News Highlights

Owners. Operators. And Insightful Investors.

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PORTLAND INVESTMENT COUNSEL®

Established in 2007

Our views on economic and other events and their expected impact on investments. January 29, 2018

Owner Operated Companies

Alphabet Inc. – Google has made its first ride-hailing investment in Asia by pumping money into Go-Jek, as the Indonesian start-up and deep-pocketed rivals rapidly expand their app-based services and digital payments in Southeast Asia. The funding deepens Google's commitment to Indonesia's internet economy," Caesar Sengupta, a vice president at Google said in a company blog on Monday. Google and Singapore state investor Temasek Holdings Private Limited were reportedly among those investing in Go-Jek as part of a $1.2 billion fundraising round. Rivals Grab and Uber Technologies Inc. are backed by Japan's SoftBank Group Corp., while Go-Jek has secured investments from Chinese technology giants Tencent Holdings Limited and JD.com Inc. Ride hailing firms are investing tens of millions of dollars to expand their digital payment systems and are also seeking to allow their users to pay for third-party services. With more than 133 million people online, Indonesia is home to the fifth largest population of internet users in the world but half of the country's population has yet to connect to the internet, Google's Sengupta said. Southeast Asia is the world's third-biggest ride-hailing market after China and the U.S.

Alphabet launched a new business unit that will sell cyber security software to Fortune 500 companies, the latest move by the parent of Google to become a big player in corporate computing. The new unit, dubbed Chronicle, is betting on the premise that machine learning software, a type of artificial intelligence, can sift and analyze massive stores of data to detect cyber threats more quickly and precisely than is possible with traditional methods. Stephen Gillett, chief executive of Chronicle and a former top official at the cyber firm Symantec Corp, said access to Google's expertise in automated data analysis would give the company an edge. The global cyber security market is worth nearly $100 billion.

Carnival Corporation & PLC, the world's largest leisure travel company, announced it has signed a shipbuilding contract for a second next-generation cruise ship for its P&O Cruises brand with leading German shipbuilder Meyer Werft GmbH & Co. KG that is scheduled to be delivered in 2022. Similar to a fellow P&O Cruises sister ship due for delivery in 2020, this second new vessel will be the largest cruise ship to be built specifically for the British market. It will be 180,000 gross tons and will accommodate approximately 5,200 guests (lower berths). Both new ships will be registered in the U.K. The new ship is part of Carnival Corporation's ongoing fleet enhancement strategy with 19 new ships scheduled for delivery between 2018 and 2022. The ship will be built by Meyer Werft at its shipyard in Papenburg, Germany, and feature the corporation's exclusive 'green cruising' design as one of the first generation of cruise ships to be powered by Liquefied Natural Gas (LNG) both while in port and at sea, which will significantly reduce air emissions with the shipping industry's most advanced fuel technology.

Energy Sector

U.S. Rigs – U.S. energy companies added 12 oil rigs past week, the biggest weekly increase since March, as crude prices hovered near their highest levels since 2014, prompting drillers to return to the well pad. Drillers boosted the oil rig count to 759 in the week to January 26, the highest level since September, as reported by General Electric's Baker Hughes energy services firm. More than half of those oil rigs were located in the Permian basin in west Texas and eastern New Mexico where the number of active units increased by 18 this week to 427, the most since January 2015. That was the biggest one-week increase in rigs in the Permian since November 2013. Those rigs were expected to help boost oil output in the Permian to a record high near 2.9 million boed in February, according to federal projections, representing about 30% of total U.S. oil production. In anticipation of higher prices in 2018 than 2017, U.S. financial services firm Cowen Inc. said 26 of the roughly 65 exploration and production companies (E&Ps) they track, including EP Energy Corp., have already provided capital expenditure guidance for 2018 indicating a 7% increase in planned spending over 2017. There were 947 oil and natural gas rigs active on Jan. 26. On average, there were 876 rigs available for service in 2017, 509 in 2016 and 978 in 2015.

