slightly offset by a lower tax rate. Total revenue was impacted by restatements made this quarter. Total bank Provisions for Credit Losses (PCL) was $137 million (13 basis points; similar to last year), well below consensus at $205 million. Specific PCLs on impaired loans were $127 million, benefiting from U.S. consumer recovery (C$36 million). Otherwise, the PCL is consistent with recent quarters. Core Equity Tier 1 ratio of 11.4% (+10 basis points Quarter/Quarter) was slightly above consensus of 11.3%. The sequential increase mainly related to strong internal capital generation (+28 basis points) and securities gains (+11 basis points), slightly offset by higher Risk Weighted Asset growth (-17 basis points), regulatory changes (-14 basis points), and share repurchases (-3 basis points; 1 million in quarter). Canadian P&C Banking earnings growth (adjusted) was stable Year/Year. Revenue increased 3% Year/Year, and expenses rose 3% implying flat operating leverage. Loan growth was up 5% Year/Year and margin declined to 2.61% (-1 basis point Quarter/Quarter). U.S. P&C Banking adjusted Net Income (in US$) increased 34% Year/Year, mainly driven by a large credit recovery (stable credit environment). Strong revenue (+8% Year/Year) benefited from loan growth of 11% Year/Year (solid commercial lending) and Net Interest Margin of 3.71% (+2 basis points Quarter/Quarter). Expenses were controlled again (+2% Year/Year) generating adjusted positive operating leverage of >5%. Capital Markets adjusted Net Income fell 3% Year/Year. Revenue was +4% Year/Year, benefiting from higher investment banking activity (+16% Year/Year) while trading revenue was slightly lower (-3%) Year/Year. Expenses rose 9% Year/Year mainly due to the KGS-Alpha Capital Markets acquisition. Wealth Management adjusted Net Income fell 10% Year/Year with insurance Net Income down 21% against a tough prior year. Traditional Wealth Net Income fell 5% Year/Year as weaker markets more than offset growth from new client assets. Assets Under Management growth was modest at +1% Year/Year.

The Bank of Nova Scotia (BNS) reported adjusted cash EPS of $1.75 (flat Year/Year; excluding pension revaluation benefit last year), below consensus of $1.82. This represents BNS's third consecutive earnings miss. Relative to expectations, total revenue and credit provisions were in line, but higher expenses and lower tax rate drove the variance. By segment: Canadian Banking and Global Banking and Markets underperformed, while International benefited from prior acquisitions (e.g. Banco BBVA Chile). Management maintained its acquisitions outlook to achieve adjusted EPS accretion of approximately $0.15/share by Fiscal Year 2020. Adjusted total bank Provisions for Credit Losses were $688 million and on impaired loans $679 million (47 basis points; +5 basis points Quarter/Quarter) vs. consensus of $645 million. Higher provisions came mainly from Canadian and International banking, while there was a recovery in Capital markets due to improving credit quality in the Oil & Gas portfolio. Core Equity Tier 1 (CET1) ratio of 11.1% came in flat Quarter/Quarter. Internal capital generation (+28 basis points) was offset by Risk Weighted Asset growth (-12 basis points), pensions (-9 basis points), and share repurchases (-3 basis points or 3.25 million shares in Fiscal Q1 2019). Quarterly dividend was increased to $0.87/share (in line; +6% Year/Year), or 2% representing a current dividend yield of 4.6%. Concurrent with the quarter, BNS entered a Non-Binding Memorandum of Understanding (MOU) on its interest in Thanachart Bank Public Company Ltd. and potential merger of TBank Ltd and TMB Bank Public Company Limited. The transactions are expected to reduce its investment in Thailand and have a positive impact on BNS's CET1 ratio of approximately 25 basis points.

