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. October 26, 2017

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Owner Operated Companies

Walgreens Boots Alliance, Inc. – U.S. drugstore chain quarterly profit and revenue beat Wall Street estimates. Big contracts from pharmacy benefit managers helped Walgreens boost revenue in its latest quarter. The company last year stole a contract from larger rival CVS Health to fill prescriptions for Tricare, a Department of Defense healthcare program, and for customers of Prime Therapeutics, a Minnesota-based pharmacy benefit manager. Tricare brought about 9.7 million new members to Walgreens, while Prime Therapeutics added 22 million. Walgreens also formed a Venture with Prime, called AllianceRX Walgreens Prime, to handle mail orders and specialty prescriptions for their combined customers. Sales at Walgreens' U.S. pharmacies rose 12.6% in the fourth quarter ended Aug. 31, after the company filled 250.2 million prescriptions, up 9% from a year ago. Walgreens also said it would review its U.S. stores network, following its acquisition of nearly 2,000 Rite Aid Corporation drugstores. The company expects the review to bring savings of about $300 million each year through 2020. Walgreens also expects to spend $750 million on acquisition costs and another $500 million on store conversions and refurbishing. The impact of Hurricane Maria in Puerto Rico, where Walgreens is the largest drugstore chain, would reduce current-quarter profit by $90 million. Walgreens also said it expects 2018 adjusted earnings of $5.40 to $5.70 per share. The forecast was largely above analysts' average estimate of $5.47, according to Thomson Reuters. Revenue rose 5.3% to $30.15 billion in the fourth quarter, topping analysts' expectations of $29.93 billion. Net income attributable to Walgreens fell 22% to $802 million, hurt mainly by the $325 million termination fee it paid Rite Aid after their failed merger. Excluding one-time items, the company earned $1.31 per share, beating analysts' expectations of $1.21.

Energy Sector

Crescent Point Energy Corp. reported third quarter results, which were slightly ahead of expectations in term or production, operating profit and cash flow. Operating profit, which excludes most one-time items, was C$33.7 million, or 6 cents per share, compared to a loss of C$22 million, or 4 cents, a year earlier. Crescent Point focuses on producing light and medium oil for the Bakken field of southwest Saskatchewan, as well as elsewhere in Western Canada and the U.S. The company's cash flow, a key indicator of its ability to pay for new acquisitions and drilling, jumped 33% to C$437 million. Crescent Point's production rose 10% to 176,069 boed during the quarter. For the year, production was guided 1% higher for 2017, to 175,500 barrels per day (bbl/d). Production gains in Uinta and Williston basins were only partly offset by sales of about 3,000 bbl/d (at a good $64k/boed price) of non-core assets. Non-core asset sales of $190 million ($280 million year to date) are encouraging, though modest for a company of Crescent Point's size. $100 million of the proceeds were re-routed towards increased capex for 2017 in the highly prospective Uinta and Torquay. Operating costs for the quarter were $12.35/barrels (bbl) while the netback including hedges was around $29/bbl, in line with last year's, though contribution from hedges was more modest in 2017.

Financial Sector

Uber Technologies Inc. and a unit of Barclays PLC are teaming up to offer a rewards-enriched credit card in the U.S through the ride-service company's mobile phone app. Uber and bank officials said on Wednesday the card will be free and offer a $100 starting bonus, plus an annual $50 credit on digital subscription services, such as Netflix. It would also offer cash back on spending, including 4% for dining, 3% for airfare and 2% for Uber rides and many other online transactions. Curt Hess, chief executive officer of Barclaycard U.S., said the Uber card spending rewards were set high to attract customers and encourage them to favour it ahead of other cards that they may have. "Given that it is no-fee, it has some of the best reward points out there," said Hess. Barclays' Uber offer is another gambit in the post-financial crisis bidding between credit card issuers for customers who will bring in transaction fees from merchants and pay to borrow at interest rates upwards of 15%. (Source: Reuters)

