# News Highlights

*Owners. Operators. And Insightful Investors.*

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

PORTLAND INVESTMENT COUNSEL®

*Our views on economic and other events and their expected impact on investments.* January 11, 2016



## Energy Sector

**Crescent Point Energy Corporation** – cut its capital budget for 2016 by 16% to 39% relative to 2015's budget. The company raised its average production forecast for the year by as much as 5% to 165,000-172,000 barrels of oil equivalent per day. Crescent Point expects to spend 16-39% lower in the current year as oil companies have been slashing their capital spending for the second year amid a 71% drop in global oil prices since peaking in June 2014. Crescent Point said it expects 2016 capital spending to be at the low end of the forecast range if spot oil prices remained depressed. The company, which cut drilling and other costs by more than 30% in 2015, said it expects an additional 5%-10% reduction in its capital costs if low oil prices persist. "We ... expect to live within cash flow to protect our balance sheet," Chief Executive Scott Saxberg said in a statement. The company said it has allocated about 84% of the 2016 budget for drilling and development activities, including drilling of about 480 to 630 net wells. We perceive the budget to be slightly ambitious, compared to our understanding from our November meeting with the management. At the time, management hinted at a $1billion +/- $100 million in a $40 West Texas Intermediate (WTI) environment. The lower end of the current budget is already higher than that in a, currently, lower than $40 WTI environment. The company announced it spent $100 million in excess of its budget during the last quarter of 2015, while its 2016 budget seems to be front-end loaded (35% to 40% in the first quarter). That, said the production targets look good, up some 2% on 28% less capital spending (at mid-point). By geography, Alberta loses some of its allocation (likely given royalty environment uncertainty), while Uinta (Utah) sees a higher allocation. Crescent Point will likely require to monetize its 2017/2018 hedges, for some $130 million in order to balance its cash flows in 2016, to support the 2016 implementation of its new strategic approach of 'living within internally generated cash-flows'.

**U.S. land rig count** fell 37 units to 635, the largest weekly decrease since April 2015, led by horizontal oil (-16), horizontal gas (-14), vertical oil (-8), and directional gas (-2), slightly offset by increases in directional oil (+3), with vertical gas flat week/week. Total horizontal land rig count has declined 17% since the end of September. **U.S. horizontal oil land rigs** decreased by 16 to 405, led by the Permian (-7), Williston (-3), Eagle Ford (-2), Granite Wash (-2), DJ-Niobrara (-1), Mississippian (-1), and Utica (-1), slightly offset by gains in the Woodford (-1). The Permian also lost 3 vertical oil rigs.

**Canadian rig count** is up 82 rigs and remains 55% off the level this time last year and is down 23% from its recent peak in July. **U.S. offshore rig count** increased by 2 to 27 and is down 50% over the last 18 months.

**Baker Hughes international rig count down 14 rigs month/month in December and down 218 year/year · Int'l land rigs** averaged 1,095 in December with land rigs down 5 and offshore rigs down 9 month/month, led by Latin America (-14) and Asia Pac (-10), partially offset by Europe (+6), Middle East (+3), and Africa (+1).

**Brazil's oil and gas industry:** On December 30th the local state government of Rio de Janeiro announced a new tax on oil and gas producers in the country. The changes proposed include a new 18% royalty rate on production and a flat additional tax rate of $0.69/barrel of oil equivalent. We see a very low likelihood of the changes being implemented given an identical bill was suspended in 2004 with issues cited over constitutionality and legality. The representatives of oil producers in Brazil have already stated that they see the tax changes as illegal and will challenge them in court. Although the news is unhelpful for sentiment over the **Royal Dutch Shell plc /BG Group** combination (BG is 13% exposed to Brazil) it is unlikely in our view to derail the deal.

## Financial Sector

**Alcentra Capital Corporation** announced some expected impairments to the fair value of DRC Emergency Services, LLC ("DRC"), a disaster recovery services provider. The markdowns are due to some legal issues outstanding around DRC's alleged failure to pay a sub-contractor. It is not expected that these marks will necessitate a new non-accrual as the equity component of this investment will most likely take the brunt of the fair value decline.

**Barclays plc** - Reuters reports that Barclays plans to shut its India equities business as part of its efforts to slash costs and boost profit, two sources with direct knowledge of the development said last Monday. Barclays equities business in India, which was rolled out in 2011, includes research and broking services for institutional investors, and it employs about two dozen people, the sources told Reuters. The final decision on closure could be taken by end of month.

