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. May 8, 2017

The views of the Portfolio Management Team contained in this report are as of May 8, 2017 and this report is not intended to provide legal, accounting, tax or specific investment advice. Views, portfolio holdings and allocations may have changed subsequent to this date. This research and information, including any opinion, is compiled from various sources believed to be reliable but it cannot be guaranteed to be current accurate or complete. It is for information only, and is subject to change without notice. The contents of this Newsletter reflect the different assumptions, views and analytical methods of the analysts who prepared them.

Owner Operated Companies

Berkshire Hathaway Inc. – We had the privilege of attending this year's AGM this year and continue to be impressed with the level of investor interest. Many of the attendees travelled large distances (with many arriving from China) to listen directly to Warren Buffett and Charlie Munger's words of investment wisdom. Buffett re-iterated the company's focus on building intrinsic value and therefore downplayed relatively weak results for the first quarter of the year, driven by the changes in fair market value of certain investments and derivative. Conversely, the relatively poor insurance underwriting results were regarded as temporary. Of interest, Mr. Buffett expects that subsequent to his eventual retirement, the share reaction would be positive helped by speculation about the company's break-up. He, of course, does not believe such an approach would lead to the addition of any lasting value. Buffett was critical of Wells Fargo's management slowness in addressing the cross-selling scandal and emphasized that, no matter at what level, the right incentives need to be used to encourage the right behaviour. Both Buffett and Munger defended Berkshire's involvement with the 3G Group, who, they believe are performing a broader and longer term social function by improving productivity of businesses they operate, contrasted with the short term impact of staff layoffs part of the restructuring process. They indicated Berkshire is very likely to continue to engage with the 3G Group on future deals. Buffett and Munger justified they're otherwise surprising interest in Apple Inc. (currently their second largest public investment) as part of a continued openness towards learning and becoming more comfortable with areas which were before less understood. Buffett also likens Apple more to a consumer goods company rather than a technology one.

The Kraft Heinz Company, North America's number three food and beverage company, reported lower-than-expected quarterly profit and sales, due to weak demand for its Velveeta cheese, Planters nuts and Oscar Mayer meats brands in the United States and Canada. U.S. sales, which account for more than two-thirds of Kraft's total revenue, dipped 3.5% in the first quarter ended April 1. Canada sales fell 12.2% in the quarter due to delayed contract agreements with key retailers, the company said. A muted spending environment in North America coupled with changing consumer tastes toward fresh, organic food over processed food has forced the packaged food maker to launch new products and revamp its ready-to-eat meals to remove synthetic colors and preservatives. Kraft, in January, had partnered with Oprah Winfrey to create a new healthy line of packaged food called Mealtime Stories. The company's net sales fell 3.1% to $6.36 billion. Kraft, which aims to reduce $1.7 billion in costs by the end of 2017, said it continues to generate savings from zero based budgeting and supply chain initiatives in all areas apart from North America. Net income attributable to shareholders was $893 million, or 73 cents per share, in the first quarter, compared with $896 million, or 73 cents per share, in the year-earlier period.

Liberty Global PLC LiLAC reported mixed results for its first quarter of 2017, with continued strong performance in key markets of Chile, Puerto Rico and Jamaica offset by weaker results elsewhere at Cable & Wireless Communications PLC, in particular in Bahamas, due to entrance of a competitor. The results also suffered on a comparative base, as the first quarter of 2016 included a number of one off adjustment prior to the integration of Cable & Wireless. The company is nearing the end of a broad reaching capital additions program and should see a pick-up in revenue subsequent to the roll-out of its initiatives. LiLAC also expects continued improvement as the roughly $150 million in additional synergies are being realized. The company disclosed it has spent $40 million buying back its shares and has roughly $260 million available for further repurchases by year-end 2019. LiLAC is on track to achieve a full separation from Liberty Global, with an SEC filing expected by mid to late summer 2017 and full legal separation by year end. The company maintained its target for about $1.5 billion of operating cash flows for 2017.