Barclays - Group Profit before tax increased to £3,448 million driven by a £932 million reduction in operating expenses, primarily reflecting lower litigation costs. Income reduced £405 million due to the non-recurrence of the £615 million gain on disposal of Barclays, share of Visa Europe Limited in 2016. Barclays UK Return on tangible equity of 10% with a 12% increase in profit before tax (PBT) driven by reduced impairment and lower cost/income ratio of 66% (Q3 2016: 67%). Barclays International Return on Tangible Equity of 10% on profit of £3,269 million (Q3 2016 £3,838 million) with income decreasing as a result of weak market conditions. Group attributable loss of £628 million (Q3 2016 profit of £1,524 million) included a loss of discontinued operations of £2,195 million reflecting an impairment of Barclays' holding in Barclays Africa of £1,090 million and a loss on the sale of 33.7% of Barclays Africa issued share capital of £1,435 million. Group loss per share of 3.0P (Q3 2016 EPS of 9.6P). But excluding the losses on sale of 33.7% stake in Barclays Africa and litigation costs of £700 million, EPS was £0.155. Disappointing set of numbers in our view, all in number £1.1 billion is about 23% below consensus including £168 million one off in provision line. Key miss in revenues 3% light particularly in equities which was down 20% quarter/quarter, CET 1 capital ratio at 13.1% was flat on quarter. Tangible book £2.81 v £2.84 in Q2.

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DNB ASA reported a slight sequential downtick in Net Interest Income in Q3 at NOK 9,007 million versus NOK 9,031 million in Q2 2017 and this was marginally below consensus' expected NII at NOK 9,051 million. We note that DNB in the Q3 report raised its loan volume growth for 2017 to about 2% from previously stable volumes in 2017 and 2018. Commissions at NOK 2,150 million were 3% above where most commission lines were stable but where investment banking fees related to M&A activity were stronger than expected. Trading came in at 1,065 million, 23% above consensus. Costs at NOK 5,321 million were 1% above consensus expectations but included non-recurring items of NOK 198 million. DNB comments on marketing of digitalization projects and high activity also in Q3. Loan loss provisions of 22bp were up versus Q2 (15bp) and DNB mentions that the successful restructuring of portfolios within oil, offshore and shipping continuing in the quarter. Consensus had expected loan losses of 28bp. Asset quality continues to improve and non-performing loans declined to NOK 19.2 billion from NOK 23.6 billion in Q2 2017. DNB has not seen signs of spillover effects to other industries, nor does it see risk for its home mortgage exposure. DNB still guides for 2016-18 loan loss provisions of NOK 18 billion. DNB reported a CET 1 capital ratio of 16.3% in Q3 which was up 50bp quarter/quarter, and 20bp above consensus expectation. Accordingly, DNB is strongly capitalized and able to continue to distribute cash in our view.

Fifth Third Bancorp reported Q3 2017 GAAP EPS of $1.35. It pegs operating EPS at $0.48. Consensus was $0.47. Operating EPS excludes a $1.037 billion one-time gain, $47 million pre-tax charge related to the valuation of the Visa total return swap and a $0.02 negative EPS impact reflecting a specific tax item and lower equity method income. Net interest income was ahead of expectations though expenses were higher than anticipated. Average loans were little changed, while average deposits declined. Operating revenues increased 2% on both a year/year and quarter/quarter basis to $1.5 billion. Tangible book increased 4% to $17.86 (1.6x) aided by its one-time gain. Its CET 1 capital ratio was 10.47%, down 5bps. Average diluted shares declined by 2.5%, while period-end shares dropped 4.5%. On July 31, Fifth Third Bancorp settled the forward contract related to its April 26 $342 million share repurchase agreement. An additional 2.2 million shares were repurchased in connection with the completion of this agreement. On Aug. 17, it initially settled a share repurchase agreement where it would purchase $990 million of its stock. This reduced Q3 2017 common shares by 31.5 million. Settlement of the forward contract related to this agreement is expected to occur on or before Dec. 18. Net interest income increased 3% (guided to +2%), reflecting the impact of higher short-term market rates, the continued shift into higher yielding consumer loans, and a higher day count. Average deposits fell 1%. Its net interest margin increased 6bps to 3.07% (guided to +2bps, was +4bps ex. interest recoveries), primarily driven by higher short-term rates and improving consumer and commercial portfolio yields, partially offset by a higher day count and a decrease in core deposits. Expense increased 2% (guided to +1%). Its Non-Performing Asset ratio declined 12bps to 0.60%. Its reserve/loan ratio declined 3bps to 1.31%.