**Berkshire Hathaway Inc.** – BYD Auto Co., Ltd., a Chinese automaker backed by Warren Buffett's Berkshire Hathaway, raised its 2015 profit estimate to a five-year high, citing strong demand for its electric and plug-in hybrid vehicles. Despite a slowing economy and volatile financial markets, Chinese automakers such as BYD and Geely Automobile Holdings Limited have flagged bumper profits for 2015, boosted by favourable government policies and consumer preferences that stoked demand for their products. BYD, which primarily makes electric and hybrid vehicles, said it expects net profit attributable to shareholders to climb between 518% and 557% for 2015, compared with an earlier forecast of a rise in the range of 435% to 481%. Government policies drove a quadrupling in demand for so-called "new energy vehicles" in China last year, while consumers snapped up sports utility vehicles (SUVs) and increasingly sought out more bang for their buck, trends that have helped Chinese automakers weather the slowest economic growth in 25 years. Some Chinese car makers are predicting further sales growth in 2016. This week, Chongqing Changan Automobile Co. Ltd. said it expects sales this year to increase at least 6.2% percent to 2.95 million vehicles, while Geely said it aims for an 18% rise to 600,000 units. Great Wall Motor Company Limited, which focuses on SUVs, said it's targeting 11.4% sales growth. The automaker's bet on Chinese consumers embracing electric and hybrid vehicles has started to pay off thanks to government subsidies, strict national fuel economy targets and big cities putting fewer limits on electric cars than traditional petrol powered vehicles. Berkshire Hathaway owns 9.1% of BYD.

**Citigroup Inc.** - Brazilian lenders Banco Bradesco and Banco do Brasil are in talks to buy Citigroup's stake in a credit card processing joint venture with Elavon Inc., a source with knowledge of the negotiations said on Saturday. The acquisition could be closed next month by Bradesco and Banco do Brasil's holding company Elo Participações SA ( Source Reuters).

**Crown Capital Partners Inc.** On January 5th, Crown announced the initiation of a quarterly dividend of $0.11/share., implying a yield of ~5%. This is consistent with their IPO objective which over the long term, is to target to pay up to 80% of its annual operating cash flow to shareholders as dividends. In December of 2015, Crown announced the closing of a $25 million 10-year term loan with PenEquity Realty Corporation. PenEquity Realty is a privately owned full-service real estate company focused on retail/entertainment centers as well as commercial and residential land developments in Ontario. In addition to the development of real estate assets on behalf of clients, PenEquity provides property, advisory and asset management services. The loan will be directly funded through cash on its balance sheet and represents the first loan under Crown's long-term financing solution business. In Nov 2015, CRN completed two short-term financing investments with Petrowest Corporation and Distinct Infrastructure Group Inc. Distinct is a utility and telecom infrastructure contractor located in Toronto. The company's clients consist of blue-chip telecommunications and utility infrastructure companies in Ontario, including Bell and Rogers.

**HSBC Holdings plc** - Sky News reports UK's Financial Conduct Authority (FCA) to end probe into Swiss tax affair and won't pursue formal action against HSBC after looking into tax-evasion allegations at its Swiss private bank unit. FCA concluded examination of the HSBC unit several months ago, the bank was informed of its decision at the time and the conclusion of FCA's probe has not been announced publicly.

**NN Group NV/ING Groep NV** - ING sold 33 million shares in NN Group in an accelerated book building offering to institutional investors priced at €31. NN Group repurchased 8 million shares of the 33 million-share offering at same price; seller ING raises €1 billion with expected net profit of ~€500 million and will raise ING fully loaded Core Equity Tier 1 ratio by approximately 30bps on a pro forma basis. ING's remaining stake in NN Group has been cut to 16.2% from 25.8% and is accounted as available-for-sale investment going forward; part of strategy to divest all insurance, investment management businesses as part of agreement with European Commission. The share repurchase is estimated to reduce NN Group's Solvency II ratio of 247% at 30 September 2015 to 242% on a pro-forma basis.

**RBC set to raise mortgage rates**: The Globe & Mail reported last Tuesday that Royal Bank of Canada is set to raise rates on several of its mortgages, the latest in a series of changes to the mortgage industry that could help cool the housing market this year. Starting Friday, the bank said it planned to increase rates on fixed mortgages of between two and five years by 10 basis points. RBC's five-year variable rate will increase by 15 basis points. The move reflects RBC's discounted rate specials given to customers who qualify, and pushes its five-year fixed rate up to 3.04%. No other major Canadian banks announced matching rate increases on Tuesday, although lenders often closely follow each other in changing mortgage rates. In an e-mailed statement Sean Amato-Gauci, RBC's senior vice-president of home equity financing, said rate increases weren't a response to recent federal rules changes, but "reflect a number of factors (beyond the bond yield), including changes in market conditions driving increased short-term funding costs and long term/wholesale funding costs."

