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. February 20, 2018

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Owner Operated Companies

Brookfield Business Partners L.P. (BBU) earned $215 million on revenue of $22,823 million in 2017. This compares with a loss of $202 million on revenue of $7.96 billion in 2016. "Over the past year we made significant progress enhancing our overall business. We closed five acquisitions and announced an additional two, deploying or committing $3 billion of capital together with institutional partners," said Cyrus Madon, chief executive officer of BBU. "Our business today has greater scale with diverse service and industrial operations." BBU reported company Funds From Operations (FFO) for the year ended December 31, 2017, of $252 million compared with $200 million in 2016. Company FFO in 2017 benefited from strong results in the partnership's business services and industrials segments, partially offset by weaker results at the partnership's construction operation. Net income attributable to unitholders was $24 million compared with a net loss of $29 million in 2016. BBU subsidiary, Brookfield Global Integrated Solutions Canada LP (BGIS) has agreed to acquire a large portfolio of Carillion facility management contracts in the U.K. Under the terms of the transaction, BGIS will acquire a portfolio of U.K. contracts for the delivery of services in the hospital, education, justice, transport and emergency services markets. The transaction is subject to closing conditions, and is expected to close in the first quarter of 2018.

The Kraft Heinz Company – Sales in U.S. business fell 1.1% to $4.79 billion. Total sales and profit for the fourth quarter fell short of estimates as well. Issues that weighed on sales included a supply shortfall of its Ore-Ida branded potato-based foods as well as a decision to limit supplies of cold cuts to preserve margins. Kraft Heinz said several of these problems are likely to persist this year. Net sales inched up 0.3% percent to $6.88 billion. Kraft-Heinz, the fifth-largest food and beverage company in the world, achieved its target of cutting $1.7 billion in costs by the end of 2017. Excluding items, the company earned 90 cents per share.

Liberty Latin America Ltd. (LILA) for the first time as an independent company announced its financial and operating results for the three months and twelve months ended December 31, 2017. CEO Balan Nair stated, "We are entering an exciting new phase for Liberty Latin America having completed the split-off from Liberty Global PLC. We believe we have a significant opportunity to grow through our unique asset base, encompassing a comprehensive range of telecommunications services from our extensive subsea network and B2B operations to our high-speed consumer mobile and fixed networks. Our assets are well-positioned across a region that remains underpenetrated and underserved by high-speed telecommunications products." In 2017, LILA upgraded or newly built approximately 465,000 home connections and there is more room to grow with a fifth of its network footprint at Cable & Wireless still served by low-speed copper connections and many homes in LILA's markets yet to be passed. LILA accelerated the rollout of our Wi-Fi Connect Boxes during the year, with 40% of its customers in Chile now benefiting from a market-leading in-home broadband connectivity experience. LILA reported operating cash flow (OCF) of $1,367 million of 2017, a 6% decline, impacted by the hurricane related interruptions in Puerto Rico and certain Cable & Wireless markets. For 2018, the company guides, conservatively, we believe, for $1.4 billion of OCF. LILA also guided for about 19% to 21% of revenue to be allocated to property and equipment additions in 2018.

Energy Sector

U.S. Rigs – U.S. energy companies added oil rigs for a fourth week in a row even though crude pulled back from three-year highs over the past couple of weeks as more drillers boost their 2018 spending plans. Drillers added seven oilrigs in the week to Feb. 16, bringing the total count up to 798, the highest level since April 2015, as reported by Baker Hughes. That was the first time since June that drillers added rigs for four consecutive weeks.

Financial Sector

Ares Capital Corporation (ARCC) reported Q4 2017 core net investment income per share of $0.38 (which excludes roughly $0.01/share of benefit related to the American Capital, Ltd. acquisition), in line with estimates of $0.38/share. Interest income was modestly better than estimates while capital-structuring fees came in lower, but was mostly offset by higher dividend income. Book value per share was $0.16/share higher quarter/quarter at $16.65, boosted by ~$0.21/share of net realized and unrealized gains on the quarter. Overall, this appears to be a solid quarter with core earnings that was in-line with the dividend rate after several quarters of a slightly lower run rate. ARCC had $1,506 million of new commitments during Q4, of which ~72% were in first lien, 18% were in second lien securities, 6% were in senior subordinated loans, 3% in subordinate notes, with the remainder in other equity and preferred securities. Against that, ARCC had $1,321 million of exits. The portfolio mix at quarter end was 44% first lien (vs. 41% previously), 32% second lien (vs. 35%), and 4% in certificates of the SDLP (vs. 4% previously). Overall yield on debt and income producing securities increased 10bps to 9.7%. Leverage of ~0.68x debt to equity, up slightly from the prior quarter of 0.66x. ARCC also announced that they will be expanding their Senior Debt Loan

Program to $6.4 billion from $2.9 billion, with $2.5 billion of new capital from AIG and another large insurance company, and with ARCC and Argon making an incremental commitment of ~$1 billion (pro rata with current ownership).

