News Highlights

Owners. Operators. And Insightful Investors.

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Established in 2007

PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. November 27, 2017

Owner Operated Companies

Brookfield Asset Management Inc. – Renova Energia SA's board has approved Brookfield Asset Management's proposal to acquire a controlling stake in the Brazilian renewable energy company for 1.4 billion reais ($433 million). Founded in 2001, Renova has struggled with a severe cash crunch since a deal with SunEdison, Inc. collapsed weeks before that company filed for bankruptcy protection in the U.S. last year. The long-awaited Renova sale is part of an asset divestment program that Companhia Energetica de Minas Gerais, or Cemig, began to pay off debt.

George Weston Limited reported its consolidated results for Q3 2017. Galen Weston, Chairman and Chief Executive Officer, of Weston Foods, commented that "Loblaw delivered solid results in an increasingly competitive market. Weston Foods had a disappointing quarter as the frozen business continued to under-perform due to soft sales and operational challenges, while the fresh, artisan, and biscuit businesses performed as expected." Net earnings increased by $166 million ($1.28 per common share) to $420 million ($3.25 per common share) in Q3 2017, compared to the same period in 2016. The increase was primarily due to an improvement in the underlying operating performance of $11 million ($0.08 per common share, driven by Loblaw) and the favourable year/year net impact of adjusting items totalling $155 million ($1.20 per common share), driven by the gain on disposition of Loblaw's gas bar operations. Net earnings also included the positive contribution from the increase in the company's ownership interest in Loblaw, as a result of Loblaw's share repurchases. Adjusted net earnings increased by $11 million ($0.08 per common share) to $277 million ($2.14 per common share). Weston Foods operating income in Q3 2017 was $36 million, a decrease of $39 million, or 52.0%, compared to the same period in 2016. Weston Foods adjusted EBITDA in Q3 2017 was $80 million, a decrease of $21 million, or 20.8%, compared to the same period in 2016. During the quarter, President's Choice Financial (PC Bank) entered into an agreement to end its business relationship with a major Canadian chartered bank which represented the personal banking services offered under the President's Choice Financial brand. PC Bank will continue to operate the PC MasterCard® program and remains committed to providing payment products to its customers and continues to strengthen its credit card services and loyalty programs.

Energy Sector

U.S. land rig count increased by 7 rigs week/week to 900, which is the third consecutive week of gains. The rig count was driven by increases in Horizontal Oil (+8), Vertical Oil (+3), and Horizontal Gas (+1), partially offset by declines in Directional Oil (-3) and Directional Gas (-2) as Vertical Gas remained flat week/week. Total horizontal land rig count is down 3% since the peak in August 2017. The Permian currently makes up 54% of all oil rigs.

U.S. horizontal oil land rigs increased by 8 rigs week/week to 644, as gains in "Other" (+6), Permian (+2) and DJ-Niobrara (+1) were partially offset by declines in Woodford (-1) as Williston, Eagle Ford, Granite Wash, and Mississippian remained flat week/week.

Canadian rig count increased by 7 rigs week/week to 214, and is up 24% from the level this time last year.

U.S. Gulf of Mexicio offshore rig count increased by 1 rig week/week to 22, and is down 59% since June 2014.

Total SA has agreed to sell a 51% stake in the Martin Linge project and a 40% stake in the Garantiana discovery in Norway. The consideration of the deal is $1.45 billion. Statoil ASA will also receive remaining tax balances with a nominal post-tax value of more than $1 billion. The Martin Linge field is due to start-up in the first half of 2019 and has estimated recoverable reserves of more than 300 million boe. The project experienced delays and cost increases due to delayed topside engineering, construction and currency impact. Operations will be controlled remotely from an onshore digital operations centre, enabling reduced operational expenditures. Statoil's stake in the field will increase from 19% to 70%. Garantiana is an oil discovery north of the Visund field in the North Sea with a recoverable resource potential between 50 to 70 million boe. Development concepts are currently being evaluated. Partner Aker BP ASA has previously indicated the project could reach first production in 2021 as a sub-sea tieback. The reservoir is high pressure and it is reported to have some challenging fluid characteristics (high CO_2 and H_2S content). The deal is expected to complete in 2018 with an effective date of 01 January, 2017. These transactions represent Total's entire interest in both fields. As a result of the transaction, Statoil will become operator and also receive remaining tax balances with a nominal post-tax value of more than $1 billion. It's calculated an acquisition value of the deal of $8.2/boe but that falls to less than $2.5/boe after taking into account the impact of tax balances. For Total, the deal helps streamline its portfolio in the North Sea towards assets with greater synergy potential while for Statoil the transaction adds growth assets where the company can leverage existing contracts to realise additional opportunities and synergies. As such, we agree with the strategic rationale of the transaction and see it as incrementally positive for both companies.

