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. January 27, 2020

Owner Operated Companies

Brookfield Asset Management Inc. – Brookfield Infrastructure Partners LP's takeover of target Cincinnati Bell Inc. has received a competing bid of $12 per share from an infrastructure fund. As previously announced on Dec. 23, 2019, Cincinnati Bell entered into a definitive agreement through which Brookfield Infrastructure Partners LP and its institutional partners would acquire all of the outstanding shares of common stock of Cincinnati Bell for $10.50 per share in cash. Cincinnati Bell has commenced discussions with the fund regarding the proposal following Cincinnati Bell's board of directors having made the required determinations under the Brookfield merger agreement that allow it to do so. The Brookfield merger agreement remains in effect and accordingly the Cincinnati Bell board reaffirms its existing recommendation in support of the transaction with Brookfield Infrastructure at this time. Cincinnati Bell has headquarters in Cincinnati, Ohio. Cincinnati Bell delivers integrated communications solutions to residential and business customers over its fibre optic and copper networks including high-speed Internet, video, voice and data. The company provides service in areas of Ohio, Kentucky, Indiana and Hawaii. In addition, enterprise customers across the United States and Canada rely on Cincinnati Bell Technology Solutions and OnX Enterprise Solutions, wholly owned subsidiaries, for efficient, scalable office communications systems and end-to-end IT solutions.

Energy Sector

Baytex Energy Corporation announced its year-end 2019 reserves, Q4 2019 and year-end preliminary unaudited financial and operating results, which included: production in 2019 through the high end of annual guidance, $329 million of FCF and a 17% reduction in net debt. Each of the company's core properties (Eagle Ford, Viking and Heavy Oil) contributed substantial asset level FCF. Baytex also achieved a strong year of reserves development with proved developed producing (PDP) reserves increasing 5% with finding and development costs of $13.04 per boe and a recycle ratio of 2.3x. Average production during Q4 2019 was 96,360 boed (83% oil and NGL) and 97,680 boed for full-year 2019. Exploration and development expenditures totalled $153 million in Q4 2019, bringing aggregate spending for 2019 to $552 million. Baytex realized an operating netback (inclusive of hedging) of $29.89 per boe in Q4 2019 and $29.47 per boe for the full-year 2019. For 2020, Baytex entered into hedges on approximately 48% of its net crude oil exposure, largely utilizing a three-way option structure on 24,500 barrels per day that provides West Texas Intermediate (WTI) price protection at US$58.04 per barrel with upside participation to US$63.06 per barrel. Crude-by-rail is an integral part of the company's marketing strategy for its heavy oil production. For 2020, Baytex is contracted to deliver approximately 11,000 barrels per day of its heavy oil volumes to market by rail. In addition, the company entered into Western Canadian Select (WCS) differential hedges on 2,500 barrels per day at a WTI-WCS differential of US$16.10 per barrel. The company's 2020 guidance remains unchanged as it targets a production of 93,000 to 97,000 boed with exploration and development expenditures of $500 to $575 million. The company announced it intended to issue senior unsecured notes, due 2027, for gross proceeds of US$500 million in a private placement. Baytex intends to use the proceeds from the offering to redeem US$400 million aggregate principal amount of its outstanding 5.125% notes due June 1, 2021 and $300 million aggregate principal amount of its outstanding 6.625% debentures due July 19, 2022.

Crescent Point Energy Corp. announced its 2020 budget, which includes expectations for approximately $200 million to $350 million of excess cash flow in 2020 at US$55 per barrel to US$60 per barrel West Texas Intermediate (WTI), allowing for continued net debt reduction and accretive share repurchases. Crescent Point targets an annual average production guidance of 140,000 to 144,000 boed, on the basis of capital expenditures of $1.10 to $1.20 billion, primarily comprised of sustaining capital. Crescent Point has currently hedged approximately 50% of its oil and liquids production for 2020. The company announced it has successfully closed the sale of certain associated gas infrastructure assets in Saskatchewan for total cash consideration of $500 million. The assets sold as part of this transaction include nine natural gas gathering and processing facilities and two gas sales pipelines with total throughput capacity of more than 90 million cubic feet per day.

