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 26, 2018

Owner Operated Companies

Berkshire Hathaway Inc. posted a record $44.94 billion annual profit, though $29.1 billion stemmed from the slashing of the U.S. corporate tax rate, which reduced the Omaha, Nebraska-based conglomerate's deferred tax liabilities. Book value per share, measuring assets minus liabilities, rose 23% in 2017. Fourth-quarter net income quintupled to $32.55 billion, or $19,790 per Class A share, from $6.29 billion, or $3,823 per share, a year earlier. Operating profit, which Buffett considers a better gauge of performance, fell more than analysts expected in the fourth quarter, and slid 18% for the year to $14.46 billion. Full-year results suffered from Berkshire's first full-year insurance underwriting loss since 2002, hurt by Hurricanes Harvey, Irma and Maria and wildfires in California. Even so, insurance float, or premiums collected before claims are paid, and which give Buffett more money to invest, rose 25 percent last year, to $114.5 billion. In his annual letter to Berkshire shareholders, Buffett said finding things to buy at a "sensible purchase price" has become a challenge and is a major reason Berkshire is awash with $116 billion of low-yielding cash and government bonds. "Berkshire's goal is to substantially increase the earnings of its non-insurance group. For that to happen, we will need to make one or more huge acquisitions." Buffett revealed in his letter that Berkshire was sitting at year-end on a $7.25 billion paper profit on what has become a 3.3% stake in Apple Inc., worth $28.2 billion. Some Berkshire stock investments are made by deputies Todd Combs and Ted Weschler, who Buffett said together manage about $25 billion, up from $21 billion a year ago.

The Kraft Heinz Company – Warren Buffett has decided to retire from the company's board following the end of his term in April to reduce travel commitments. H.J. Heinz Company, L.P., backed by Buffett's Berkshire Hathaway and Brazil's private equity firm 3G Capital, acquired Kraft Foods Group, Inc. in 2015 to create one of the biggest food and beverage companies in the world. Berkshire Hathaway is Kraft Heinz's biggest shareholder with 26.7% stake as of Dec. 31, according to Thomson Reuters' data. In the last few years, Buffett, 87, has shed many of his non-Berkshire responsibilities. Last month, he gave two top executives Ajit Jain and Gregory Abel greater oversight of Berkshire's operating businesses, cementing their status as the front-runners to succeed Buffett atop the conglomerate. Kraft said it plans to nominate Alexandre Van Damme, a board member of Anheuser-Busch Inbev SA/NV and Restaurant Brands International Inc., to stand for election to Buffett's place in its 2018 annual stockholder meeting. Abel and Tracy Cool, chief executive of Berkshire's unit, Pampered Chef, Ltd. are the other Berkshire representatives on Kraft's board.

Energy Sector

BP PLC is now one year into what is an ambitious five-year plan. We believe that progress is on track, if not slightly ahead of plan, with both marketing and manufacturing delivering strong results. There is still a long way to go, but momentum across the entire BP business is building and we expect it to become increasingly evident over the coming 12 months that BP can deliver a material and sustained improvement in FCF. Approximately one-third of BP's upstream cash flow in 2020 is set to come from fixed price contracts – such as those in Oman and Egypt – the equivalent of approximately $9 billion. It seems reasonable to assume that this will be a similar proportion on a post-tax FCF basis – the equivalent of about $3 billion per year. Adding this to the post tax figure from the downstream of approximately $5.5-6 billion, would imply that total post tax FCF from the downstream and the fixed price part of the BP portfolio could reach approximately $8.5-9 billion. This compares to the annual 100% cash dividend bill of $8 billion, leaving plenty of excess FCF for the group to make capital allocation choices, with additional share repurchase our preferred way of returning cash to shareholders. Of all the targets included in the BP strategy, the downstream is the most eye-catching, in large part because the market had become used to this being a stable business. One year into a five-year plan and we believe BP has already achieved $1 billion of the planned $3 billion improvement, driven by both improved advantaged crude processing and growth in marketing. This ties up with the unit downstream earnings of $4.3/barrel being the best result we believe on record at the Q4 stage. There will doubtless be bumps in the road over the four remaining years of the plan yet the improvement in operational and financial performance we anticipate remains at odds with the valuation of the shares with the dividend yield remaining at 6%.

