News Highlights

Owners. Operators. And Insightful Investors.

Phone: 1-888-710-4242
Web: www.portlandic.com
Email: info@portlandic.com

PORTLAND INVESTMENT COUNSEL®

Established in 2007

Our views on economic and other events and their expected impact on investments. December 13, 2019

Owner Operated Companies

Liberty Latin America Ltd. announced that Dr. John C. Malone has retired from the Liberty Latin America Board of Directors, and will transition to a Director Emeritus role going forward. As a Director Emeritus, Dr. Malone may attend Board meetings and provide active support and advice to Liberty Latin America, but will not have a vote on matters presented to the Board. "The Board and the management team appreciate John's invaluable contributions to Liberty Latin America and we look forward to continuing to benefit from his counsel and advice as a Director Emeritus," said Mike Fries, Liberty Latin America's Executive Chairman. Dr. Malone said, "I have decided to retire from the Board of Liberty Latin America to reduce my travel schedule and focus on fewer board positions. Liberty Latin America has made great progress over the last two years as an independent company and is well-positioned for future success and growth. I remain significantly invested and interested in the Company's performance and look forward to continuing my strong relationships with the board members and management team in an advisory capacity." In conjunction with Dr. Malone's retirement from the Board, on December 12, 2019, the Board elected Daniel Sanchez who will bring a tremendous amount of experience and expertise to Liberty Latin America. Mr. Sanchez currently serves as a director of Discovery, Inc. and Lions Gate Entertainment Corp., and was previously a member of the Starz Board of Directors from 2013-2016. Mr. Sanchez is Dr. Malone's nephew.

Linamar Corporation announced that it has entered into an exclusive Strategic Manufacturing Agreement with Synaptive Medical Inc. to manufacture Synaptive's patented Modus V™ and Evry™ products. Concurrently with this Agreement, Linamar also announced a US$5 million equity investment in Synaptive. The announcement closely aligns with Linamar's innovation and diversification strategy by bringing significant value to an innovative early stage company for mutual growth. It allows Linamar to participate as both a shareholder and manufacturer in the rapidly growing and dynamic medical device and biotech market. Linamar initially plans to incubate the manufacturing of Synaptive's products at the Linamar Innovation Hub in Guelph, Ontario.

Oracle Corporation reported Q2 2020 results, which included revenue that fell short of quarterly revenue estimates as growth in its cloud services failed to counter declines in its traditional licensing business. The company has been aggressively pushing into cloud computing to compensate for a late entry into the fast-growing business that helps companies move away from the traditional on-premise model. Oracle has announced plans to hire 2,000 additional workers to roll out its cloud computing service to more locations to compete with bigger rivals Amazon Web Services (AWS) and Microsoft Azure. In Oracle's second quarter, revenue from cloud and on-premise license business fell 7% to $1.13 billion, while revenue from cloud services and license support rose 3% to $6.81 billion. Chairman Larry Ellison said on a post-earnings call that there were no plans to hire a second CEO after former co-chief Mark Hurd died in October 2019. Hurd and Safra Catz were named co-CEOs in 2014, after Ellison decided to step aside to focus on his role as Chief Technology Officer. Total revenue rose to $9.61 billion in Q2 2019, but fell short of analysts' average estimate of $9.65 billion. Excluding extraordinary items, the company earned 90 cents per share, beating estimates of 88 cents per share.

Energy Sector

Cardinal Energy Ltd. announced that its Board of Directors has approved an operating and capital budget for 2020 that will focus on debt reduction, a sustainable dividend, operating costs reductions and increasing production volumes. Cardinal also announced that the Toronto Stock Exchange (TSX) has accepted the notice of Cardinal's intention to commence a normal course issuer bid (NCIB). Cardinal's 2020 operating budget is expected to produce adjusted funds flow of approximately $125 to $130 million ($1.11 per share), assuming a royalty rate of 17%, a West Texas Intermediate (WTI) oil price of US$55/bbl, US/CAD exchange rate of 0.76 and a $1.75 per one thousand cubic feet (MCF) Alberta Energy Company (AECO) natural gas price. During 2020, Cardinal's operating expenses per boe are forecasted to decrease by approximately 5% over 2019 levels due to the Company's 2019 cost reduction projects in operation for 2020 combined with new cost reduction projects being forecasted to be implemented in 2020. Cardinal's 2020 budget includes the abandonment of over 80 non-producing wells and reclamation of 100 inactive leases. In addition, the budget forecasts a 15% reduction in net debt.

Financial Sector

HSBC Holdings plc has announced a reshuffle of its top executives and hired a new chief operating officer and a new interim chief executive officer, Noel Quinn. In addition, Marc Moses, the bank's chief risk officer, will be replaced by Pam Kaur, head of wholesale market and credit risk. Mr. Moses will continue to "provide support" to Mr. Quinn until next December. HSBC also announced it would replace its existing chief operating officer with John Hinshaw. Andy Maguire, who currently holds the role, will retire in June 2020. HSBC confirmed that Samir Assaf would step down as the head of its investment bank, to take on a new role as chair of corporate and institutional banking.