Financial Sector

Nothing significant to report.

Activist Influenced Companies

Brookfield Business Partners L.P. – Teekay Offshore Partners L.P. announced that, effective January 22, 2020, Brookfield Business Partners L.P., together with certain of its affiliates and institutional partners, has completed its acquisition by merger of all of the outstanding publicly held and listed common units representing limited partner interests of Teekay held by other parties. Teekay also announced certain changes to the Board of Directors and that following the closing of the merger and the completion of the partnership's separation from Teekay Corporation, the partnership plans to change its name to Altera Infrastructure L.P. and to rebrand its consolidated group of companies under the new umbrella of Altera Infrastructure.

Dividend Payers

Brookfield Property Partners L.P.- on January 17, 2020 the S&P announced changes to the S&P/TSX Composite and S&P/TSX 60 Indices to reflect Encana Corp.'s anticipated name change and moving of its head office to the U.S. Encana has been removed from all S&P/TSX Indices as of January 23, 2020. As its replacement, Brookfield Property Partners has been added to the S&P/TSX 60 Index. We believe this should show continued support for the security as passive investors will be looking to purchase this security in order for them to rebalance to the reconstituted index.

Johnson & Johnson Q4 2019 results were mixed. Johnson & Johnson guides above street guidance for annual sales of US$85.4 to US$86.2 billion. Johnson & Johnson guides adjusted annual EPS to below the street estimates of US$8.95 to U$9.10 with the expected EUR/USD foreign exchange rate impact likely being the driving factor. Organic sales were up 3.4% driven by the pharmaceutical business. Quarterly sales were US$20.7 billion, which were below Bloomberg estimates of US$20.9 billion. However, quarterly adjusted EPS of US$1.88 came in above Bloomberg estimates of US$1.87.

Economic Conditions

U.S. housing market continues to surprise in a good way. **U.S. existing home sales** waved goodbye to expectations in December 2019, jumping 3.6% to 5.54 million units annualized with no revisions made to the November data. That's the largest monthly increase since February 2019 and the highest level since February 2018. The gain leaves sales up a hefty 15.1% year/year, the fastest increase in three years. Both **single** and **multi-units** moved higher. On a regional basis, only the **Midwest** declined, while the all-important **South** rose 5.4%, recovering from November's losses. The supply of single-family homes available to be bought hit a record low in December 2019. Condos have seen stronger days but they're close to record lows, too. With dwindling supplies, the months' supply fell to a record-low. It is a double-edged sword where this is good for homeowners and not good for those looking to purchase a home with fewer options and prices up nearly 8% year/year. Borrowing costs do remain low at less than 4%, but it bodes well for new housing construction to meet this demand.

U.S. flash composite PMI increased 0.4% in January 2020 to a 10-month high of 53.1. The details of the report were mixed. On the one hand, the services sector saw operating conditions improve the most since March (PMI at 53.2 vs. 52.8 the prior month) thanks in part to yet another expansion in payrolls (52.3 vs. 51.7). Alternatively, the manufacturing PMI slipped from 52.4 to a 3-month low of 51.7. Employment at U.S. factories also expanded the least since September. Growth in factory output was unchanged (52.4) but new orders accumulated at a slower pace.

U.S. - one of the highlights of the week will be the central bank's monetary policy meeting. The Fed may acknowledge a slight reduction in global uncertainty following the signature of the Phase One trade deal between Beijing and Washington but this is unlikely to materially alter its view that the current stance is appropriate. The general outlook hasn't changed much since the last meeting, and inflation remains roughly where it was in early December.