Total SA - 2017 was an important year for Total, with the group generating some of the best FCF growth of the sector while also enhancing its future resource base through acquisitions. We believe Total is exiting the industry crisis of the last three years stronger than it entered it, with low gearing and above sector average returns. From 2018, we see the company entering the next phase of growth. This will be driven in part by higher prices but also the acquisitions made and a ramp-up of production on new projects. Importantly, during this phase, we expect management to maintain their discipline on costs and capex, which should drive a material uplift in FCF. The management and board have committed to returning a large part of this to shareholders through the combination of higher dividends and share repurchase – a step that we see as a welcome signal that shareholders will share in any oil price upside.

Total's underlying cash flow in 2017 of $22 billion was up 33% year/year. This was driven in part by higher prices but also a successful reduction in costs and higher volumes, with upstream production up 27% from the low point of Q2 2014. Over the next three years, in a $60/barrel world, we see the company entering the next phase of cash flow growth with the group set to finish 2020 with cash flow 27% higher than it is today and above the 18% we expect from peers. Taking the middle of the group's capex guidance, implies organic FCF pre dividends of approximately $12 billion per annum over the 2018-2020 period and helps explain management's proposal to increase the dividend by 10% over the next three years.

Financial Sector

Barclays PLC's operating subsidiary has been charged by Britain's Serious Fraud Office (SFO) with giving Qatari investors an illegal loan which was then used to prop up its shares during the banking crisis, deepening the lender's legal difficulties. Barclays denies the SFO's allegation that the $3 billion loan it made to Qatar in November 2008 was connected with a Qatari investment in the British bank which ultimately helped it avoid a British government rescue, unlike its rivals Lloyds Bank PLC and Royal Bank of Scotland Group PLC. Qatar, which is a major investor in Britain with real estate and other assets, has not been accused of wrongdoing itself, but public companies in Britain are normally prohibited from lending money for the purchase of their own shares, known as "financial assistance". The SFO had levelled the same charge against the bank's holding company last June, but it is the operating unit Barclays Bank that is licensed for banking operations, meaning any conviction could also prompt sanctions from regulators. (Source: Reuters)

Barclays showed its confidence in future earnings last week by restoring its full dividend, despite lacklustre investment banking income, restructuring costs and U.S. tax reforms hitting the bank's 2017 bottom line. Although Barclays posted a pre-tax profit of £3.5 billion ($4.9 billion) for 2017, up from £3.2 billion a year ago, this was worse than the £4.7 billion average of analysts' forecasts compiled by the bank. Those forecasts excluded conduct charges, with the bank taking a £700 million hit for mis-selling of payment protection insurance and a fresh £240 million charge relating to alleged foreign exchange manipulation. Barclays reported a £1.9 billion attributable loss, after a £901 million tax write-down in the U.S. and a £2.5 billion loss on the sale of Barclays Africa. Q4 2017 results. PBT Q4 2017 was £93 million, -84% (-£477 million) below company provided consensus. However, this result included the material F/X litigation charge. Adjusted profit before tax (PBT) Q4 2017 of £333 million was -42% behind £570 million consensus driven by weak revenue and higher costs. Pre-provision earnings were -24% light. Revenue growth may be somewhat better (consensus looking for +1% in International vs. "up" although will be some offset for Q4 disappointment). With expectations of dividend increase and talk of buybacks, the shares are not expensive on about 0.74x tangible book in our view (Tangible net asset value as at December 31, 2017 was £2.76). A key positive to us is reduction in pension deficit (-£3 billion) which improves valuation by approximately 12p (post tax) with target CET 1 of approximately 13% (Lloyds 14%). (Source: Reuters). The group stated its ROTE, excluding material items mentioned above and the conduct charges was 5.6%, whereas its 2019 target excluding litigation and conduct charges is greater than 9% and greater than 10% in 2020 based on the CET 1 target of 13%. The bank declared a full dividend of £0.03 per share in 2017 and intends to pay £0.065 in 2018.