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He will be replaced by two co-heads: Georges Elhedery, who runs the bank's markets business, and Greg Guyett, head of banking.

Activist Influenced Companies

Pershing Square Holdings, Ltd. – Billionaire investor William Ackman's hedge fund Pershing Square Capital Management said it bought shares in testing equipment company Agilent Technologies Inc., only its second new investment this year as the fund has reported a 51% return. Agilent, which serves the life sciences, diagnostics and applied chemical markets, was created two decades ago when it was spun off from Hewlett-Packard.

Dividend Payers

Barrick Gold Corporation announced the divestiture of its 83.25% stake in the Massawa project in Senegal to Teranga Gold Corporation for total attributable proceeds of $398 million. This includes approximately $278 million in cash and around $74 million in stock (19.2 million shares at $3.85 per share, 11.45% stake in Teranga), plus a contingent payment of up to approximately $46 million over the next three years post-closing of the transaction, which is expected in Q1 2020. The headline $430 million sales price includes total proceeds received by both Barrick and its Senegalese JV partner that held a combined 90% stake in Massawa (the Government of Senegal retained its 10% stake in the project). The total proceeds of $398 million represent a valuation of 1.6x Price/NAV. However, excluding the contingent payment (around $46M attributable to Barrick), the valuation is still healthy at 1.4x Price/NAV, in our view. The total consideration is close to the $500 million flagged in the media in July 2019 and therefore should not be a big surprise to the market. The sale of Massawa plus Kalgoorlie brings total non-core asset sale proceeds to $1,148 million ($398 million for Massawa and $750 million for Kalgoorlie). Barrick has a target of $1.5 billion by the end of 2020.

Nestle S.A. has announced an agreement to sell its U.S. ice cream business for $4 billion to Froneri (in which Nestle has around a 45% share). Brands include: Dreyer's/Edy's, Haagen Daaz and Skinny Cow. The deal is expected to complete in Q1 2020. The business had sales of $1.8 billion in FY 2018 and it is estimated that sales grew mid-single digits in the first nine months of this year. Froneri's Net Debt/Adjusted EBITDA at end of 2018 was just over 6x. It is estimated the deal would reduce Nestlé's Net Debt/EBITDA by 0.1x. In October, Nestle announced a SFr 20 billion buyback commencing next year. It is conceivable this is enlarged or accelerated once this deal completes. Following the sale of Nestlé's Europe, Middle East and Africa (EMEA) ice cream business to Froneri in 2016, there is a clear logic to this deal for both parties, in analysts' view (it was made simpler by the closure of the direct store distribution operation this business shared with Nestlé's U.S. frozen food business earlier this year).

Northland Power Inc. announced that John W. Brace, a current Director of Northland, has been named Chair of the Board effective immediately. James C. Temerty has stepped down as Chair but will continue to serve as a Director of the company. Mr. Temerty has led the company since its inception in 1987 and was instrumental in shaping Northland as it grew from a start-up Canadian Power Producer to a global player in the renewable power sector. Mr. Temerty commented, "I am extremely proud to have worked with some of the most talented and dedicated professionals in the power sector over my 32 years with Northland. I also want to acknowledge the tremendous contribution that all current and past board members have made to Northland's success. I have every confidence that the company will continue its track record of steady growth with John leading the Board and I look forward to my continued involvement with Northland." Mr. Brace joined Northland in 1988, shortly after the company was founded. He was appointed Chief Executive Officer (CEO) in 2003 and served in the role until his retirement in 2018.

Economic Conditions

U.K. Election brought in the biggest Conservative majority since 1987 and means political certainty and improved clarity with respect to domestic affairs, and direction of travel regarding Brexit. Key pledges from the new Prime Minister & his government include: Brexit done by January 31st 2020; Invest record sums in the National Health Service (50,000 more nurses and 40 new hospitals); 20,000 more police; Investment in science, education, infrastructure and action to reach Net Zero emissions by 2050; all without raising the rate of income tax, VAT or National Insurance. U.S. President Trump tweeted that the U.K. and U.S. "will now be free to strike a massive new Trade Deal after BREXIT", potentially "far bigger and more lucrative than any deal that could be made with the E.U.".

U.S. Consumer prices rose 0.3% in November 2019, with nudging from higher gasoline prices, lifting the yearly rate to 2.1% from 1.8%. Core prices rose an expected 0.2%, holding the yearly rate at 2.3%, just a tick above this year's average. While the six-month pace is running hotter (at 2.8%), this reflects some heating up in the summer. Both it and the yearly pace are likely to fall in coming months in analysts' view, as the 3-month pace has ratcheted down to 2.1% from a recent high of 3.4% in August 2019.