Canadian Imperial Bank of Commerce (CIBC) reported its second quarterly EPS miss, mainly relating to much larger than expected provisions. There were positive points in the quarter: (1) settlement of the Enron Corp. case (removes overhang); (2) U.S. Commercial Banking & Wealth Management (adjusted Net Income rose 24% Year/Year); (3) Canadian Commercial Banking & Wealth Management (positive operating leverage of 5.6%, supported by loan growth of 13% Year/Year). Core Equity Tier 1 ratio of 11.2% (-20 basis points Quarter/Quarter) ranks below peers. CIBC raised its quarterly dividend by 3% (implying yield of 5.0%), but no share repurchases in Fiscal Q1 2019. The firm plans to grow dividends in line with EPS growth. With a pattern of dividend increases every other quarter, management's signal of at least 5% dividend growth in Fiscal 2019 is consistent in our view with its target of achieving EPS growth at the bottom end of its 5-10% medium-term range. The main priority for excess capital is to support organic growth.

Crown Capital Partners Inc. has announced it has completed an upsizing of approximately $43 million for Crown Capital Power Limited Partnership increasing the Fund's total capital to approximately $58 million. Launched in June 2018, Crown Power Fund is a private fund that intends to provide investors with attractive, utility-like income through the direct ownership of integrated energy platforms that provide electric and thermal energy under long term contracts to mid- to large- scale energy consumers, such as industrial and commercial businesses, recreational facilities and condominiums, offering these customers more energy efficient, more reliable and less expensive energy than comparable services from public utilities.

JPMorgan Chase & Co., the biggest U.S. bank by assets, said it expects to face rising costs for deposits, a key part of its business, and slowing global economic growth. Still, executives, speaking at the bank's annual investor day, painted a picture of stable financial performance and maintained a key profit goal for the next three years. Chief Financial Officer Marianne Lake said while JPMorgan is strong in many of its businesses, the bank was uncertain whether the near-term future for interest rates and the U.S. economy would provide the underlying strength that could boost its bank-wide profit targets. Lake said the bank expects deposit growth to slow and the interest it pays for them to rise, reducing profit margins on its loans. At the same time, new regulations are making those loans less profitable and pushing the bank to invest more in securities. "The further out you go, the less confidence we have that we won't see" changes in interest rates and a downturn in the economy, Lake said, when asked why the bank did not raise its target for profitability. The bank accounts for about 14% of U.S. banking industry revenue, according to estimates by analysts at Barclays. (Source: Australian Finance Review)

Standard Chartered Plc (StanChart) is preparing the ground for a sale of its stake in Indonesian Bank Permata Tbk PT as part of plans to free up capital to return to investors via share buybacks. The bank last week signaled its intention to divest its roughly 45% stake in the Indonesian lender by saying that it would reclassify its holding as "non-core". StanChart announced the move alongside a new three-year strategic plan that aims to boost its return on equity — a key measure of profitability — to more than 10% by 2021, from its current level below 5%. The lender also said it would restructure its operations in four under-performing markets — Korea, Indonesia, the United Arab Emirates and India — although it stopped short of announcing a complete exit from any of the 60 countries where it operates. Chief Executive Officer Bill Winters added: "We already have a healthy investment budget baked into our plans, so incremental capital generation should be available for buybacks in the relatively short term." (Source: Financial Times)

The Toronto-Dominion Bank's (TD) cash operating EPS of $1.57 missed consensus expectations of $1.70/$1.71. The miss was in Wholesale Banking, which reported a loss this quarter. Canadian Private & Commercial (approximately 75% of Canadian Retail) was up 8% and U.S. Retail (excluding TD Ameritrade Inc. (AMTD)) was up 9%. Provisions for Credit Losses (PCL) ratio of 50 basis points (vs. 44 basis points) reflected in part a name-specific provision in U.S. utility. Core Equity Tier 1 was a strong 12%. TD increased its quarterly dividend by 10% to $0.74 per share. Canadian Retail segment's earnings of $1.86 billion were up 6% Year/Year with Canadian Private & Commercial up 8% to $1.42 billion, on 6% average earning asset growth and 1 basis point better risk-adjusted margins and positive 2.6% operating leverage. In Canadian Wealth & Insurance, the balance of the segment, earnings were flat Year/Year on flat Assets Under Administration. U.S. Retail (excl. AMTD) segment's earnings of $929 million were up 9% Year/Year, with 15 basis points higher risk-adjusted margins and 8% volume growth offsetting essentially neutral operating leverage. Year/Year average loan growth in source currency of approximately 3% was below the 5-6% rate the segment had been delivering in the past year with commercial loan growth of approx. 4% and consumer loan growth of approx. 3%; unsecured personal loan growth was approx. 3%. Wholesale Banking segment's net loss of $17 million compared with recent trough level of approx. $223 million hurt by lower trading revenue of $251 million (down 51% Year/Year) and weak origination activity (lack of client activity and higher market volatility); expenses were up 18% Year/Year.