Canadian Imperial Bank of Commerce (CIBC) reported adjusted cash EPS of $3.18 (+10% year/year) vs. consensus of $2.83. The firm reported solid results across most business segments. Fiscal Q1 adjusted EPS surprise of 12% topped their 9% beat last quarter and compared to peer high average of <6% beat over the past 12 quarters. CIBC's much lower credit provisions (-$88 million) drove $0.20 of the $0.36 variance to EPS due to strong credit conditions. Total revenue was approximately 3% higher, driven by Other income, while expenses was generally in line. CET 1 ratio of 10.8% (+20 bps quarter/quarter) mainly benefited from strong internal capital generation (+36 bps) and by its dividend reinvestment program (+14 bps), slightly offset by IFRS 9 (-7 bps), and Risk Weighted Assets (RWA) (-16 bps). CIBC increased their quarterly dividend to $1.33 (from $1.30; +2.3%), slightly above consensus of $1.32. With the increase, CIBC pays a peer high dividend yield of 4.6%.

Citigroup Inc. said on Friday that it had failed to properly reduce interest charges on some 1.75 million credit card accounts since 2011, prompting a $335 million refund to customers later this year. The refund, which will average $190 per account, stems from the bank's discovery that it had not used a proper method for reducing interest charges for cardholders who resumed timely payments after having had to pay penalty rates for lapses. The errors amounted to about 10% of the interest reductions cardholders were due, the bank said. It estimated that the other 90% of rate savings were properly credited to accounts. The cost of the reimbursements has already been factored in to Citigroup's 2017 results. Under a federal law known as the CARD Act, banks have been required since 2011 to cut back on penalty interest rates after cardholders resume timely payments. The bank said it found it erred in how it calculated some of those reductions. (Source: Reuters)

JPMorgan Chase & Co. China's central bank on Tuesday named JPMorgan as yuan clearing bank in the U.S., as Chinese authorities seek to boost global use of the yuan. The pick of the bank was made according to an agreement with the U.S. Federal Reserve, the People's Bank of China said in a short statement on its website. Senior Chinese and U.S. officials agreed to facilitate yuan trading and clearing in the U.S. during a bilateral Strategic and Economic Dialogue in 2016. China and the U.S. would each pick a yuan-clearing bank in the U.S., Chinese officials have said. Sept 2016, the central bank named Bank of China's New York branch to be a yuan-clearing bank in the U.S. (Source: Reuters)

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Royal Bank of Canada reported a fiscal Q1 profit of $3.01 billion vs $3.03 billion, although excluding various gains/charges, profit was up by 7% year/year. Stronger results were seen in each of the Personal & Commercial Banking, Capital Markets and Wealth Management groups, while the provision for credit losses rose to $334 million vs $294 million year/year, largely due to the impacts of IFRS accounting. Capital levels remained strong, with the CET 1 at 11.0% (unchanged year/year, and up from 10.9% quarter/quarter).

The Royal Bank of Scotland Group PLC - Q4 2017 PBT was -£0.6 billion, compared to -£1.7 billion company provided consensus which included U.S. Retail Mortgage-Backed Securitization litigation (approximately -£2.2 billion vs. -£0.4 billion in results). Adjusted PBT Q4 2017 of £512 million was -28% (-£196 million) behind £708 million consensus driven by weaker revenue, higher costs and higher provisions. Divisional miss was focused on Commercial Banking, where revenue and Impairments missed expectations tangible NAV per share of 294p was +4% better than consensus 283p - Q3 2017 299p. CET 1 15.9% +1.2% ahead of consensus. RWAs of £201 billion were -4% below expectations. Requirement greater than 13% in short to medium term. Guidance – Look to reduce guidance expectations including dropping flat costs 2020 target.