The Bank of Nova Scotia has agreed to buy investment firm Jarislowsky Fraser for C$950 million mostly in stock. The deal, valued at $755.35 million in U.S. dollars, is the second this year for Scotiabank, which has focused on growing its operations in the Pacific Alliance - a Latin American trading bloc comprising Mexico, Peru, Chile and Columbia. Scotiabank had agreed to buy a portion of Citibank's operations in Columbia last month. Scotiabank said the latest deal would C$40 billion in Jarislowsky's assets under management and add to earnings by 2020. Scotiabank said it intends to buy back some shares to offset the dilution expected by the deal. (Source: Reuters)

Brookfield Asset Management Inc. (BAM) reported a strong quarter with impressive results from several areas of its business, led by the renewable energy and infrastructure divisions. For Q4 2017, BAM posted FFO per share of $1.28, up 28% from the year-ago quarter. Excluding disposition gains, FFO per share was $0.86, up from $0.80 in the year-ago period, and materially higher than consensus of $0.64 and our estimate of $0.60. The beat was primarily due to stronger-than-expected results from the renewable energy division and Norbord Inc. BAM increased its quarterly dividend to $0.15 per share, which equals $0.60 per share on an annualized basis. The new dividend is up 7%, and equates to a current yield of 1.5%. As BAM continues to successfully grow its fee-bearing capital through fundraising in its various funds and public subsidiaries, fee-related earnings have grown considerably. Year/year, BAM increased its fee-bearing capital by 15%, from $109.6 billion at year-end 2016 to $125.6 billion at year-end 2017. Consequently, the annualized base management fee run-rate jumped 19%, from $995 million in Q4 2016 to $1.2 billion in Q4 2017. Including carried interest, incentive distributions and other performance/transaction services, BAM now generates fees of $2.5 billion on an annualized basis, up 22% year/year.

HSBC Holdings PLC - Reported Q4 underlying Profit Before Tax (PBT) of $3.6 billion which was 8% worse than consensus. Revenues were 1% light with costs 3% worse. Significant items of $1.3 billion were higher than expected leaving reported PBT $2.3 billion - $0.7 billion below expectations. Net Interest Margin was flat quarter/quarter at 1.63% with asset pricing pressure eroding the benefit of U.S. rate rises. Encouragingly the balance sheet continued to progress with loans +1% quarter/quarter underlying, and stronger mid-single digit growth flagged for 2018 (consensus +4%). Tangible Net Asset Value and CET 1 ratio were at $7.26, (-$0.03 quarter/quater) and 14.5% or -0.1% including the impact of U.S. tax changes. The dividend was in line at $0.21 with no new buyback.

RioCan Real Estate Investment Trust reported FFO per diluted unit of $0.44, up 9% from the year-ago quarter, and generally in line with both consensus and our estimate of $0.45. Same-property Net Operating Income (NOI) growth was very strong at 2.9% year/year, the largest quarterly same-property growth since Q4 2010. As of February 13, 2018, RioCan has either completed or agreed to sell $511.9 million of properties in secondary markets at a weighted average cap rate of 6.07%, approximately 25% of the intended disposition target. Notably, the asset sales are in line with RioCan's International Financial Reporting Standards (IFRS) values. Same-property NOI jumped $4.9 million or 2.9% compared to Q4 2016. Approximately 75% of the growth was from improved occupancy, higher rental rates on renewals and contractual rent increases. The remaining growth was from Target Corporation's backfills and other completed expansion/redevelopment projects. Committed occupancy increased 100bps to 96.6% as of December 31, 2017 as compared to December 31, 2016.

Activist Influenced Companies

Nothing significant to report.

