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. April 16, 2018

Owner Operated Companies

Nothing significant to report.

Energy Sector

CAPP Energy Symposium – We attended the 2018 Scotiabank Canadian Association of Petroleum Producers (CAPP) Energy Symposium, which took place in Toronto last week. The symposium was well attended, both on the side of energy producers and oil field services companies and on the side of the investment public. However, the event came on the heels of the surprise Kinder Morgan announcement about stopping work at its Trans Mountain pipeline project and imposing a May 31 deadline for a final investment decision/withdrawal from the project. This topic stirred up a lot of discussion and was top of mind for most participants; in particular in the light of the earlier Keystone pipeline accident in December and subsequent broadening of the discount the Western Canadian producers receive for their heavier crude oil. At the same time, more natural gas focused producers have been affected by congestion and slow growth of the NOVA Gas Transmission Ltd. (NGTL) system, which caused the Canadian natural gas price benchmark, Alberta Energy Company, Ltd. (AECO), to trade at rock bottom levels and major discounts to its U.S. counterpart, the Henry Hub benchmark. Relatedly, the Premier of Alberta, NDP politician Rachel Notley was a keynote speaker at the event and made a passionate appeal to all the stakeholders towards moving forward the now stalled Kinder Morgan project. She expressed confidence in all three projects currently on hold or progressing slowly, including Trans Mountain, Keystone XL and Enbridge Line 3 expansion, being eventually completed. Christy Clark, the former Premier of British Columbia was also a keynote speaker and supporter of the energy projects, though she did point out that some political calculations are likely to play a role. The federal liberals, in her opinion, stand to lose about 10 seats in British Columbia in exchange for advancing the Trans Mountain pipeline. Egress issues aside, the companies presenting at the symposium were cautiously optimistic. Crude oil focused producers were certainly pleased with the recent direction of the global crude oil prices and of the North American benchmark, the WTI (West Texas Intermediate). Most companies pointed out that the current environment affords them to maintain and modestly grow production per share within the cash flows they generate at prices above $55/bbl. Many of them also pointed to healthy FCF generation (cash flow in excess of capital expenditure needs and financing requirements).

We had the opportunity to have one-on-one meetings with most of our energy holdings, including Crescent Point Energy Corp., Whitecap Resources, Inc. and Baytex Energy Corp. Below are the key points from the meetings, underpinning the investment thesis for each company.

Crescent Point Energy – Crescent Point continues to be a very active driller throughout the downturn and its key properties in the Williston Basin and Southwest Saskatchewan have been delivering steady production and FCF. The company was also able to grow reserves at an impressive pace, organically replacing 152% of the 2017 production, with reserves growth across all core basins and 40% increase in the Uinta Basin (Utah). The company's current five year plan affords a 7% CAGR (compound annual growth rate) within the internally generated cash flows at a $55/bbl WTI price level. Obviously, higher price levels would result in material FCF generation, which is most likely to go towards strengthening the balance sheet and/or propping up the share price through buy-backs. In the past, the company has proven very adept to transferring technical knowledge and best practices across its asset base. Currently, the company's growth is most likely to come from its Uinta Basin, where a stacked pad (multiple wells targeting multiple oil producing rock layers) has been producing around 3,500 bbl/d, levels more commonly seen in the U.S. Permian Basin. The company re-iterated that it does not expect uptake issues in the basin, with ample refining capacity in place and expansion plans, as well as ample rail capacity available if needed. Recently, the company also disclosed the acquisition of a significant land position in the highly prospective (for nonconventional drilling) East Shale Duvernay Basin, with very promising results thus far, though it is still very early days. The company paid about $100 million on the land and raised about $320 million through the course of 2017 from sale of non-core assets. Crescent Point continues to target the divestiture of about $1 billion more of non-core assets.