Activist Influenced Companies

Nomad Foods Ltd. reported better-than-expected sales for the last quarter of 2019, as the company benefited from acquisitions of frozen food brands Aunt Bessie's and Goodfella's Pizza. Nomad has been strengthening its European frozen foods brands in a bid to boost sales, starting with the acquisition of Goodfella's Pizza in April last year. The company also bought Aunt Bessie's, known for its Yorkshire puddings and frozen potatoes, for €240 million in July last year. The acquisitions boosted the frozen food maker's revenue growth by 17.3% points in the fourth quarter ended December 31, 2018. "We are pleased with our progress integrating Aunt Bessie's and Goodfella's, which have outperformed their plans since being acquired in the middle of 2018," Chief Executive Officer Stéfan Descheemaeker said in a statement. Nomad's revenue surged 21% to €614.8 million, beating the average analyst estimate of €588.5 million, according to Refinitiv. Net income rose to €40.8 million in the quarter from €27.3 million a year earlier. Excluding items, the company earned €0.29 per share, in line with the average analyst estimate.

Dividend Payers

Bunzl Plc - Full year constant currency revenue growth of 9%. Organic growth: 4.3% in Q4 2018 and 4% in Q3 2018. Acquisition contribution of approximately 5%. FX: 3% drag. Net debt: £1,387 million, 6% below expectations. One new acquisition announced last week which is engaged in the sale of personal safety equipment in the U.S., with revenue of $93 million in 2018, which we believe the group paid approx. £90 million. Management says the acquisition pipeline remains active. Outlook: Management expects organic growth and is continuing to focus on improving operating efficiencies to offset cost inflation pressures. In our views these are solid (not exciting) numbers, as usual. The shares are trading on approx. 19x 2019 expected P/E and approx. 15x EV/EBITA, with a 2.1% dividend yield and an approx. 5% free cash flow yield.

Northland Power Inc. reported Q4 2018 EBITDA (adjusted) of $221.3 million, above consensus of $215.8 million ($202.0 million - $229.8 million). Funds From Operations came in at $88.7 million reflecting a payout ratio of 60.4%. Northland Power provided 2019 expected EBITDA (adjusted) guidance in the range of $920 million – $1,010 million. Management expects 2019 expected Free Cash Flow in the range of $1.65 – $1.95 per share. The 2019 expected guidance includes Pre-completion revenue from Deutsche Bucht of $55 million - $75 million and reversion to normalized wind resource at Gemini and Nordsee One. Toronto Stock Exchange approved Northland's application to proceed with a normal course issuer bid commencing December 17, 2018 and ending December 16, 2019. Northland may purchase up to 8.0 million common shares representing approximately 4.5% of Northland's issued and outstanding common shares. Northland provided updates on its projects under development: Deutsche Bucht (DeBu) – Northland expects to invest $804.2 million in capital expenditure on the DeBu project, which is expected to be completed by the end of 2019 expected; Hai Long – Northland expects the 1,044MW Hai Long wind project (60% ownership interest) to begin commercial operations in 2025. Management expects to secure Power Purchase Agreements in 2019 and move forward with procurement and supply chain strategies. Northland Power subsequently announced it has signed a 20-year Power Purchase Agreement (PPA) under Taiwan's Feed-in-Tarif (FiT) program for the 300 MW (gross) Hai Long 2A project (the first of the three Hai Long projects). Recall, Hai Long comprises a total 1,044 MW (gross) offshore wind project in Taiwan, which is expected to begin commercial operations in 2025. The remaining two projects (Hai Long 2B and Hai Long 3) look to secure agreements under auction. Northland owns 60% of the project and the remaining 40% is owned by Yushan Energy PTE Ltd.