Dividend Payers

Barrick Gold Corporation - During Q4 2017, Barrick produced 1.34 million ounces (MoZ) gold and 99 million pounds (Mlb) of copper (previously reported) and generated adjusted (excludes an impairment at Pascua-Lama and Bulyanhulu) net earnings of $253 million or $0.22 EPS, compared to consensus $0.20 EPS. Moving into 2018, ABX is in a solid financial position in our view, finishing the year with $2.2 billion in cash after generating FCF of $240 million in the quarter. During 2017, reserves decreased from 86.0Moz to 64.5Moz gold, driven by the Veladero & Cerro Casale disposals (9.2Moz combined) and reclassifying Pascua-Lama reserves (14Moz). Net of these, Barrick added 1.7Moz with notable additions at Turquoise Ridge (2.1Moz), Cortez (1.4Moz), Goldstrike (1.3Moz), and Goldrush (1.5Moz). Despite posting a strong quarter operationally (that was pre-announced), Barrick's near-term and longer-term guidance was not favourable. Barrick noted that Q1 2018 production will be particularly weak, with only 1Moz gold of attributable production expected (~25% below Q4 2017 production) due to lower grades at Barrick Nevada and scheduled maintenance at Pueblo Viejo. Attributable production from Acacia will also be lower, driven by Buzwagi (processing low-grade stockpiles) and Bulyanhulu (optimization study ongoing, potential mine restart in 2019). Overall, 2018 production (4.5 - 5.0 Moz) is guided to be ~6% lower than anticipated. Barrick also disappointed on cost control. 2018 cash costs are expected to rise ~6% ($540 - $575/oz gold) with CapEx also forecast to increase up to 15%. Long-term gold production guidance to 2022 also disappointed (4.2 - 4.6Moz vs. CG est. ~4.8Moz) despite the inclusion of Goldrush, Cortez Deep South, Turquoise Ridge and Laganus Norte. Beyond 2022, Barrick notes potential for contributions from Pascua, Donlin, Cerro Casale, and

Alturas. Given frustration with respect to these long-dated project options we are becoming more concerned that Barrick may choose potentially share-dilutive or cash-depleting M&A to moderate the production decline. Barrick is currently trading at 0.54x NAV, in line with its similarly undervalued peers.

BHP Billiton PLC - Underlying Net Profit After Tax US$4.1 billion (consensus US$4.3 billion). Underlying EBITDA US$11.2 billion (US$11.6 billion), EBITDA margin 53%. 55 cents per share (cps) (USD) dividend (fiscal year 2017 final 43cps, 1st Half 2017 interim 40cps) – 72% payout, well above 50% minimum. Period end net debt higher than expected US$15.4 billion (consensus US$14.1 billion), net gearing 19.9% (Jun 30, 21%). The main driver was poor cost performance in the coal business, while iron ore unit costs were also slightly ahead of expectations. Notwithstanding that, BHP has retained opex guidance for all divisions ex-coal on constant FX basis, while the new coal guidance is slightly higher than our estimate ($66/tonne vs. $64/tonne). A negative movement in productivity of US$496 million was recorded reflecting, 1) Olympic Dam smelter maintenance campaign impact (US$202 million); reduced volumes at Queensland Coal Corporation (US$225 million); and favourable change in estimated recoverable copper in the Escondida sulphide leach pad in the prior period (US$206 million). Underlying EBITDA by operation: Petroleum – US$2 billion (consensus US$2.1 billion) – conventional unit costs up 23% to US$10.38/boe; Copper – US$3.2 billion (US$3 billion) – unit costs up 17% to US$1.27/lb (Escondida up 16%, FX-related); Iron Ore – US$4.3 billion (US$4.5 billion) – unit costs down 1% to US$14.90/metric tons; Coal – US$1.8 billion (US$2.1 billion). Group Return On Capital Employed 12.8%. The group guides it is on track to deliver US$ 2 billion productivity gains by end 2019 and that its 2018 FCF should be greater than US$ 12 billion at current spot prices. Net debt range of US$10-15 billion to be maintained and Capital and exploration expenditure to remain below US$8 billion per annum for 2019 and 2020. In response to the activist Elliott Management Corporation, the board ruled out changing part of its operating structure as not in the best interests of shareholders.

Fortis Inc. reported 2017 fourth quarter and annual financial results, including Q4 adjusted EPS of C$0.62. Going forward, the impact of U.S. tax reform will increase rate base growth over the next five years (to 2022) by about 50bps. The company sees compound annual growth in rate base over next five years of roughly 5%. Targeted annual dividend growth is expected to be around 6% through 2022. Fortis guided for a five-year Capex program from 2018 to 2022 to be approximately $14.5 billion

Nestlé SA reported fiscal year 2017 organic sales growth of 2.4% (1.9% in Q4) of which 0.8% was price (consensus was expecting 2.7%; guidance was for a similar outturn to the 2.6% reported at 9 months). FX (-0.1%) and changes in scope (-1.9%) – primarily the deconsolidation of most of the non U.S. ice cream sales – meant reported sales increased 0.4% (SFr 89.79 billion). Organic sales growth of 0.7% in developed markets was impacted by share loss in North America and adverse weather on water sales. Emerging Market organic sales growth was 4.8% driven by price (primarily in Latin America) and volume growth in Asia/Africa (Maggi and Milo). ‘Underlying’ margin increased by 40bps to 16.4% (guidance was for “at least 20bps”). Nestle now excludes ongoing restructuring costs – 75bps of sales - from the calculation. This uplift reflects a 60bps decrease in gross margin (e.g. higher milk costs) being more than offset by efficiencies and mix. CEO Schneider is guiding for organic sales growth of 2-4% and signaling an improvement on fiscal year 2017. Given the targeted acceleration in cost savings, the guidance is for a underlying margin improvement in-line with 2020 target (17.5%-18.5%). Benefitting from recent US tax reform, Nestlé’s underlying tax charge is expected to be ~25%.