Whitecap Resources – Benefitting from one of the best and most engaged management teams in the industry, in our opinion. Whitecap has struck a number of key acquisition during the current downturn on very attractive terms, most recently through the acquisition of Husky Energy Inc.'s Saskatchewan assets and Cenovus Energy Inc.'s Weyburn assets. The two most recent acquisitions have had the added benefit of significantly reducing the company's corporate decline rate, which is currently in the neighbourhood of 18%. This translates in reduced capital requirements to maintain production. In fact, Whitecap is in the enviable position of being able to cover its capital expenditure and increased dividend requirements even in a $45/bbl price environment. A testimony of the company's operational excellence, the operating costs in the producing area acquired from Husky were reduced from $16.70/bbl at the time of acquisition, about a year ago, to $11.75/bbl currently. The company expects to extract operating cost benefits from its newly acquired Weyburn pool as well. The introduction of the newer drilling and fracking techniques have produced impressive well deliverability improvements at its Alberta Deep Basin and Saskatchewan fields. Whitecap expects to generate some $165 million of FCF (80% total payout) in a $55/bbl environment, which could improve to $190 million in a $60/bbl environment. The company has initiated and plans to expand a share buyback program, in addition to paying down debt and increasing its dividend. It estimates it could have as much as $500 million available for more acquisition if the opportunity presented itself.

Baytex Energy – In the improved commodity environment, the company is finally seeing some relief from its debt constraints, as it has been able to steadily reduce its leverage. Its Eagle Ford operations are showing very promising acceleration in well deliverability as the company's operating partner, Marathon Oil, has been applying some of the most advanced drilling and fracking techniques. The company saw fast reserves growth in the area and improved production. In addition, the company's Eagle Ford production is sold at a premium to WTI which made the asset a strong FCF generator. Insofar as the company's Canadian heavy oil operations are concerned, Baytex was able to increase its existing crude-by-rail program, from 5,000 bbl/d to 6,500 bbl/d, thus partially avoiding the penalty of larger WCS (Western Canada Select) discounts. In addition, Baytex has voluntarily built inventories in the month of April, in order to avoid selling at April historically high differentials/discount. Baytex focused on reducing its operating expenses, which are currently as low as $10.50/boe, including a 35% reduction of operating costs at the Peace River property acquired from Murphy Oil. In addition, the company reduced its general and administrative (G&A) cost to $1.72/boe for 2018, partly by shutting down its Houston office. At price levels above $55/bbl, Baytex is in position to generate FCF, which could increase substantially due to the company's operating leverage at its Canadian heavy oil operations and due to its financial leverage.

Financial Sector

Bank of America Corporation reported Q1 2018 EPS of $0.62. Consensus was $0.59. It released $77 million of loan loss reserves, compared to a $236 million release last quarter, while net Debt Value Add gains in trading were $64 million. Each added about a half cent. Revenues increased 4% year/year and rose 13% linked quarter (+7% core) to $23.1 billion. Tangible book declined 0.7% sequentially to $16.84 (trading at 1.8x). It posted a 10.9% ROE, and 15.3% ROTE. Its CET 1 capital ratio was 11.3%. It repurchased $4.9 billion of common shares during the quarter. Average diluted shares declined 1.4%.

BNP Paribas S.A. has reached a deal to buy the bulk of Raiffeisen Bank International A.G.'s Polish business, in the latest case of consolidation in Poland's banking sector. The banks said on Tuesday that BNP would pay €775 million for Raiffeisen's core Polish assets, but that Raiffeisen would keep its portfolio of foreign currency mortgages and transfer them to a new Polish entity. The deal will bolster The French group's Polish assets by about €9.5 billion, and Przemek Gdanski, chief executive of BNP's Polish business, said that the deal would "strengthen our position amongst the largest banks in Poland, bringing us much closer to the top five". "We are glad to have become with this transaction an active participant in the consolidation of the Polish banking sector. This is an opportunity for us to create a bank that is larger, more profitable and more effective," he added. Analysts suggested the move was in order to gain scale in a difficult market. (Source: Financial Times)

Citigroup Inc. Q1 2018 EPS better than expected at $1.68 (consensus $1.61) with upside owing to revenue modestly above forecast—upside across the Global Corporate Banking and credit costs lower than forecast although Fixed Income Currency and Commodities trading down was 7% year/year. ROE 9.7%, ROTE of 11.4% (ex. gain on sale of Hilton portfolio as anticipated); CET 1 capital ratio of 12.1%; $3 billion+ of capital return.

JPMorgan Chase & Co. – Q1 2018 EPS at $2.37—ex. $0.11 per share of mark to market gains better than consensus of $2.28 with revenue above forecast (strength in trading—Fixed Income Currency and Commodities and equities, solid loan and deposit growth as well and credit costs lower than forecast, in aggregate. All in ROE 15 %; ROTE 19%-solid profitability in our view; CET 1 Capital Ratio of 11.8%.