The U.S. Bureau of Economic Analysis will publish its advance estimate of Q4 2019 GDP growth on January 30, 2020. Trade should have been one of the main contributors to growth, but only because of a sharp drop in imports. Residential investment should also have driven the expansion judging from previously-released data on construction spending and housing starts. However, these contributions may be partially offset by weak business spending on machinery and equipment (on account of stagnating shipments of non-defense capital goods excluding aircraft) and structures. As for household consumption, it should have contributed positively to growth but to a lesser extent than what we have grown accustomed to of late. At least, that's the message sent by recent retail sales reports. Overall, it is expected that the economy will have expanded approximately 1.5% in annualized terms in the last quarter of 2019.

Canada - the consumer price index was flat month/month in December 2019 and held at 2.2% over 12 months. The Bank of Canada's three core inflation measures year/year were as follows: 2.0% for the CPI-common, 2.1% for the CPI-trim, and 2.2% for the CPI-median. The average of the three stayed put at 2.1%, its highest level in a decade. In Canada, retail sales rose 0.9% in November, better than the 0.6% print expected by consensus. November's retail volumes were up 0.7%. After mustering a 1.1% annualized gain in the third quarter, retail sales are on track to decline 3.4% in Q4 2019. After sagging 0.2% in October, Canadian manufacturing shipments sank 0.6% in November to $57.0 billion. Disruptions in rail transportation owing to a weeklong strike at CN Rail were responsible at least in part for the disappointing headline result. In volume terms, shipments fell 0.8% month/month, meaning they were likely a drag on GDP growth on the month. As expected, the Bank of Canada left its target for the overnight rate unchanged at 1.75% for the 10th time running. Notably, the Bank of Canada opted to delete the word "appropriate" in describing the current level of the overnight rate. This was seen by market participants as suggesting willingness to consider a near-term rate cut in light of the downside risks that have crystalized. Analysts' believe as long as inflation hovers around the target rate of 2.0% that Governor Poloz will be unlikely to make any changes in the interest rate until the end of his term in June 2020. The global economy is showing signs of stabilization, with some trade developments deemed "positive". However, uncertainty remains elevated, as geopolitical tensions have re-emerged. The Canadian economy continues to demonstrate

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resilience, but a number of indicators are "mixed". GDP growth looks to be weaker and the output gap wider than what was envisaged in October. In Canada, the release of November GDP data will attract the most attention. Negative contributions are expected from the manufacturing and wholesale sectors based on previously-released monthly reports on these indicators. The construction sector may not contribute much to growth either if stalling building investment during the month is any guide. Alternatively, retail (judging from rising sales volumes) and utilities (on account of abnormally cold temperatures) may provide some lift to GDP. Add to the calculus temporary factors such as the strike at CN Rail and GDP may have retraced roughly 0.1% in November. That would be the second consecutive monthly contraction in output, a development that would leave us on track for almost no growth in Q4 2019 as a whole.

U.K. Flash PMI composite jumped to 54.2 from 49.3 in December 2019 and well above the 50.7 consensus. The services reading rose to 52.9, its highest level since September 2018. The reaction in GBP was muted as it looked like positioning was already long. GBP topped out at 1.3180 before giving back a big figure after the release. At the last European Central Bank (ECB) meeting Christine Lagarde, President of the ECB, kept to a relatively dovish stance similar to her predecessor, Mario Draghi. Draghi took a good amount of criticism for easing monetary policy towards the end of his term. Lagarde looks to be gathering consensus before really determining the next stance.

Global - Stocks sharply declined early on Monday after more cases of the coronavirus were confirmed over the weekend. This has increased fear over the effect this will have on the global economy and its growth. There are 2,862 confirmed cases so far in China and the death toll in China has risen to 81. The World Health Organization's director general is traveling to China to meet with government and health officials. In the U.S., a fifth case of coronavirus was confirmed over the weekend. The CBOE Volatility Index has sharply increased reflecting the markets current unease about this situation. Traditional safe havens such as government bonds and gold have got a lift while travel stocks have been hurt the most with investors fearing the reduced amount of travel due to this situation.

Financial Conditions

The U.S. 2 year/10 year treasury spread is now 0.17% and the U.K.'s 2 year/10 year treasury spread is 0.11% - 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 3.60% (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 18.40 (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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