Energy Sector

U.S. land rig count increased by 4 rigs to 853 rigs, breaking 7 consecutive weeks of double digit gains. The rig count was driven by gains in Horizontal Oil (+7) and Directional Gas (+2), offset by declines in Horizontal Gas (-2), Vertical Oil (-1), Vertical Gas (-1), and Miscellaneous (-1). Total horizontal land rig count is down 47% since the peak in November 2014 (See Fig. 1). The Permian currently makes up 51% of all oil rigs.

U.S. horizontal oil land rigs increased by 7 rigs to 598 as gains in Permian (+10), "Other" (+3), and Utica (+1), were partially offset by declines in Woodford (-4), Williston (-1), Eagle Ford (-1), and Mississippian (-1) while DJ-Niobrara and Granite Wash remained flat week/week.

Canadian rig count decreased by 4 rigs, but is up 138% from the level this time last year.

U.S. Gulf of Mexico offshore rig count increased by 1 rig to 18 and is down 67% since June 2014.

BHI international rig count is up 13 rigs month/month in April and up 10 year/year, which is the first year/year increase since Nov 2014.

International rigs averaged 956 in April, with land rigs up 9 and offshore rigs up 4 month/month, led by gains in Africa (+6 land,

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

+3 offshore), Asia Pac (+3 land, +4 offshore), and Middle East (+3 land, flat offshore), partially offset by declines in Europe (-3 land, flat offshore) and Latin America (flat land, -3 offshore).

BP PLC - Adjusted earnings before interest and tax of $2,703 million was 10% ahead of consensus. Upstream production of 2,388kboed (thousand barrels of oil equivalent per day) was down 2% year/year but higher 9% quarter/quarter. Underlying upstream operating profit of $1370 million was $220 million above consensus. It is estimated upstream net income per barrel of $4.3/boe, up $7.9/boe year/year and compares to the $19.5/barrel increase in Brent oil price. Downstream operating profit of $1,742 million was $332 million above consensus. Dividend unchanged at 0.10/share flat quarter/quarter. With capital expenditure of $3.5 billion and dividends of $1.3 billion, there was a positive free cash flow post capital expenditure and dividends of $0.4 billion. Gearing of 28% was up 1% quarter/quarter. Management outlook: material improvement of cash flow from operations from 2nd half 2017.

Baytex Energy Corp. first quarter came in ahead of expectations, helped by a pickup of roughly US$2.00/barrel in realized prices. Netback, as a result, improved by about C$2.00/barrel, with Western Canada Select (WCS) spread marginally higher. Costs, both in Texas and in Canada, continued to improve. The most important takeaway, we believe, is Marathon's (the operating partner in Eagle Ford) increasing activity to 5 drilling rigs and expecting to maintain a 4 to 5 drilling rig pace for the rest of the year; this likely led to the company's tightening of its production outlook towards the upper bound of the previous range.

Cardinal Energy Ltd. reported production which 15,200 boed in Q1 2017, relative to 14,600 boed in Q4 2016, and, after having caught up with the completion backlog, is currently producing approximately 17,000 boed. Operating costs are trending back down to normalized levels as the company has reduced the workover frequency on its base production. Operating costs averaged $22.90/boe in Q1 and are expected to drop to $20/boe in Q2. Operating costs for 2017 are expected to remain in the $20/boe range. Cardinal continues to maintain an active hedging program with 43% of its 2017 crude oil production hedged at an average floor price of $62.73 Cdn/barrel.

Royal Dutch Shell PLC - 1st Quarter adjusted earnings before interest and tax of $4,210 million was 22% ahead of consensus, driven mainly by a stronger than expected downstream performance. The Chemicals result of $826 million came in 67% above consensus and is possibly the best performance in a quarter for Shell. Upstream net income of $540 million was broadly in line with consensus. Integrated Gas net income of $1,181 million was $287 million above consensus. Underlying operating expenses are now annualizing below $37 billion versus guidance of below $40 billion. Reported cash flow from operations of $9.5 billion was up 4% quarter/quarter. With capital expenditure of $4.5 billion and dividends payments of $2.7 billion, there was a positive free cash flow post capital expenditure and dividends of $4.2 billion ex working capital. Net debt of $72 billion was down 2% quarter/quarter with just $123 million of disposals closed in the quarter. Gearing (net debt to equity) of 27.2% was down 1% quarter/quarter.