Financial Sector

The Royal Bank of Scotland Group PLC (RBS) – U.K. chancellor Philip Hammond has for the first time put a March 2019 deadline on when the government will start selling its £24 billion stake in RBS, despite currently sitting on a loss of more than £26 billion. The plan to start selling the government's 71% stake in RBS in the next 16 months comes less than one month after the bank said it was confident that it would settle a multibillion-dollar fine with U.S. authorities this financial year for miss-selling mortgage securities. Mr. Hammond has previously said he would not begin selling RBS shares until the bank had agreed the size of an expected fine with the U.S. Department of Justice, which some analysts estimate could be as high as $12 billion. The U.K. Treasury said in last Wednesday's Budget that it "intends to recommence the privatisation of RBS before the end of 2018-19 and to carry out over the forecast period a programme of sales expected to dispose of about £15 billion worth of shares, which represents around two-thirds of our stake at current market prices". Unlike the sale of the government's stake in Lloyds Banking Group PLC - which the government completed this year at a slight profit to the taxpayer - the sale of the RBS stake is likely to leave the government nursing a loss (Source: Financial Times).

Last week, the Financial Stability Board (FSB) published its 2017 list of global systemically important banks (G-SIBs) using end-2016 data and an assessment methodology designed by the Basel Committee on Banking Supervision (BCBS). One bank (Royal Bank of Canada) has been added to the list of G-SIBs identified in 2016 and one bank (Groupe BPCE) has been removed, and therefore the total number of G-SIBs remains the same as the 2016 list. The list is comprised of 30 of the world's largest banks, and appearance on it imposes a higher regulatory capital requirement (CET 1). Depending on its ranking, a bank will be designated to "buckets" 1 through 5 that trigger additional CET 1 buffers ranging from 100bps to 350bps (no banks are currently assigned to the most onerous "bucket"). Globally, we note that Royal Bank of Canada's (RBC) 10.9% Q3 2017 CET 1 ratio compares to a 13.3% average for the 16 other banks currently assigned to the same G-SIB bucket. RBC's relative CET 1 ratio positioning would suggest that the bank could face a material capital build requirement. However, this analysis ignores different approaches to regulatory capital requirements in other jurisdictions. Some of the CET 1 surcharges comprise: JPMorgan Chase & Co. (250bps), Bank of America Corporation and Citigroup Inc. (200bps); Goldman Sachs Group Inc. and Wells Fargo & Company (150bps); and The Bank of New York Mellon Corporation, Morgan Stanley and State Street Corporation (100bps). Citi moved down from the 250bp bucket last year. BNP Paribas S.A lowered -50bps to 150bps surcharge and Credit Suisse Group lowered -50bps to 100bps surcharge.

Activist Influenced Companies

Pershing Square Holdings, Ltd. reduced its stake in Restaurant Brands International Inc. by 32.3% to 26.5 million shares, according to its SEC filing as of Sept 30, 2017 and compared with the previous quarter ended as of June 30, 2017. According to Pershing Square's November investor letter, "Tim Hortons's same-store-sales were roughly flat, as customers have been slow to try the espresso-based drinks and new offerings on the lunch menu that were introduced at the end of the quarter, [...]. We believe sales in recent quarters have also been negatively impacted by the recent public dispute with a group of franchisees." Portland funds exited their Restaurant Brands International investments in September, at significant profit.

Dividend Payers

AT&T Inc. – The U.S. Department of Justice sued AT&T to block its $85.4 billion acquisition of Time Warner, Inc., saying the deal could raise prices for rivals and pay-TV subscribers while hampering the development of online video. The Justice Department is arguing that AT&T would use Time Warner's films and movies to force rival pay TV companies to pay "hundreds of millions of dollars more per year for Time Warner's networks". AT&T, which sees the deal as a way to compete against emerging technology companies such as Netflix and Amazon.com, Inc.'s Prime Video, described the lawsuit as "a radical and inexplicable departure from decades of antitrust precedent." AT&T head lawyer David McAtee said vertical mergers, between companies on different steps in a supply chain, are routinely approved. The No. 2 U.S. wireless carrier is trying to buy Time Warner, which also owns the premium channel HBO and movie studio Warner Bros. Entertainment Inc. so it can bundle video entertainment on its mobile service.

Aryzta AG reported negative organic growth for the quarter of 2.6%, slightly better than consensus. Volume was down 3.6%, offset by positive pricing of 1.0%. Foreign Exchange impact was a negative -2.9%. Organic growth of 0.6% (-0.7% volume and 1.3% pricing), still impacted by the phasing out of the Coop contract in Switzerland, ongoing negotiations with customers to increase prices on the back of higher raw material prices and Brexit. The situation in Germany is improving.