**US Financial Accounting Standards Board to remove mark-to-market rule for bank debt**: Jamie Dimon, CEO of JPMorgan Chase and Company, correctly in our view, denounced the 2007 mark to market rule as "one of the more ridiculous concepts that's ever been invented in accounting". Under the rule, banks were to use market prices when valuing their own debt, resulting in them booking profits when their debt fell ….and vice versa… and so the closer a bank was seen to default the cheaper its debt traded and the greater the profit the bank booked …. Bank's successfully lobbied for the removal of this non-sensical accounting standard known as DVA ( debt value adjustments) from the income statement to the balance sheet as part of other comprehensive income" …..The rule finally brings the US in line the London-based International Accounting Standards Board which changed its rules in July 2014 …and so brings to a close a ruling which in our view throughout the global financial crisis hindered effective investment analysis.

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## Activist Influenced Companies

**Restaurant Brands International Inc.** (RBI) and Ampex Brands of Columbus and Dayton have announced an agreement to strengthen and grow the iconic Tim Hortons brand in Central Ohio. The agreement, which makes Ampex one of the largest restaurant owners in the Tim Hortons system, includes acquiring existing Tim Hortons restaurants in the area along with aggressive development commitments over the next 6 years. This agreement is the most recent by RBI in its plans to grow Tim Hortons in the U.S. In October 2015, RBI announced the establishment of an Area Representative and Developer Agreement for the Cincinnati area with Seven Invest. Tim Hortons opened its first restaurant in the U.S. in 1984 and its first restaurant in Ohio in 1996. Today, the brand maintains a strong base of restaurants across Canada, the U.S. and the Gulf Cooperation Council.

## Canadian Dividend Payers

Nothing new to report.

## Global Dividend Payers

**Diageo plc** is running slightly behind the market in volume terms according to North American Nielsen research.  In the 3 months to November, Diageo volumes grew +2.9% in North America, compared to +3.7% for the market, with the gap vs. the market stable sequentially.  Diageo's biggest volume brand, Smirnoff, is in growth, up +3.2% in 3months to November.  The stellar performer has been Crown Royal growing at 27% due to very strong shipments for the Regal Apple variant (n.b. Crown Royal would have been down -3% without Regal Apple); however, the rate of growth of Regal Apple is slowing sequentially.  On a positive note, Captain Morgan has stabilized at +1.1%.

## Economic Conditions

**U.S. nonfarm payrolls** rose a stronger-than-expected 292,000 in December following upward revisions of 50,000 in the prior two months. The increase took the 2015 tally to 2.7 million, the second best year since 1999. After slowing in late summer, job growth has reaccelerated. Virtually every industry created jobs in December (outside of mining/energy), led by sturdy gains in construction and business services. Manufacturing even added 8,000 positions after sagging in recent months under the weight of the strengthening U.S. dollar. The **jobless rate** stayed at 5.0% for a third straight month due to a hefty 466,000 expansion in the labour force. More people looking for work is a solid vote of confidence in the economy. The participation rate now shows signs of steadying after trending down, which should take some pressure off the tightening labour market. Indeed, to great surprise, average hourly earnings were flat in December, tempering the increase in the yearly rate to 2.5% (amid a weak year-ago comparison). The average duration of unemployment continued to fall.

**U.S. goods and trade** deficit shrunk in November, to $42.4 billion from $44.60 billion, exceeding the consensus expectations which were factoring in a $44.0 billion deficit. Exports retreated by 0.9% in the month, impacted by a stronger dollar, but imports retreated by 1.7%, which might foreshadow weak retail numbers down the road.

The U.S. non-manufacturing purchasing managers index (NMI), issued by the Institute for Supply Management (ISM), produced a lower reading than expected for the last month of 2015, at 55.30 index points. However, unlike its manufacturing equivalent, it is still pointing towards expansion in the services sector.

**Canada** – The Canadian economy created 22,800 jobs in December, ahead of the expected 10,000 payroll gains, driven chiefly by advances in part time employment. The headline unemployment rate held steady at 7.1%, while the participation rate improved marginally to 65.9% from 65.8%.