JPMorgan Chase & Co. has partnered with data analytics start-up Mosaic Smart Data to help its fixed-income sales and trading business become more profitable. The bank, has signed a multi-year deal to use Mosaic Smart Data's technology division globally, the companies said in a joint statement released last Sunday. The London-based start-up has developed technology that aggregates and analyses vast amounts of data from the fixed-income trading division of investment banks to help them make more informed decisions and gain a competitive edge. That includes helping traders decide which clients to focus on in a given day or enabling management to assess which trader, or trading desk has been performing better. The partnership underscores the growing demand by banks for technology that can help them gain greater insight from the large quantity of data they produce and store. (Source: Reuters)

Nordea Bank AB – Net Interest Income misses consensus by 1%. Fees -3% vs consensus. Trading -5% vs consensus. Total income -3% vs consensus. Costs are a 3% beat (lower) and Loan loss costs are also lower than expectations which brings operating profit in line with consensus. CET 1 capital ratio is ahead at 19.2%, which is flat quarter/quarter and ahead of consensus at 18.6%. Nordea announced a cost save plan, in which they will cut c.12.5% of their full time work force (32,000) plus an additional 2,000 consultants, targeting a 2018 total cost base of €4.9 billion, down to €4.8 billion in 2021. However, consensus is already at €4.9 billion, so little to get excited about. Overall a poor set of results in our view missing consensus on key revenue lines plus no new plans for any additional capital returns above the current dividend plan as they increase the capital buffer...so no benefit of moving its headquarters to Finland.

Unicredit SpA - released Q3 2017 preliminary results with a net result of €2,820 million, adjusted net profit (excluding Pioneer disposal and a non-recurring non-operating item in Non-Core) of €838 million, and CET 1 capital ratio expected to be above 13.5%, broadly in line with expectations.

Activist Influenced Companies

Nothing new to report.

Dividend Payers

AT&T Inc. reported net income of $3.0 billion, or 49 cents a share, for the quarter ended Sept. 30, down from $3.3 billion, or 54 cents a share, in the year-earlier period. Excluding some items, it reported earnings of 74 cents. On that basis, analysts on average were expecting earnings of 75 cents per share, according to Thomson Reuters I/B/E/S. Revenue was $39.7 billion, down from $40.9 billion in the year-earlier period. Analysts had expected $40.1 billion, on average. The company is in the process of buying Time Warner, Inc. for $85.4 billion in an effort to turn itself into a media powerhouse that can bundle mobile service with video. It has said it expects the deal to close by the end of the year.

ABB Ltd reported operating profit 2.7% ahead of consensus on a 2.4% sales beat with orders coming in-line. The biggest surprise came from the Industrial Automation business that delivered a 9.5% EBIT and 8.4% revenue beat with organic growth turning positive (+1%) in Q3 despite a 12-month rolling book:bill firmly below 1x in Q2 and driven by a pick-up in short cycle business (measurement products and service). Robotics and Motion margin surprised positively (16.2% vs consensus) driven by cost cutting measures, prices increases and stabilisation in process. Cost savings are confirmed at $2 billion for full-year, which bodes well for Q4 in our view. On the negative side, cash was soft (-12% year/year) and central costs line was c$25 million higher than expected (investment in Digital and no more Cable profits) with full-year outlook increasing to c-$430 million (from c-$400 million before). Management outlook has improved slightly with macro comment turning positive for Europe (further to US already positive and China growth continuing) with overall global market now showing modest growth.