Roche Holding AG will acquire Flatiron Health following on from an existing equity stake of 12.6% (Jan 2016). Roche will pay US$1.9 billion and the deal is expected to close in 1st Half 2018. Flatiron Health is a privately held, New York City based healthcare tech and services company founded by ex-Google employees. It is active in oncology-specific electronic health record software, as well as the development of real-world evidence for cancer research. With its large network of oncology practices and academic medical centres across the U.S., Flatiron Health has created a platform designed to learn from the experience of every patient. Today, intense cancer research allows breaking down large indications into always smaller, but better-defined diseases. Together with the scientific advances in cancer research, the complexity of finding the right treatments for the different cancers has increased tremendously. Thus, it is important, that Pharma companies find ways to master this complexity in order to come up with new treatments at bearable costs. Flatiron has a lot of data that helps Roche understand, how different medicines react in various cancer patients. Working with real life data should allow to design clinical cancer trials faster and with the right patient selection - increasing speed and efficacy, as well as lowering attrition rates. As such, today’s acquisition is an important step in Roche’s personalized healthcare strategy in our view.

Wal-Mart Stores, Inc. reported adjusted Q4 2018 earnings of $1.33 below consensus at $1.37. U.S. comparisons were +2.6% much better than consensus at +2.2% and driven by traffic of +1.6%. E-commerce had a +0.6% impact on comparisons, compared to ~+0.8% for the first three quarters of fiscal year 2018. Guidance for 2018/19 adjusted EPS guidance of $4.75-$5.00 compares to consensus at $5.02 (for estimates that have been updated in 2018); using the tax rate guidance lowers our prior EPS to ~$5.06. This guidance includes a $0.05 benefit from currency rates. This is based on a +2.0% Walmart U.S. comparison – in line with Consensus and a consolidated EBIT margin range of 4.3%-4.4% in constant currency vs. Consensus. International total sales increased 6.7% on a constant currency basis or 2.8% on a reported basis compared to consensus at +4.0%. In terms of key markets, the U.K., Walmex, Canada, and China had comps of +0.5%, +6.1%,

+2.9%, and +2.3%, respectively. The gross margin was lower by 75bps. Adjusted segment operating income of $1,748 million was above consensus at $1,640 million. Overall Q4 2018 EPS was lower than estimate, primarily due to a lower gross margin with cited difficultly managing peak demand at the e-commerce business in Q4 2018 which resulted in some challenges. 2019 EPS and operating income are below our forecast and E-commerce 'growing pains' / losses may not moderate next year.

Economic Conditions

The U.S. economy expanded 2.3% in 2017, picking up from 2016's 1.5% average pace and finishing in a strong fashion (final domestic demand grew 4.3% annualized in Q4 alone). With tax cuts starting this year, 2018 should improve upon last year's performance; with Bank of Montreal forecasting 2.6%. (Source: Bank of Montreal)

U.S. industrial production in January unexpectedly fell for the first time since August, down 0.1% (+3.7% year/year), while December's 0.9% utilities-induced jump was slashed in half via the power of revisions and is now reflecting a 0.4% increase. November's 0.1% decline, though, was revised higher and is now showing a 0.3% increase. So let's call it a wash.

U.S. housing starts beat expectations with a 9.7% jump to 1.326 million units annualized in January, the 2nd highest level in 10½ years (or, more specifically, August 2007). And there was an upward revision to December (to 1.209 million, instead of 1.192 million). Gains came from both the singles and multi-unit segments, and from nearly all parts of the country with the exception of the Midwest (which was hit with heavy snow and blizzard conditions in the latter part of the month). Also, Building permits unexpectedly gained ground, jumping 7.4% in the month to 1.396 million units, the first increase in three months. So, with permits > starts, and with a still-tight supply of homes available for sale, look for construction to continue adding to economic growth (assuming builders can find enough workers for the construction sites, and drivers to transport the materials, and enough trucks to do the actual transporting, and so on).

Financial Conditions

The U.S. 2 year/10 year treasury spread is now .68% 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 4.38% (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 21.40 (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 Global Sustainable Evergreen Fund
- Portland Global Sustainable Evergreen 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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