Financial Sector

Barclays PLC - Tiger Global Management LLC, the U.S. hedge fund has invested more than US$1 billion into Barclays to become its 7th largest investor with about a 2.5% stake (according to Bloomberg) at circa £1.80 per share in November 2017.Tiger appears to back CEO Jes Staley's view that the bank's 40% discount to book value is unjustified after it completed its multiyear restructuring and likely its strategy of its Atlantic focus … U.S.-led investment bank and U.K.-based consumer banking operation (Source: Financial Times).

Barclays is eliminating as many as 100 senior staff at its investment bank as the unit's chief, Tim Throsby, overhauls the underperforming division. The cutbacks will fall mainly at the managing director and director levels and are evenly split between Europe and the U.S. Employees in the banking division, which raises debt and advises companies on mergers and strategy, are being informed this week, with reductions to the markets side of the unit, which houses fixed-income and equity traders, to start next week. (Source: Australian Finance Review)

Fifth Third Bancorp reported Q4 2017 EPS of $0.67. Results included a net positive $0.15 impact on reported EPS. Excluding these items, adjusted EPS was $0.52 and consensus was $0.48. Operating revenues increased 4% year/year and were little changed with Q3 2017. Tangible book increased 1.3% to $18.10 (trading at 1.8x). Its Return On Tangible Capital Employed was 11.7%. Its CET 1 ratio (transitional) was 10.61%, up 2bps. Its average diluted share count declined by 2.2%. Net interest income declined 1%. Still, adjusting for the $27 million leveraged lease remeasurement, net interest income (NII) increased 1%, reflecting higher interest earning asset yields as well as the continued shift into higher yielding consumer loans. Its reported net interest margin declined 5bps to 3.02%. However, adjusting for the leveraged lease re-measurement, its net interest margin expanded 3bps to 3.10%, reflecting higher securities portfolio and consumer loan yields, partially offset by an increase in funding costs associated with deposit rate changes and the full quarter impact of Q3 2017's auto securitization. Expenses looked to be little changed with Q3 2017, reflecting lower other noninterest expense and salaries, wages and incentives, offset by higher employee benefits and technology and communications expense. Its adjusted efficiency ratio was 61.8%. Its Non-Performing Asset ratio declined 7bps to 0.53%. Its reserve/loan ratio declined 1bp to 1.30%.

JPMorgan Chase & Co. unveiled a $20 billion investment plan on Tuesday to hike wages, hire more, open new branches and expand its business as it takes advantage of sweeping changes to the U.S. tax law and a more favorable regulatory environment. The bank joined several other U.S. companies that have already announced spending plans after the federal tax overhaul was signed into law in December, bringing lower corporate rates and other changes. In the most explicit use of tax savings announced by any major bank, JPMorgan said it would raise wages for 22,000 employees by an average of 10%, to between $15 and $18 per hour, hire 4,000 employees and add up to 400 Chase branches. The largest U.S. bank by assets will also increase small business lending by $4 billion and increase loans to customers seeking affordable homes by 25% to $50 billion. (Source: Reuters)

Nordea Bank AB – Q4 2017 results - are weaker than expected at the headline which misses market expectations by 9%. Core revenue line items of NII again disappoint, coming in 4% lower than consensus & fees 3% lower. On the positive, costs are 1% better, loan losses 27% better and the group reports a CET 1 ratio of 19.5% (20bps better on lower Risk Weighted Assets) and a dividend of 68c (1c higher than expectations). While the slightly higher dividend is encouraging, Nordea's CEO is quoted not to be happy with the quarterly development and as we expected, the focus is on a more benign outlook in 2018.

Standard Chartered PLC - has launched a new business unit that will invest in financial technology and manage its current investments, Financial Times reports. The new unit SC Ventures will also act as internal consultant to help promote fintech innovation within the bank. New fund will be led by Alex Manson, who has led StanChart's global transaction banking.

Activist Influenced Companies

Pershing Square Holdings, Ltd. – Billionaire investor William Ackman said that his hedge fund Pershing Square Capital Management made a new bet on sportswear company Nike last year that has already earned his portfolio a roughly 30% return. Ackman, one of the world's most closely watched activist investors whose bets have often helped push up a target company's share price, bought Nike when it was trading around $53 a share. The bet on Nike is unusual in that Ackman has no plans to push the company's management to make changes, leaving it as one of his few "passive investments."