Bunzl PLC - trading in the third quarter was in line with expectations at the time of the half year results and management is happy with estimates for the full year. Organic sales growth has increased from c5% in Q2 to 5-6% in Q3, due to new contract wins ramping up. Acquisitions added another 6% to sales in the quarter, taking total growth to 11%. No new acquisitions were announced this week but the group is working on other transactions and the acquisition of the French company, **Hedis** – a large deal compared to Bunzl's average size – is expected to complete by the end of the year.

Novartis AG reported solid Q3 results with Sales and Core EBIT 2-3% ahead of consensus. In Pharma, strong Cosentyx revenue offset weakness for Entresto and Gilenya. Alcon showed further signs of revenue and profit recovery (albeit from a very low base) and Sandoz saw EU biosimilars offset further weakness in U.S. retail generics. In line with our expectations, Novartis announced that a spin-out/listing was the preferred strategy for Alcon Surgical. Management believes a track record is essential for the equity story so 1st Half 2019 is the earliest possible window. PharmaValues assumes a value of $16.5 billion. Our concerns focus on mid-term growth driven by building competition for Cosentyx and pressure of multiple patent expiries (Gilenya, Afinitor, Exjade, Ciprodex, Vigamox, Lucentis and Galvus).

Economic Conditions

U.S. durable goods orders, a key indicator of U.S. business activity, advanced 2.2% in September, well ahead of the expected 1.0% improvement and building on August's robust 2.0% growth. As usual, the headline reading was impacted by the bulky aviation orders. The core figure, which excludes transportation orders, was up a more modest 0.7%, yet still ahead of expectations, which were calling for a 0.5% improvement. Orders were particularly strong in computers and electronic capital goods.

U.S. new home sales surged 18.9% (biggest move since 1992) in September to a decade-high 667,000 units annualized. Every region saw gains (even the South), some more than others. Inventories were unchanged, so the months' supply took a dive to 5.0, a half-year low.

Financial Conditions

The Bank of Canada kept interest rates on hold, warning it would remain "cautious" when considering future hikes as it gauges the economic impact of gains in the Canadian dollar and higher rates while flagging the risk of growing protectionism in the U.S. Policy makers led by Governor Stephen Poloz left the benchmark overnight rate at 1% Wednesday, pausing after consecutive hikes at the bank's last two decisions in July and September even as they acknowledged rates are likely to go up. The central bank cited several concerns and questions including a stronger Canadian dollar that is weighing on inflation and exports, the growing risks associated with renegotiation of the North American Free Trade Agreement and evidence of continued slack in the labor market despite recent strong economic growth. "While less monetary policy stimulus will likely be required over time, Governing Council will be cautious in making future adjustments to the policy rate," policy makers said. "The Bank will be guided by incoming data to assess the sensitivity of the economy to interest rates, the evolution of economic capacity, and the dynamics of both wage growth and inflation."

European Central Bank - left rates untouched today with refinancing rate (0.00%), marginal lending facility (0.25%), and the deposit facility (-0.40%). The Quantitative Easing (QE) program is to be extended by nine months—to September 2018—and the amount of bond purchases is intended to be cut from €60 billion to €30 billion, starting in January with the qualifying statement that "If the outlook becomes less favourable, or if financial conditions become inconsistent with further progress towards a sustained adjustment in the path of inflation, the Governing Council stands ready to increase the APP (asset purchasing program) in terms of size and/or duration."

The U.S. 2 year/10 year treasury spread is now .83% and the U.K.'s 2 year/10 year treasury spread is .91% - 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.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 3.94% (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 4.2

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 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 11.18 (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

Net Asset Value:

The Net Asset Values (NAV) of our investment funds are published on our Portland website at http://www.portlandic.com/prices/default.aspx

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.

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, 'ROE' return on equity, 'ROTE' return on common equity.

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