U.S. Retail sales rose a light 0.2% in November 2019, with offsetting revisions the prior two months (October up 0.4%, reversing September's similar-sized decline). Clothing sales continued to sag, partly due to lower prices, while auto sales revved higher (0.5%) and non-store retailers continued to prosper (0.8%). Of some concern, discretionary spending on sporting goods and restaurants retreated for a second straight month. The control group (retail sales excluding food services, cars, gas and building materials) that feeds into personal spending cooled to a 0.1% advance from 0.3% in October 2019. The consumer is, in our view, downshifting given the fading effects of tax cuts, but arguably, remains well positioned to help drive the expansion into 2020.

Equifax Canada reported that the average Canadian consumer owed $72,500 in debt at the end of September 2019, an increase of 2.1% compared to the same time last year. Non-mortgage debt was up 1.5% to $23,800, a significant slowing from recent trends. In total, Canadians owed $1.966 billion in consumer credit, a rise of 4.1% from the same time last year. Much of the increase in consumer debt came from mortgages, which was up 4.5% to $1.320 billion. Non-mortgage debt rose 3.2% to $646 billion, the slowest year/year growth rate since early 2016. "Consumers finally seem to be tempering their appetite for credit with slowing growth in non-mortgage debt in the last two quarters," said Bill Johnston, Vice President of Data & Analytics at Equifax Canada. "That is a positive sign, as other indicators suggest more people are challenged with their current financial situation." The most recent data indicates that more Canadians are missing their monthly payments. The 90-day-plus delinquency rate for non-mortgage credit rose 9.7% to 1.15%, the highest Q3 reading since 2012. British Columbia (14%), Ontario (12.4%) and Alberta (12%) had the most significant increase in delinquency. All age groups reported more missed payments after Seniors had become the first group to show the impact in late 2018. Mortgage delinquencies have also been on the rise. The 90-day-plus delinquency rate for mortgages rose to 0.18%, an increase of 6.7% from last year. Ontario (17.6%) led the increases in mortgage delinquency followed by British Columbia (15.6%) and Alberta (14.8%). The most recent rise in mortgage delinquency extends the streak to four straight quarters.

Financial Conditions

The U.S. Federal Reserve, as widely expected, left the fed funds rate unchanged at 1.50-1.75%. The rate paid on excess reserves was also kept at 1.55%. The Fed says the current stance of monetary policy "is appropriate to support sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2% objective". As in the last statement, the Fed was encouraged by the "solid" labour market but bemoaned weakness in exports and business investment. The Fed's decision to keep rates unchanged was unanimous. The Fed's new economic projections: The central tendency forecast for real GDP growth (Q4/Q4) was trimmed slightly for 2019 to 2.1-2.2% (versus 2.1-2.3% previously), but raised for 2020 to 2.0-2.2% (versus 1.8-2.1% previously), while 2021 and 2022 were little changed. The central tendency projections for the unemployment rate were lowered slightly over the forecast horizon. Central tendency PCE inflation forecasts were lowered slightly in 2019 and 2020 (1.8-1.9% versus 1.8-2.0% previously) but the Fed expects inflation to return to its 2.0% target in 2021. Central tendency forecasts show participants' estimate of the "longer run" or equilibrium interest rate at 2.4-2.8%, slightly lower than previously estimated. The dot plots show 13 Federal Open Market Committee participants expecting rates to remain unchanged through 2020, with the remaining four expecting a 25 basis point rate increase next year.

Canada's biggest banks are being ordered again to set aside more capital to guard against shocks, as reported by Bloomberg, an indication the country's banking regulator is getting more concerned about vulnerabilities such as household debt. The Office of the Superintendent of Financial Institutions (OSFI) lifted its so-called domestic stability buffer for Canada's six-biggest banks to 2.25% of total risk-weighted assets, effective April 30, 2020. This marks the third 0.25% increase since the regulator started publicly disclosing the buffer in June 2018. Vulnerabilities to banks including Royal Bank of Canada and Toronto-Dominion Bank, "remain elevated, and in some cases show signs of increasing," the regulator said in a statement from Ottawa this week. Those include Canadian household indebtedness, asset imbalances and institutional indebtedness, OSFI said. "In addition, global vulnerabilities related to ongoing trade tensions and rising leverage are growing, which could increase the chance of a spillover of external risks into the Canadian financial system," the regulator said. Against a backdrop of low interest rates and stable economic conditions, the regulator said it was "prudent" to build additional resilience against potential shocks to the financial system, according to OSFI.

The U.S. 2 year/10 year treasury spread is now 0.25% and the U.K.'s 2 year/10 year treasury spread is 0.25% - 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 3.73% (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 13.11 (compares to a post-recession low of 18.00 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.

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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, 'GDP' gross domestic product, 'netback' is a measure of oil and gas sales revenues net of royalties, production and transportation expenses and is used to compare performance in the oil and gas industry, 'ROE' return on equity, 'ROTE' return on tangible equity, 'ROTCE' return on tangible common equity.

Portland Investment Counsel Inc., 1375 Kerns Road, Suite 100, Burlington, Ontario L7P 4V7 Tel.:1-888-710-4242 • www.portlandic.com • info@portlandic.com

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