Dividend Payers

Diageo PLC - 1st half results – Operating profit (pre exceptions) £2,190 million (0.8% below consensus) with EPS of £0.678 (3.5% above consensus) and dividends per share of £0.249 in line with expectations. Organic sales growth was up 4.2% (above consensus +3.7%) and expectations of stronger organic sales growth in 2nd half 2018 (India, for one, surely has to improve).

Dufry AG plans to sell 39.4 million shares in its North America subsidiary Hudson Group (fiscal year 2016: sales US$1.7 billion, EBITDA margin 9.3%), and there will be an over-allotment option for another 5.9 million shares; offering price will be between US$19-21/share which gives a value of US$750-830 million resp. with the over-allotment option US$860-950 million. The 39.4 million A-shares are 43% of total outstanding shares of 92.5 million, incl. the over-allotment option it will be 45.3 million (=49% of total). Therefore, Dufry will continue to control its North America business, owning B-shares which have the same right with the exception of the voting (10x); therefore, Dufry has a 93% voting power. With the cash inflow from the IPO, Dufry will reduce its net debt considerably (net debt Q3 2017: CHF 3.5 billion) bringing its net debt/EBITDA from 3.5x (Q3 2017, covenants 3.75x) to 2.5-2.8x. Hudson also indicated an org. growth of +8-11% in Q4, compared to +6.0% after 9 million. With the IPO of its North American unit (21% of group sales), Dufry wants to expand this business into Food & Beverage, which is an even bigger market than travel retail in North America. In addition, the cash inflow allows Dufry to reduce its leverage considerably, giving them more financial flexibility for add-on acquisitions. The total value of Hudson Group (US$1.8-2.0 billion, EV/EBITDA 18E 11-12x, Dufry with 10.5x) makes up 23-25% of Dufry's market cap.

GEA Group AG pre-released 2017 headline numbers and 2018 preliminary guidance. 2017 adjusted EBITDA came in at €565 million below guidance of €580-640 million including bottling charges of €20 million. GEA guides to 2018 adjusted EBITDA of

€590-640 million. That includes recent acquisitions, notably Pavan. Pre-Q3, consensus was looking for adj. EBITDA of €660 million excl. acquisitions. If we assume €30 million from Mergers and Acquisition (M&A), consensus stood at ~€690 million. GEA says it expects 2018 revenue to be flat on 2017 excluding acquisitions. But the weakness in dairy processing and beverage segments as well as adverse impact from wages (€40 million) and €10 million incremental IT costs are highlighted as key drivers behind the lower-than-expected earnings in 2018.

Novartis AG reported a strong Q4 with solid underlying growth in Pharma becoming apparent as Glivec generic erosion annualised out, as expected. EPS core (basic): $1.21 vs consensus $1.19. Group product sales, up 2%cc in Q4, were 2% ahead of consensus. Group Core EBIT, up 5%cc, was in line with consensus expectations but marginally below CS forecasts. The company declared a 2017 dividend of SFr 2.80. Management targets low-to mid-single digit sales growth and mid-to-high single digit Core EBIT growth for the 2018. For each division: Pharma Q4 Sales (+4%cc year/year) and Core EBIT (+9%cc year/year) were 2% and 6% ahead of consensus respectively; Sandoz was broadly in line with consensus forecasts at the sales level (-4% cc year/year). Core EBIT (+1%cc year/year) was 6% ahead of consensus; Alcon showed continued positive momentum with sales 2% ahead of consensus (+6%cc year/year) and Core EBIT (+36% year/year) 8% ahead of consensus. The improvement was driven by continued re-acceleration in the core Surgical franchise from the very low levels seen in Q4 2016. Management continues to work towards a strategic review of the business with 1st half 2019 remaining the target for a likely action.