Financial Sector

BNP Paribas SA - Underlying Profit Before Tax (PBT) excluding the Corporate Centre was €2,705 million, 12% above consensus. BNPP's Investment Bank PBT was 32.5% above consensus (thanks to strong Equities, provision reversal), Domestic Markets 3.8% above consensus (despite a miss in Italian retail) and International 5.5% above consensus (EuroMed beat). Revenues were up 7% year/year, expenses up 4.9%, cost of risk falling 22%. Core Tier 1 capital ratio at 11.6%.

HSBC Holdings PLC first quarter earnings, underlying PBT was $5,937 million or 12% ahead of consensus with Income 3% ahead, costs 2% worse and impairment significantly better by $0.4 billion. Net loans were 2% higher quarter/quarter at $876 billion with the loan/deposit ratio increasing 1% to 69%. Tangible Net Asset Value finished at $7.08 compared to consensus of $6.90 whilst the Core Equity Tier 1 ratio was up 0.7% quarter/quarter to 14.3% beating consensus by 60 basis points and return on net asset value/tangible book was 9.3%, with the dividend remaining at $0.10.

Royal Bank of Scotland Group PLC presented to sales-force last week and highlighted the "+" in their 12%+ Return On Tangible Equity target and were comfortable dismissing suggestion of more restructuring charges to achieve goals. Over the next 3-5 years RBS is going to look increasingly like Lloyds Bank which is not reflected in the current share price in our view.

Standard Chartered PLC has had its credit rating downgraded by Moody's Investors Services by one notch to A1 from Aa3. The agency said its downgrade reflects expectations that profitability "will be structurally lower following management efforts to de-risk Standard Charter's balance sheet." (Source: Financial Times)

Activist Influenced Companies

Mondelez International Inc. - We believe Mondelez's +0.6% year/year organic sales growth was well ahead of expectations with its earnings per share (EPS) +$0.03 higher than consensus. North America organic sales declined -1.9% year/year, reflecting a U.S. biscuit performance that was below expectations, in our view. Notably, Mondelez tempered its overall Q2 organic sales outlook, calling for a sequentially softer performance. The company acknowledges that to meet its reaffirmed 2017 organic sales guidance of "at least +1.0% year/year", U.S. biscuit category growth needs to accelerate. Meanwhile, we believe visibility remains intact for the company's mid-16% full year operating margin target.

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

Canadian Dividend Payers

Ares Capital Corporation reported Q1 2017 core net investment income per share of $0.32 (which excludes roughly $0.06/share of costs related to the American Capital, Ltd. (ACAS) acquisition), lower than consensus of $0.38, with the miss driven primarily by lower interest income. Book value per share was $0.05/share higher quarter/quarter at $16.50. Ares had $864 million of new commitments (ex. ACAS) during Q1. Against that, Ares had $836 million of exits, $284 million of which was legacy investments from ACAS. Thus far in Q2, Ares had $533 million of commitments but exited $810 million of investments ($105 million of which was from ACAS). The portfolio mix at quarter end was 24% first lien (vs. 23% previously), 34% second lien (unchanged), 17% in certificates of the senior secured loan program (SSLP) (22% prior), and 2% in certificates of the senior direct lending program (SDLP) (vs. 3% previously). Overall yield on debt and income producing securities was flat quarter/quarter at 9.3%. Balance Sheet and Leverage: Leverage of ~0.65x debt to equity, down from 0.75x the prior quarter.

Brookfield Property Partners L.P. (BPY) continues to recycle capital through divesting partial interests in mature properties and reinvesting in its platform which should position it to grow Funds From Operations (FFO) at a faster pace in coming years. For Q1 2017, BPY reported FFO per diluted unit of $0.34, up 10% from $0.31 in the year-ago period and ahead of estimates of $0.32 although the primary reason for the 'beat', was a one-time lease settlement of $20 million ($0.025 per unit) from a lease at Canary Wharf. The driver of the growth in FFO per unit was an increase in same-property Net Operating Income of 4% in the office portfolio. The reported IFRS Net Asset Value (NAV) was essentially unchanged at $30.42 per unit at quarter-end Q1 2017, compared to $30.72 at Q4 2016. Asset sales continue to occur at, or above, NAV, which in our view provides evidence that the IFRS NAV is realistic. BPY's units currently trade at a 28% discount to IFRS NAV. During Q1 2017, BPY repurchased 4.4 million units at an average price of US$22.90 per unit, for a total investment of $101 million.