**Canada's manufacturing activity hits record low in December**: The Globe & Mail reported last Monday that Canada's manufacturing sector contracted for the fifth consecutive month in December as activity fell to a record low, data showed on Monday, the latest indicator that the economy may have been weaker than anticipated in the final quarter of the year. The RBC Canadian Manufacturing Purchasing Managers' Index (PMI), a measure of manufacturing business conditions, fell to a seasonally adjusted 47.5 in December from 48.6 in November. It was the lowest level for the survey that goes back to 2010. A reading below 50 indicated contraction in the sector. The index fell short of that 50 threshold for nine months of the year in 2015. Measures of output, new orders and employment all fell in October. Firms cited subdued business confidence as resulting in lower spending levels and delays to new projects. One bright spot was an uptick in new export orders as firms benefited from the drop in the Canadian dollar compared to the U.S. currency.

Much like its U.S. counterpart, Canada's trade deficit narrowed to a $1.98 billion in November level from $2.49 billion in October, surprising on the downside. Exports advanced 0.4%, likely helped by the weaker currency, driven by gains in autos, forestry and minerals. Imports, meanwhile pulled back by 0.7%, dragged lower by weaker imports of energy and minerals.

The Canadian housing activity slowed markedly in December, despite unseasonably warm weather. The Canadian housing starts dropped to a 173,000 units annualized level, from November's 212,000 units annualized and compared to an expected reading of $200,000 units annualized. Weakness was more pronounced in Toronto and Alberta. Building permits issued in November also dropped, by 19.6%, compared to expectations for a 3.0% correction and a 9.9% advance in October.

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**UK Jobs**: The December Report on Jobs, a survey of UK recruitment consultants, has seen growth ease after a strong November. There is reported to be an increase in demand for staff, however, especially on permanent contracts, which could be interpreted as solidifying business confidence. The survey continues to report an acute shortage in candidate availability although the rate of contraction eased in December and the rate of growth in pay for both permanent and temporary staff is the lowest it has been for close to two years. Highlights from the December report: (i) Growth of Permanent placements eases from a seven month high, to 55.1 in December from 57.1 in November (50 signals expansion), a solid rate despite it being slower than November; (ii) Temporary billings growth has eased slightly from five month high, slowing to 56.2 from 57.4. Growth was strongest in the Midlands and weakest in London; (iii) Marked rise in demand for staff, with the Vacancy Index increasing from 31.2 in November to 62.2 in December, signaling a strong and accelerating demand for staff. Private sector demand for staff continued to grow, while public sector demand declined (private permanent 63.0 vs. public permanent 48.7). By sector, IT & Computing saw the strongest demand in both Permanent and Temporary; (iv) Rate of growth in permanent salaries eased to a 26 month low, from 61.3 to 58.7 and the rate of growth in temporary pay eased to a 21 month low (55.3 from 56.7); (v) The availability of suitable permanent candidates declined further to 35.1 but that was an improvement on the 33.3 seen in November. Temporary staff availability fell further (37.2), although eased from November's 18 year record of 35.5.

## Financial Conditions

The U.S. 2 year/10 year treasury spread is now 1.21 % and the UK's 2 year/10 year treasury spread is 1.25% - 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 their costs of capital.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 3.97% (was 3.31% end of November 2012, the lowest rate since the Federal Reserve began tracking rates in 1971). Existing US housing inventory is at 5.1 months supply of existing houses. So the combined effects of low mortgage rates, near record high affordability, a more promising economic recovery, job creation, and low prices are finally supporting the housing market with housing inventory well off its peak of 9.4 months and we believe now in a more normal range of 4-7 months.

The VIX (volatility index) is 27.01 (compares to a post-recession low of 10.7 achieved in early June) and while, by its characteristics, the VIX will remain volatile, we believe a VIX level below 25 augurs well for quality equities.

**And finally...Dreams of silver screen grandeur managed to bring down the notoriously elusive Joaquin "El Chapo" Guzman, but not before he shared tequila shots with Sean Penn in a Mexican jungle. He was arrested by Mexican authorities after six months on the run - his second escape from prison - and is now likely to be extradited to the US.**

### Mutual Funds

Portland Investment Counsel Inc. currently offers 7 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

### Private/Alternative Products

Portland also currently offers private/alternative products:

- Portland Focused Plus Fund LP
- Portland Private Income Fund
- Portland Global Energy Efficiency and Renewable Energy Fund LP
- Portland Advantage Plus Funds
- Portland Private Growth Fund

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.