News Highlights

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INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. March 7, 2016

Energy Sector

Baytex Energy Corporation (BTE) – reported Q4 and full-year 2015 results, as well as an updated 2016 guidance, which were well received by the markets. Key highlights from the announcement and the call just ended include:

BTE's 2016 capital program was reduced to $225 million to $265 million, in line with our expectations for about $250 million, down from the previous guidance of $325 million to $400 million, and a 53% reduction compared to its 2015 capital spend. BTE targets capital expenditures in-line with its funds from operations, though on the current crude oil forward curve we believe is still likely to incur some $25 million to $50 million of additional indebtedness. BTE is shutting-in some 7,200 barrels of oil per day (boed) of production, which it expects to bring back in Q3 of this year (i.e. when West Texas Intermediate (WTI) is expected to be closer to $40/bbl based on the forward curve); new production guidance for 2016, as a result, is 68,000 to 72,000 boed, down from previous guidance for a roughly 76,000 boed average. BTE is participating in all the Eagle Ford wells proposed within the scope of the area of mutual interest (AMI) agreement with Marathon Oil. BTE managed the rare feat (in the current environment) of increasing its 2P (proven + probable) reserves in Eagle Ford by 8% to 203 million boe in 2015 or 22% since the time of its Eagle Ford asset acquisition in June 2014. Overall 2P reserves decreased by 3% to 417 million boe due to technical and commodity price revisions for the company's heavy oil and thermal assets. Based on independent reserves evaluation, the present value (at 10% before tax) of BTE's reserves is estimated at $4.3 billion. BTE generated $93.1 million of funds from operations in the last quarter of 2015, ahead of expectations, due to strong Eagle Ford operations and cost savings. BTE generated an operating netback of $12.32/boe ($16.41/boe with hedges), including $18.77/boe in Eagle Ford and $5.73/boe for its Canadian operations. 45% of 2016 production is hedged, with 19% fixed at US$61.50/bbl and 29% using a 3-way collar structure (the payout using the current prices would be WTI + US$10), as well as 35% of its WCS (Western Canadian Select)/WTI crude differential exposure and 41% of its natural gas exposure, for a grand total of $152 million of unrealized gains as of February 25th. Long term debt was $1.88 billion as at December 31, with no new debt added other than the currency translation of its US dollar denominated debt. BTE maintains $820 million of undrawn capacity, however the focus is on maintaining a Debt/Earnings before interest, taxes, depreciation and amortization (EBITDA) (12 months trailing) ratio of below 5.25x, measured at 2.97x as at December 31; as mentioned in our previous notes the company reminded investors its option of securitizing up to US$575 million of the bank loan facilities. We believe the markets appreciated in particular the reduction in the capital program, the increase in Eagle Ford reserves (both of which we expected), and the fact that the company did not incur additional debt in the quarter. The key challenge now should be for the management to proactively seek covenant relief (via securitization of its bank lines), which is counter to the possibility that such relief might not be necessary, should WTI recover faster than expected.

Whitecap Resources Inc. (WCP) – reported operational and financial results for 2015 which have exceeded its initial full year projections despite a challenging commodity price environment. The company has taken proactive measures subsequent to the year end to ensure it maintains financial flexibility and strength; including a $70 million disposition of facilities (no production impact), reducing its 2016 capital program by $80 million, adjusting its monthly dividend payment to $0.0375/share ($0.45/share annually) and raising $95 million of equity capital. These initiatives provide a total of $325 million of additional liquidity resulting in approximately $455 million of unutilized credit capacity on its current bank lines of $1.2 billion. WCP remains focused on being the lowest cost light oil producer with Q4/2015 cash costs (royalties, operating, transportation, general and administrative and interest expense) of $20.21/boe and its priority in the current environment is maintaining its balance sheet strength and positioning the business to provide strong economic returns when the commodity price environment improves. WCP achieved record Q4/2015 production of 42,067 boed which was 467 boed higher than its initial forecast of 41,600 boed due to better than anticipated drilling results and the Boundary Lake asset consolidation which closed in late December 2015. Production grew 26% year over year to 40,953 boed (3% per fully diluted share) compared to 32,458 for 2014. The company realized strong cash netbacks of $28.93/boe in Q4/2015 and $32.30/boe for the full year 2015, demonstrating the strength its asset base enhanced by an active and effective risk management program and a focus on reducing controllable costs. Whitecap continued to actively reduce its cost structure resulting in a 14% reduction in cash costs to $20.21/boe in Q4/2015 compared to $23.43/boe in Q4/2014. Cash costs decreased 19% year over year to $20.72/boe compared to $25.47/boe in 2014. WCP achieved a total payout ratio (after development capital spending and dividend payments) of 93% in 2015. Business development initiatives include the successful integration of the Beaumont corporate acquisition of $579.9 million in addition to $225.7 million net strategic property acquisitions within its core operating areas which provides our shareholders a base for long term value creation. The company expects to meet or exceed its output guidance of 43,000 boed in Q1 2016 and to increase its annual target of 38,800 boed.