WPP Plc – Fiscal Year 2018 net sales declined 2.4% to £12,827 million, down 0.4% on an organic basis (30 basis points better than consensus). EBITA declined 8.9% to £1,962 million, 1% below consensus. Headline EPS declined 10.3% to £108.0, 1% better than consensus. The Company's press release states "we have begun the process of seeking a financial and strategic partner for Kantar." The results presentation states "preparation for Kantar progressing well, launch of sale process imminent, expected to announce outcome in Q2". We believe that WPP intends to use a similar structure to Thomson Reuters' disposal of their market business, Refinitiv, i.e. sell a levered asset and as such we do agree with management that WPP can sell The Kantar Group Limited without impacting EPS.

Economic Conditions

Canada's consumer price index (CPI) was up 0.1% (not seasonally adjusted) in January, taking the year/year inflation rate down to 1.4% (from 2.0%), which was in line with consensus. In seasonally adjusted terms, CPI was down 0.1% as rises in food, shelter, clothing and alcohol/tobacco/cannabis were more than offset by declines in household operations, transportation and healthcare. Recreation/education was flat. The Bank of Canada's preferred core measures on a year on year basis were as follows: 1.9% for CPI-trim, 1.8% for CPI-median and 1.9% for CPI-common, all in line with consensus. Also note that with this release, the basket of goods and services used in the calculation of the CPI was updated using 2017 weights instead of 2015 weights. One major change is that cannabis was introduced in the basket this month. Medicinal cannabis is added in Health and personal care major category. Recreational cannabis prices, however, will be trackable under the alcoholic/tobacco major category rebranded as alcoholic beverages, tobacco products and recreational cannabis which now represents 3.16% of the basket (2.58% in 2015). Recreational cannabis represents 0.55% of the basket and its price is in a downward trend since its peak in 2004 ($11.26 per gram in 2004 vs. $7.15 per gram in 2017). The release of the January 2019 CPI will also mark the implementation of methodological changes for rent index which represents 6.2% of the CPI. In summary inflation was in line with expectations for January. This weakness was expected as gasoline prices dropped for a 6th consecutive month and a pullback was expected given the past month's surge in the air transportation component. However, the central bank should not be overly concerned by this monthly weakness in our view as it was far from being widespread among components. Indeed, the Bank of Canada's preferred measures, which are less affected by moves in specific components, registered stronger increases. On a year-over-year basis, the average of the three core measures remains close to 2%, the mid-point of the Bank of Canada's inflation target range.

U.S. economy - Real GDP grew 2.6% annualized in Q4 2018, slowing from 3.4% in Q3 2018. This was a little better than the consensus estimate. For all of 2018, growth came in at 2.9%, the best since 2015, while on a Q4/Q4 basis, the economy grew 3.1%, the fastest since 2005. It is estimated that a good percentage point of the expansion was due to the temporary fiscal boost. Consumer spending slowed to a still-solid 2.8% pace in Q4 2018 from 3.5% in Q3 2018, as the impact of tax cuts waned. But a 4.2% annualized jump in personal disposable income amid strong job growth provided underlying support. Spending likely fell in the final month of the year, based on dismal retail sales, as confidence was dinged by the tumult in equity markets. However, with stocks getting off to their best annual start in over two decades, confidence is bouncing back, and another burst of hiring in January will also support spending in Q1 2019. Business investment was a big positive surprise, with non-residential spending soaring 6.2% on the back of a 6.7% jump in equipment spending and a large 13.1% increase in intellectual property products. Tariffs and the trade war are denting business sentiment, but evidently not enough to seriously derail hiring or spending plans in our view.

China Economy - The Caixin Purchasing Manufacturers' Index (PMI) jumped to 49.9 last month — close to the 50 mark that divides expansion and contraction — and soundly beating the consensus of 48.5. Similar to recent signals in the official PMI data, the forward-looking new orders showed a strong rebound, Bloomberg Economics said.

Financial Conditions

Greece – Credit Rating Agency Moody's has raised Greece's sovereign rating two notches to B1 from B3; outlook stable.

The U.S. 2 year/10 year treasury spread is now 0.19% and the U.K.'s 2 year/10 year treasury spread is 0.50% - 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 4.35% (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 13.69 (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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