Activist Influenced Companies

Nomad Foods Limited announced the appointment of Samy Zekhout as CFO, effective April 2018. Upon joining the Company, Mr. Zekhout will also be appointed to the Company's Board of Directors. Mr. Zekhout joins Nomad Foods with more than 30 years of global consumer products experience at The Procter & Gamble Company, most recently as CFO and Vice President of Global Grooming over the past 11 years. During his tenure at Procter & Gamble, Mr. Zekhout was instrumental in driving increased profitability and cash flow performance, step-change revenue growth across the portfolio and the successful execution and integration of several acquisitions. Throughout the course of his career, he has held various finance roles at Procter & Gamble while residing in several countries including France, Belgium, Czech Republic, Switzerland and the U.S.

Dividend Payers

Bunzl PLC - Full year revenue of £8,581 million about in line with expectations; organic growth of 4.3% compares to 0.3% last year. EBITA of £589 million approximately 1% ahead of expectations EPS - 119.4p approximately 4% better due to one off tax benefit. Net debt of £1,524 million a bit lower than expected. The net debt to EBITDA ratio is 2.3x, if you include a full year's contribution from last year's acquisitions, despite it being a record year for mergers and acquisitions (M&A). Dividend Per Share – 46.0p (+10% year/year). Record committed spend of £616 million on 15 acquisitions. The outlook statement mentions some inflationary pressures in the U.S. but says it is taking steps to offset these. The expectation of continued organic growth in 2018 is encouraging given the tough comparative of 2017. The shares are trading on approximately 15.5x 2019 estimated Price / Earnings with a 2.5% dividend yield and a 6.3% FCF yield.

Northland Power Inc. (NPI) reported financial results for the year ended December 31, 2017, which included the completion of two offshore wind projects totaling $4.0 billion on or ahead of schedule and under budget. NPI's total operating capacity is currently over 2 gigawatt. NPI acquired a third offshore wind project, with a total project cost of $1.3 billion. During the year, NPI achieved a 22% increase in adjusted EBITDA and a 6% increase in FCF over 2016, with a 11% dividend increase announced in December.

Economic Conditions

Canada – Retail sales in Canada fell well short of the expectations for the month of December, down 0.8% relative to an expected increase of 0.2%. Core retail sales, which exclude sales of vehicles and parts, were down 1.8% in the same month, compared to expectations for a 0.3% improvement. Much of the drop is likely explained by the effect of the November Black Friday sales, which pulled-forward sales volumes. Most retail categories underperformed in December, led by electronics and appliances.

Inflation in Canada dropped a couple of notches in January, to a 1.7% year on year consumer price index (CPI) headline change, from 1.9% in December. The core reading, which excludes the effect of the most volatile price series, including food and energy, kept steady, at 1.2%.

U.S. existing home sales unexpectedly fell for the 2nd month in a row, down 3.2% in January to 5.38 million units annualized, the lowest since September and below last year's average of 5.44 million. The decline was broad-based across the four regions of the country (so bad weather can't be blamed). In addition, single-family home sales took another hit (-3.8%). Only condominium sales managed to avoid the hit, rising 1.6% in the month. Inventories of homes available for sale are still 9.5% below year-ago levels…in other words, supply is still very tight. The months' supply of 3.4 may be a tad higher than December that is still well below normal levels of around 5-6. As disappointing as this result is, the underlying sources of support are still in place in our view…job creation and wage growth. However, standing in the way of stronger sales are the lack of options for potential buyers, rising prices and rising mortgage rates.

Financial Conditions

The U.S. 2 year/10 year treasury spread is now .61% and the U.K.'s 2 year/10 year treasury spread is .71% - 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 4.40% (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 3.4 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 16.30 (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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