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Financial Sector

Barclays' plc investment bank swung to its first quarterly loss in at least two years, hurt by a drop in equities revenue, as Chief Executive Officer Jes Staley shrinks the securities unit. The investment bank posted a loss of £146 million (US$204 million) in the fourth quarter compared with a pretax profit of £35 million in the year-earlier period. The unit's cost to income ratio, a measure of efficiency, soared to 109% from 97%. (Source: Bloomberg). The CEO also announced that the British bank has decided to exit its African operations over next 2-3 years to refocus the bank on its core UK and US markets. After a review of the African business led by Jes Staley, the bank's board decided last week that in principle it made strategic sense to get out of the continent. The board has delegated authority to a subcommittee to examine the practicalities of how and when to sell Barclays Africa, one of its four main lines of business. By delegating authority it avoided having to disclose the decision immediately (Source: Financial Times).

Bank of Nova Scotia reported cash Earnings Per Share (EPS) of $1.44, which was above the consensus expectation of $1.43. The results were driven by Canadian Banking (higher year-over-year risk-adjusted margins and good volume growth) and solid results in International Banking (with higher risk adjusted margins, positive operating leverage and double-digit volume growth in source currency). Global Banking Markets results were reflective of the challenging market environment, with better trading revenue offsetting lower underwriting & advisory fees. Total bank Provisions for Credit Losses ratio of 45 bps compares with 47 bps last quarter (which included a 5 bps collective allowance add); energy-related provisions in the quarter were $79 million compared with $24 million last quarter, and the bank added four new energy accounts to its 'watchlist'. The Core Equity Tier 1 capital ratio was a 10.1% and the bank increased its quarterly dividend by about 3% to $0.72.

Citigroup Inc. announced they reached an agreement to sell its 20% equity stake in China Guangfa Bank co., Ltd. to China Life Insurance Company Limited. The company expects the transaction to close in the second half of 2016 and noted that the terms of the transaction are not material to Citi's earnings. Reuters is speculating that Citi's stake will be sold for about $3 billion and noted that the stake was purchased in 2006 for $610 million, equating to a roughly $2.4 billion gain. We would consider any gain associated with this sale as non-operating, however assuming it closes in 3Q16 it is estimated the gain would increase tangible book value by $0.55 to $65.80 and the Core Equity Tier 1 ratio to 12.55% from 12.4% under the advanced approaches.

Goldman Sachs Group Inc. and **Bank of America Corporation** plan to lean on their periodic culls of low performers this year to rein in costs as a market rout pressures returns. Goldman Sachs will eliminate more than 5% of traders and salespeople in its fixed-income business, cutting those operations more deeply than the annual companywide sweep normally used to make way for new hires. Bank of America will dismiss about 150 trading and investment-banking employees next week as Chief Operating Officer Thomas Montag pushes managers to trim expenses. (Source: Bloomberg)

Activist Influenced Companies

Hertz Global Holdings, Inc. (HTZ) – Hertz's updated guidance for 2016 was better than the markets have feared (in the light of last week's Avis announcement), albeit lower than the previously provided guidance. Some of the key points from the fourth quarter of 2015 results announcement and the subsequent call include:

