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. December 23, 2019

Owner Operated Companies

Berkshire Hathaway Inc. – The auto insurer Geico named Todd Combs, one of Warren Buffett's portfolio managers at Berkshire Hathaway Inc., as its chief executive officer. Todd Combs, 48, will take over on Jan. 1, 2020, replacing Bill Roberts, who became chief executive officer in June 2018 and will become a Geico vice chairman. Roberts had succeeded his long-time predecessor Tony Nicely, who remains Geico's executive chairman. The change adds to Combs' responsibilities at Berkshire, which he joined in 2010, and where he will continue to oversee about $14 billion of investments. Many investors consider Combs and Buffett's other portfolio manager, Ted Weschler, the top candidates to succeed Buffett as the Omaha, Nebraska-based conglomerate's chief investment officer. Combs is also a director at JPMorgan Chase & Co. and helped spearhead the creation of Haven, the venture among Berkshire, JPMorgan and Amazon.com Inc. to reduce employee healthcare costs.

Brookfield Asset Management Inc. – Brookfield Infrastructure Partners LP will buy telecommunications company Cincinnati Bell Inc. for about $529.42 million. Under the deal, Cincinnati Bell shareholders will receive $10.50 per share, representing a premium of 36% to the company's last closing price. Including debt, the deal is valued at $2.6 billion.

Carnival Corporation – forecast 2020 profit is largely above analysts' expectations and reported better-than-expected quarterly earnings, driven by strong demand for its Caribbean cruises. The company expects adjusted profit between $4.30 and $4.60 per share for its financial year ending 2020. "The Caribbean remains strong in occupancy and yield growth overall for our brands," said Chief Executive Officer Arnold Donald on a post-earnings conference call. Changes in fuel mix, fuel prices and currency exchange rates are expected to increase earnings by $0.17 to $0.24 per share in fiscal 2020 compared with 2019, the company said. Carnival's net revenue rose 7.3% to $4.78 billion, helped by efforts to draw passengers and increase on-board spending through attractions such as roller coaster rides, IMAX theaters, water parks and live music. Revenue from on-board spending, which accounts for nearly a third of total revenue, jumped about 30% to $1.52 billion. Excluding extraordinary items, the company earned 62 cents per share in the fourth quarter ended Nov. 30, 2019.

Danaher Corporation – U.S. medical equipment maker Danaher secured conditional EU approval for its $21.4 billion bid for General Electric's biopharma business after agreeing to sell five businesses to address competition concerns. Danaher unveiled the deal in February, which will boost its presence in the biopharma industry, giving it access to tools for research and development of drugs. The European Commission said Danaher will sell businesses in the United States, China, France and Britain after it voiced concerns that the deal would have reduced competition and pushed up prices of certain products in some markets.

Energy Sector

Nothing significant to report.

Financial Sector

A group of global banks, including Barclays, UBS, Citi, JP Morgan and BNP Paribas, were ordered to pay a total of $337 million to settle antitrust claims around the alleged rigging of the $550 billion market for bonds backed by Fannie Mae & Freddie Mac. Barclays has agreed to pay $87 million, while a group of 12 others (including affiliates) have agreed to pay a total of $250 million. Details of the split between banks are not disclosed. For Barclays, while this amount was not specifically reserved, the matter is now firmly put to bed. Very simplistically, assuming an equal split of the $250 million among the 12 banks, we come to around US$21 million, which is manageable for all, and may not be visible in the P&L thanks to litigation provisions in place.

Standard Chartered PLC has sold its stake in Indonesia's Bank Permata for $1.3 billion in a move that will free up capital that could be used to fund a fresh share buyback. The bank said it had sold its 44.56% stake in the lender to Bangkok Bank, which also acquired a stake of the same size from Astra International. Bill Winters, chief executive officer of Standard Chartered, said: "The sale of our stake in Permata will allow us to focus on our wholly-owned business in the… Indonesian market, and will release capital for reinvestment or return to shareholders." (Source: Financial Times)

Activist Influenced Companies

Pershing Square Holdings Ltd (PSH) announced an additional share buyback program for $100 million of PSH's outstanding public shares on the London Stock Exchange and Euronext Amsterdam Stock Exchange. The program will commence following the completion of the previously announced $100 million share buyback program. The program is accretive to net asset value per share and will reduce PSH's capital. As of December 13, 2019, PSH had completed 49.5% of the previously announced $100 million share buyback program. PSH commenced that program on October 29, 2019 and has repurchased a total of 2,692,215 PSH public shares at an average price of $18.40 per share. Since PSH commenced its first share buyback program on May 2, 2017, PSH has repurchased a total of $527 million of PSH public shares, representing 35,823,841 PSH public shares at an average price of $14.70 per share. Jefferies International Limited will continue in its role as sole buyback agent for the program which will enable the purchase of shares during closed periods.