The problematic Cloverhill represented -7.0% of the growth with volume down -7.1% and pricing up 0.1%. Excluding Cloverhill ('progress at Cloverhill is proving difficult' with a lawsuit from McKee Foods Corporation) organic growth would have been at 1.0%, a sequential acceleration from -4.7% in Q4 2017, mainly thanks to strong performance in Canada. The business issues remain unchanged from last update in September. Management is confirming fiscal year 2018 EBITDA guidance 'to be broadly in line with fiscal year 2017 EBITDA. Volume remains the key challenge for Aryzta, which needs to increase its capacity utilization rate in some factories in order to boost returns. We continue to believe that Aryzta represents a restructuring that is underway but will take a while for more positive results to show.

Johnson Matthey PLC (JMAT) reported 1st Half 2017/18 underlying profit before tax of £233 million, in-line with consensus (£233 million). Guidance retained for approximately 6% sales growth and flat operating profit at constant currency (underlying growth offset by higher pensions/medical charges). However, pensions costs are now expected to be only a small headwind vs £12 million headwind previously – JMAT highlight they are reinvesting the additional funds into restructuring efforts.

South 32 Limited (S32) has announced the approval of the Klipspruit extension project for $301 million, approximately $50 million higher than expectations/previous indications, and that it will manage South Africa Energy Coal (SAEC) as a stand-alone business from April 2018 with the intention to reduce ownership which ultimately could lead to a listing on the Johannesburg Stock Exchange. Using sum of parts stripping out South African coal EBITDA on a SA mining peer multiple of 6.75x, implies 'South 32 less SAEC' is cheaper than headline levels (3.3x EV/EBITDA vs 3.4x). Overall a big and very astute move (overall positive in our view) to simplify the business and unlock value – we believe this removes one of the main reasons for the equity discount vs peers (due to amongst other things Mining Charter/South Africa political risk), probably ingratiates them with the SA government in our view and will make the equity market focus on why the parent S32 trades on a cheaper multiple than SA domestic mining equities. This process also underlines S32 management quaplity that they are prepared to act decisively to deal with a problem area of the portfolio in a way that is likely to create value for shareholders.

Economic Conditions

Germany - Political uncertainty has heightened on the back of German Chancellor Angela Merkel's failure to forge a three-way coalition government. The pro-business Free Democrats (FDP) abruptly pulled out after more than four weeks of negotiations with Merkel's conservative bloc and the ecologist Greens. Negotiations were always going to be difficult as the three parties' opinions differ significantly – with the main sticking points reportedly surrounding refugee, climate-change and tax policy. However, by the week-end Angela Merkel has laid out yet another potential path to another alliance between her CDU-led bloc and the Social Democrats, (SPD). She's set to meet with SPD head Martin Schulz on Thursday.

Europe - The collapse of talks on a new German government means that the euro zone's ambitious plans for deeper economic integration could be put on hold, euro zone officials said last Tuesday. German government coalition talks collapsed raising the prospect of new elections. Euro zone leaders are to set a direction for deeper euro zone economic integration at a summit in the middle of December, at which Germany's input is crucial. "As long as Germany does not have a clear position, it will by default not agree to anything. Therefore, delay is the most likely option," one senior euro zone official involved in the euro zone integration talks said. (Source: Reuters)

UK and Brexit - Paris has won a battle to host the European Banking Authority (EBA), which will relocate from London after the UK leaves the European Union. The French capital's victory follows a win earlier for Amsterdam, which will host the European Medicines Agency (EMA). Paris was picked after lots were drawn when three rounds of voting failed to produce a winner. The EMA and the EBA currently employ about 1,000 people in London. (Source: BBC)

Financial Conditions

Canada retail sales fell short of expectations in September, advancing a more modest 0.1%, relative to the expected 0.9% improvement. Nonetheless, the advance was superior to August's 0.3% pullback. Core retail sales, which exclude the effects of vehicle and parts sales, were up 0.3%, still short of the expectations for a 1.0% improvement. Growth was driven by building materials and furniture sales, while clothing and sporting goods suffered in the month.

U.S. new home sales reached a 685,000 annualized level in October, ahead of the expected 625,000 units and September's 667,000 units annualized. The 6.2% improvement built on September's strong 14.2% advance, with gains in the month spread broadly across the country. The tight inventory in the existing home market is providing impetus for the new builds.

U.S. existing home sales jumped 2.0% in October to a 4-month high of 5.48 million units annualized, the second increase in a row and the largest monthly gain since March was spread out between single-family homes and condos. The inventory of homes that are available to the highest bidder also fell … again. They dropped for the fifth consecutive month and are now down 10.4% from a year ago, which, along with the jump in sales, pulled the months' supply to a super-tight 3.9, the lowest since March. Prices continued to climb (+5.5% year/year) but that didn't dissuade homebuyers…first-timers, in fact, made up 32% of total sales, the highest in three months, while seasoned homebuyers made up 55%. The strong job market is clearly giving confidence a boost.

The U.S. 2 year/10 year treasury spread is now .58% and the U.K.'s 2 year/10 year treasury spread is .79% - 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 3.92% (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 10.16 (compares to a post-recession low of 9.52 achieved in early November) 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
- Bay & Scollard Development Trust

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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