The spin-off of Hertz Equipment Rental Corporation (HERC) (equipment rental business) still targeted for mid-2016, with the likely post spin-off leverage in the 3.0 – 3.5x, relative to the 3.5x – 4.0x prior target, due to market conditions. HERC has already divested its France and Spain businesses. HTZ's 2016 adjusted EBITDA target sits now at $1,600 million - $1,700 million, lower by $100 million compared to prior guidance (it includes HERC at $600 million to $650 million). Management continues to target longer term (2018) EBITDA margins of 16% to 18%, from Q4 2015's 11% level. Capital expenditures guidance has also been lowered, to $200 million to $225 million from $250 million to $275 million, as HTZ plans to shrink its fleet by 2.0% to 3.0%. US (75% of revenue) Rent-a-car (RAC – i.e. HTZ minus HERC) revenue growth is currently pegged at 1.5% to 2.5%, down from 2.5% to 3.5%, predicated on higher fleet utilization rates and higher ancillary revenue on a background of flat pricing. Weakness in RAC was caused by lower business demand, in particular energy, but also higher competition in top-tier markets from established competitors and over-capacity in Florida and California. Oil and gas revenues also caused significant revenue pressure at HERC (where oil and gas accounts for about 25% of revenue). HTZ realized $230 million in savings, over the course of 2015, well in excess of its $200 million target, and expects a further $350 million of cost-outs in2016, which will likely be offset though by higher interest costs (due to re-terming of its debt and HERC spin-off financing costs), higher depreciation costs and further investments (IT mostly).

The company's decision to shrink the fleet was driven by desire to act responsibly in the face of industry challenges and potential economic slow-down, as well as a 2.5% worsening of the car residuals (HTZ owns and has to re-sell some 80% of its fleet). As expected, HTZ has accelerated its share buy-back program adding 22 million shares in the fourth quarter for a total of 37 million shares in 2015 (about 8% of the outstanding shares) for about 60% of its $1 billion program. Overall, HTZ's announcement largely confirmed the industry trends revealed in Avis' report, while at the same time exceeding expectations on cost savings and margins (mostly on the back of better depreciation costs during the quarter). We expect

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the next few quarters to be critical for both the industry and HTZ as we'll have to see if HTZ's decision to shrink its fleet is followed by the other players (most importantly Avis and Enterprise) and what the impact of such decision will have on pricing; as well as what profitability improvements will be delivered by the management's initiatives on cost cutting, IT improvements and initiatives around ancillaries and ride sharing fleet management pilots.

Canadian Dividend Payers

Northland Power Inc. – announced that the first turbine of the 600 MW Gemini offshore wind project located in the North Sea is now producing power. Installation of the turbines will continue throughout 2016, led by the project's EPC contractor and co-owner Van Oord Dredging and Marine Contractors BV (Van Oord) and turbine supplier Siemens. The project is expected to be completed in 2017. Energy generated will flow into the Netherlands at Eemshaven where the project connects to TenneT's high voltage grid. Electricity supplied to the grid prior to full commercial operation will generate revenue that will be used to fund a portion of the project's construction costs. The wind farm encompasses two 34 square kilometer areas and is located 85 kilometers off the coast of Groningen in the Netherlands. Invisible from the coast, the project will generate energy in a part of the North Sea where wind speeds are among the best in the world for offshore wind power. 'To have the first turbine up and running represents another critical achievement on our first offshore construction project. This significant milestone follows construction of the electric infrastructure in 2015, and installation of the turbine foundations in only 110 days', said John Brace, CEO of Northland. 'We are very pleased that the project continues to advance on budget and on schedule, and would like to acknowledge the extraordinary efforts of the Gemini team, partners, and contractors.' The project is owned by Northland Power (60%), Siemens Financial Services (20%), Van Oord (10%) and N.V. HVC (10%). Once fully operational Gemini will generate clean and renewable energy for 1.5 million people in the Netherlands.