Fortis Inc. reported EPS of C$0.69 vs. C$0.67 last year, consensus of C$0.72. Results from the regulated Canadian operations were relatively stable, with a modest upside from Fortis BC Energy (the former Terasen Gas), and modestly softer results at Fortis Alberta (lower power consumption). BC Gas was better by C$0.02. Offsetting these positive drivers was foreign exchange which moved from 1.37 last year to 1.32 this year and higher corporate expenses.

Global Dividend Payers

Dufry AG reported 7.2% growth in Q1, a sequential growth improvement from Q2 2016. March was also broadly in line with the months of Jan. and Feb., which were at >7%. Latin America reported the strongest growth at 12.7%. Dufry is mentioning as well strong growth in markets such as the U.S., the U.K., Spain, as well as Eastern Europe and Turkey. Hong Kong and Singapore remained in negative territory. Strong gross margin improvement by 1% to 59.6%, well above expectations, thanks to the synergies of the World Duty Free acquisition.

Syngenta AG - China National Chemical Corporation announced the acquistion of Syngenta has been approved by Shareholders.

Economic Conditions

Canada – payrolls were up by 3,200, falling short of expectations for a 10,000 jobs addition, as growth in the education and healthcare sectors were offset by losses in hospitality and manufacturing. The headline unemployment rate dropped to 6.5% in April, from 6.7% in March, helped by a lower labour participation rate.

U.S. Nonfarm payrolls rebounded in April, rising **211,000** after a downwardly-revised gain of 79,000 in March. The three-month average gain moderated to 174,000 from 186,000 in the past year. Job growth was across almost all industries, led by the service sector. Manufacturing rose for a fifth straight month. Unemployment rate was 4.4%, returning to its previous cycle low in 2007. The jobs report fits the Federal Open Market Committee's description of the labour market as"solid", as well as its view that Q1's GDP stumble is *"likely to be transitory"*.

U.S. nonmanufacturing ISM beat expectations with a 2.3 point rise in April, to 57.5, which essentially erased March's loss. The employment component edged down 0.2 points to 51.4 whereas the other three components (weighing in at 25% each), were solid. New orders, and indication of future activity, jumped 4.3 points to an over 4-year high (or August 2005) of 63.2. Business activity (aka production) and indication of current activity, rose 3.5 points to a 2-month high of 62.4 (or 2nd highest in 1½-years). And suppliers experienced greater delays, with the component up 1.5 points to a 1-year high of 53.0.

The French election Emmanuel Macron defeated Marine Le Pen by 66% to 34%. Macron who is 39 will be the youngest President in the 59-year history of France's Fifth Republic. Macron will still have a battle as many foresee a possible hung parliament given his one year old party, En March, has no current members in Parliament. General elections are next month and Macron will have to work in order to get his agenda and laws passed.

Financial Conditions

Reserve Bank of Australia left cash rates unchanged at 1.5% last week, as expected.

Italy - Standard & Poor's confirmed Italy's debt ratings at "BBB-" with a stable outlook saying it expected structural reforms to keep a stable debt-to-GDP ratio.

The U.S. 2 year/10 year treasury spread is now 1.04% and the U.K.'s 2 year/10 year treasury spread is .99% - 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 4.02% (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 3.6 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 10.12 (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 8 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
- Portland 15 of 15 Fund

Private/Alternative Products

Portland also currently manages the following 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
- Portland Global Aristocrats Plus Fund

Individual Discretionary Managed Account Models - SMA

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.

TO SUBSCRIBE TO THIS NEWSLETTER, AND MORE, SIGN-UP HERE
www.portlandic.com/subscribe.html

Portland Investment Counsel Inc. | portlandinvestmentcounsel | Portland Investment Counsel Inc. | @PortlandCounsel

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

PIC17-032-E(05/17)