Economic Conditions

U.S. home sales- After three consecutive monthly gains, existing home sales pulled back 3.6% in December and November's outsized gain was shaved to 5.1%, leaving sales at 5.57 million annualized. That's down from the previous decade-high, though still up 1.1% from a year ago, continuing a six-year upward move. The pullback was partly due to an earlier hurricane-related bump in the South, though sales retreated in the other three major regions as well. First-time buyers accounted for 32% of sales, up from the prior month, but little changed from earlier trends and less than normal, hinting at some possible pent-up demand in our view. The investors' share rose moderately to 16% as stocks and cryptocurrencies aren't the only games in town. On the supply side, listings have never been leaner, both in absolute terms and relative to sales. That's keeping median prices locked into a near 6% pace (up 5.8% year/year in December). Still-low mortgage rates, easier lending standards and solid income gains in the face of tax cuts should support home sales in the first half of the year.

U.S. – U.S. **economy** advanced by 2.6% in the last quarter of 2017, shy of the expectations for a 3.0% improvement, driven by business investment and the change in net exports (fuelled by a cheaper U.S. dollar), but the consumer sector and government spending also added to growth in the quarter.

The U.S. **personal consumption** increased by 0.3% in December, while the U.S. personal income improved by 0.4% in the same month, ahead of the expectations for a 0.3% advance. The core personal consumption expenditures (PCE), the U.S. Fed's favourite inflation gage, clocked in at 1.5% year/year, in line with the expectations and on par with November's reading.

Canada – Canadian retail sales inched higher by 0.2% in November, falling short of the expectations for a 0.7% improvement, as auto sales dropped 3.6% in the month. Core retail sales, which excludes sales of vehicles and parts, jumped by 1.6%, ahead of the expectations for a 0.8% advance. Sales of electronics led in the month, supported by clothing, sporting goods and general merchandising.

Inflation in Canada, as measured by the changes in the consumer price index (CPI), was in line with the expectations, at 1.9% for December's headline reading. The core inflation, which excludes the effects of price changes for the most volatile price series, such as food and energy, was, at 1.2% year/year, muted and a touch lower than November's 1.3% reading.

Japan's export growth continued to stay positive but eased to 9.3% year/year in December (from 16.2% in November). Nonetheless, this was the 13th consecutive month of export expansion since November 2016 and growth was driven by strong demand for machinery (13.9% year/year, 2.8ppt), Manufactured goods (12% year/year, 1.3ppt), and electrical machinery (9% year/year, 1.6ppt) which includes semiconductors. Exports to key destinations that were in double-digit growth included China (15.8% year/year) and Europe (12.3% year/year) but exports to US eased to 3.0% year/year (from 13% year/year in Nov).

Financial Conditions

The European Central Bank (ECB) announced that the various interest rates would be kept on hold this month: main refinancing operations 0.00%; marginal lending facility 0.25% and deposit facility -0.40%. And guidance was the same: On rates: "… key ECB interest rates to remain at their present levels for an extended period of time, and well past the horizon of the net asset purchases."; On purchases: "… at the new monthly pace of €30 billion, are intended to run until the end of September 2018, or beyond, if necessary", or at least until they see inflation on the path to 2%. And they're ready to buy more if things go awry. The economic commentary was more upbeat than the last meeting. Economic growth is still robust, but inflation has yet to show convincing signs of a sustained upward trend. The recent Euro volatility represents a source of uncertainty and requires monitoring for its implications on its price stability. The economic risks are broadly balanced…. could have positive growth surprises in the near-term, thanks to strong cyclical momentum, while any downside risks are in global factors, including FX markets. Still, an ample degree of monetary accommodation was still needed.

The U.S. 2 year/10 year treasury spread is now .56% and the U.K.'s 2 year/10 year treasury spread is .83% - 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 4.15% (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 12.06 (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 Advantage Plus - Everest and McKinley Funds
- Portland Focused Plus Fund LP
- Portland Focused Plus Fund
- Portland Global Aristocrats Plus Fund
- Portland Global Energy Efficiency and Renewable Energy Fund LP
- Portland Private Growth Fund
- Portland Private Income Fund
- Portland Special Opportunities Fund
- Portland Value 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.

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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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PIC18-008-E(01/18)