Global Dividend Payers

ABB Limited will deliver 250 robots to Valmet Automotive for use at its Mercedes-Benz GLC SUV body shop in Uusikaupunki, Finland. Production of the GLC sport utility vehicle will begin in early 2017. The order includes the IRB 6700 robots line, introduced in 2013, which is more robust and 15% more energy efficient than its predecessor. Maintenance has been simplified, making it – according to ABB - the best performing robot with the lowest total cost of ownership in the 150-300 kg class. The IRB 8700 line, ABB's largest robot launched in November 2015 with a reach of 3.5 meters and capable of handling a payload of up to 800 kg, is also part of the order. ABB has installed more than 250,000 robots worldwide.

Economic Conditions

U.S. Nonfarm payrolls increased 242,000 in February (versus expectations of around 190,000), while revisions tacked on an extra 30,000 jobs in the prior two months. The three-month tally of 228,000 is in line with last year's healthy pace, implying no signs of slowing. Across industries, only manufacturing showed weakness, retracing most of the prior month's gain. We believe that relates to the ongoing trade headwind, with the U.S. trade deficit expanding to $45.7 billion in January amid a further sharp drop in exports. Household survey employment tacked on another 530,000 positions to take its three-month tally to 1.63 million, the most since the fading days of the tech boom in 2000. That should have dropped the jobless rate from 4.9%, but didn't, as the labour force grew even faster, boosting the participation rate two-tenths to 62.9%. The "all-in" jobless rate fell to 9.7%, the lowest since the early days of the Great Recession, as the number of discouraged workers continued to decline. However, the duration of joblessness backed up, while its downward trend has surprisingly stabilized, something to keep an eye on. Despite a labour market that is edging closer to full employment, wage costs remain in check. Average hourly earnings retraced some of the prior month's sharp 0.5% gain, which was partly due to minimum wage hikes in many states. This hauled the yearly rate down to 2.2%, though the underlying trend is closer to 2½%, the highest since the recession. Wage growth should trend higher in our opinion as the jobless rate creeps down to 4½% later this year.

U.S. manufacturing activity continued to contract in February, but at a slower pace. The U.S. manufacturing ISM (Institute for Supply Management) index rose more than expected last month, up 1.3 pts to a 5-month high of 49.5. This is the second consecutive improvement, which we haven't enjoyed since late 2014. The headline is still below 50 which indicates contraction but the rest of the economy is still growing, particularly the key consumer sector, which accounts for two-thirds of GDP. And now, we are just 0.5 pts from 50….not bad in our view, considering the still-strong USD and sluggish growth outside of the U.S. are hurting manufacturers. Besides, none of the major economies showed much of a spark either, in manufacturing….namely China and Canada (contracting), while Japan, Euro Area and the U.K. are all just above the 50 mark.

Greece's creditors will attempt to bridge their differences at a meeting of eurozone finance ministers this Monday amidst mounting concerns Athens' €86 billion third bailout is already headed for crisis, the Financial Times reports. The EU and the IMF are at loggerheads over the strength of reform measures Athens must adopt to complete the rescue's first quarterly review, which must be closed before the eurozone will consider the politically combustible issue of granting Greece debt relief. Without the acquiescence of the IMF, which has not formally signed onto the third bailout yet, the entire rescue risks falling apart since a German-led group of creditor

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countries have insisted they cannot approve EU bailout funds without IMF participation.

Portugal - Fitch has downgraded Portugal's outlook to stable from positive. Fitch says fiscal performance was well off target in 2015, with the general government deficit at an estimated 4.2% of GDP compared with the 2.7% initially expected. Portugal's rating was affirmed at BB+. Fitch forecasts headline deficit of 2.8% for 2016.

Financial Conditions

The Reserve Bank of Australia (RBA) left the overnight cash rate steady at 2.0%, but clearly maintained its easing bias. There were little changes to March's accompanying statement, with the RBA concluding that "Over the period ahead, new information should allow the Board to judge whether the improvement in labour market conditions is continuing and whether the recent financial turbulence portends weaker global and domestic demand. Continued low inflation would provide scope for easier policy, should that be appropriate to lend support to demand".

Russia - Central Bank increases reserve requirements to 5.25% in foreign currency.

The U.S. 2 year/10 year treasury spread is now 1.01% and the UK's 2 year/10 year treasury spread is 1.00% - 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 3.64% (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 5.2 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 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 16.86 (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.

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 Focused Plus Fund
- 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.

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