Dividend Payers

Brookfield Infrastructure Partners LP's (BIP) $375 million investment into Indian telecom towers has been confirmed as expected - management has been speaking about this opportunity for some time. BIP and its institutional partners have agreed to purchase around 130,000 telecom towers in India from Reliance Jio; this business generates stable and predictable cash flows and it should benefit from expected increases in data usage. The towers are recently constructed and are well-positioned for the rollout of 5G and other future technologies given they are largely connected by fiber. There is also opportunity to create further growth with a 45,000 tower build-out program, which Reliance Jio has committed to partially fund.

Bunzl plc- Little change in underlying trading in Q4 2019 with organic sales growth modestly weaker but still around -1%, while margins remain firm. There's some positive news on acquisitions with one new deal announced last week and management commentary about as positive as it gets before deals complete. The new acquisition is FRSA (Fire Rescue Safety Australia) which is based in Perth and is a distributor of specialist safety and protection equipment focused on fire, with annual sales of around £19 million. The company is said to have paid a multiple of 7 times earnings before interest and taxes (EBIT) for the acquisition. As we look into 2020, there's a foreign exchange downgrade of around 3% due to the strength of the pound but otherwise no change to expectations. This has been an unusual year with organic growth and acquisitions both weak. Acquisition spend for the year is at around £120 million compared to the £300 million average in recent years. The pipeline continues to be described as active with discussions ongoing. Analysts' expect 2020 to see trends improve with acquisitions likely to increase in the first half and organic growth to pick up in the second half, once the drag from the Walmart contract annualizes.

Economic Conditions

Canada's budget - Bloomberg reported that Prime Minister Justin Trudeau's government released new budget estimates that showed federal finances in much worse shape than expected, even before the Liberals move ahead with tens of billions of dollars in new campaign pledges. According to the article, the government is currently on track to run a deficit of $26.6 billion this year and $28.1 billion in 2020, according to a fiscal update released last week in Ottawa by Finance Minister Bill Morneau. That's above the $19.8 billion and $19.7 billion deficits projected in the government's last budget. Deficits in the five years between 2019 and 2023 will exceed projections by about $35 billion. The article notes that the Liberals pledged new annual measures that were expected to cost about $15 billion annually over the next four years, though planned tax increases will buffer some of the impact on deficits. As such, it will be a difficult balancing act for Trudeau. Not only must he finance his own ambitious campaign pledges, he may also need to accommodate new demands from provinces and opposition parties. At the same time, he's trying to reassure Canadians, and credit rating agencies, the government remains fiscally prudent by keeping debt as a share of the economy on a declining path.

Canadian Home Sales Rise for Ninth Consecutive Month – data released by the Canadian Real Estate Association (CREA) indicates that the number of homes sold nationally rose 11.3% in November 2019 compared with a year ago. According to the article, the increase in sales came as the national average price for a home sold in November was about $529,000, up 8.4% compared with a year ago. Excluding Greater Toronto and Greater Vancouver, the average price was about $404,000, up 6.9% compared with last year. The article notes that price gains also saw regional variances, with the Greater Vancouver benchmark price down 4.59% from a year ago and Prairie home prices also down, while Greater Toronto saw gains of 6.52%, Greater Montreal had gains of 8.72% and Ottawa registered gains of 11.45%. For 2020, CREA says it expects home sales to rise 8.9% next year to 530,000 (vs. its revised 2019 forecast of 482,000 home sales). The national average price is forecast to rise 6.2% to $531,000.

U.S. housing starts jumped 3.2% in November 2019, beating expectations, to a 3-month high of 1.365 million units annualized. October's gain was revised higher - instead of a 3.8% increase, we are now looking at a 4.5% rise. More ground was broken for both single-family construction (up 2.4% to a near one-year high) and multi-family construction (up 4.9%), with the former key as it accounts for two-thirds of total starts. The one negative to point out is that the increase in starts was not everywhere—the Northeast and the Midwest were down, but the biggest region, the South, saw a sizeable rise, as did the West. An indication of future starts, building permits unexpectedly rose for the second straight month, up 1.4% to 1.482 million units annualized, the highest since May 2007.

U.S. industrial production jumped a higher-than-expected 1.1% in November 2019 (the same month that the manufacturing ISM production index reached a 3-month high), the largest monthly gain since October 2017 (right after Hurricane Irma) and snapping two consecutive declines. The forever-volatile utilities component tacked on a sizable 2.9% increase (colder-than-usual weather), but even removing that impact, production was still up a very respectable 0.8%. Mining lost ground for the third month in a row. But the all-important

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manufacturing sector rebounded 1.1% (thanks to the return of GM as production of motor vehicles and parts surged 12.4%). Note that manufacturing still remains 0.7% below year-ago levels, even with this jump.

Financial Conditions

The U.S. 2 year/10 year treasury spread is now 0.27% and the U.K.'s 2 year/10 year treasury spread is 0.22% - 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 12.63 (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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ON BEHALF OF ALL OF US AT PORTLAND WE WISH YOU A MERRY CHRISTMAS, HAPPY HOLIDAYS AND WITH BEST WISHES FOR THE NEW YEAR!

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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.

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