Standard Chartered PLC said last week it had not taken any decision regarding its holding in Indonesia's Bank Permata, after a newspaper report said a team led by Farallon Capital Management, L.L.C. is seeking a 44.56% stake in the bank. Standard Chartered and Indonesian conglomerate PT Astra International jointly control the Indonesia bank, each owning 44.56%. There has been persistent speculation in the last few years that the ownership structure of Bank Permata could change, with the bank linked to takeover talk. "With regard to our stake in Permata Bank, the Bank (Standard Chartered) has not reached a decision. Having been operating in Indonesia for more than 150 years, we maintain our longstanding commitment to the country," Standard Chartered said in a statement. (Source: Reuters)

Wells Fargo & Company – Q1 2018 EPS of $1.12. Consensus was $1.06. Results included several gains including a $643 million gain on the sale of $1.6 billion of Pick-a-Pay PCI mortgage loans, $250 million in mark-to-market unrealized equity gains under the new financial instruments accounting standard and a $202 million gain on the sale of Wells Fargo Shareowner Services. Revenues declined 2% year/year and decreased 1% linked quarter to $21.9 billion. Tangible book slipped 0.3% linked quarter to $31.33 (trading at 1.6x). It posted an ROE of 12.37% and ROTE of 14.75%. Its CET 1 ratio was 12.0%, in-line with the prior quarter. It repurchased 50.6

million shares in Q1 2018, a similar pace as Q3 2017 and Q4 2017. Average diluted shares declined 0.7%.

Activist Influenced Companies

Nothing significant to report.

Dividend Payers

Barrick Gold Corporation announced preliminary first quarter production posting a weak quarter operationally, as telegraphed. Barrick had guided to Q1 production of around one million ounces at costs that will be proportionally higher than those anticipated for the remainder of the year, largely due to lower grades at Barrick Nevada, and the timing of planned maintenance at Pueblo Viejo. Equity gold production of 1,049koz was down 22% from Q4 2017 (1,339koz) while copper production of 85Mlb was down 16% from the prior quarter and 26% below Q3 2017. Gold sales of 1.07Mozs were clearly better than the "one million ounce" production guidance, driven mainly by the continued (and expected) inventory release at Turquoise Ridge. Copper output, however, missed expectations.

GEA Group AG announced that it expects Q1 orders down 3% year/year to €1.1 billion due to weak March orders in Solutions, 8% behind estimates. Q1 EBITDA margin of 6.2% missed estimates by ~510 bps, primarily due to a weaker relative gross margin posted by the Business Area Solutions, notably in the American companies. The order intake includes negative currency effects of €60 million. Q1 revenues were 1% ahead of estimates to €1,035 million (vs. Q1 2017: €1,004 million). Management maintains the full year outlook, based on the backlog, indicating however, that in a 'challenging environment' the Q2 order intake will be 'essential' for achieving the business outlook. The CEO announced last month that he will not renew his contract next year. Despite the disappointing Q1 2018 margin of 6.2% (-340bps year on year) the first quarter is relatively small as a part of the full year (usually 15%) and we believe the Solutions margin should be improving in Q2 2018-Q3 2018 because the comparative quarters in 2017 included -€22 million impact from bottling contracts should not be repeated.

WPP PLC announced that CEO Martin Sorrell stepped down with Roberto Quarta, Chairman of WPP, becoming Executive Chairman until the appointment of a new CEO and with Mark Read, CEO of Wunderman and WPP Digital, and Andrew Scott, WPP Corporate Development Director and Chief Operating Officer, Europe, appointed as joint Chief Operating Officers. This is the end of an area for WPP. While recent performance has been lacklustre, Martin Sorrell's achievements, founding the company 33 years ago and taking it to more than £15 billion in revenues and over 130 thousand employees, are more than impressive. In our view, the main potential positive outcome from a change in management would be a more rapid and radical restructuring to address the industry's current woes.

Economic Conditions

U.S. retail sales rose 0.6% in March, beating expectations which were looking for 0.4%. Sales of motor vehicles and parts rose for the first time in five months, climbing 2.0% on a monthly basis. Without that category, sales advanced a more modest 0.2% month/month, thanks to gains for health/personal care products (+1.4%, the steepest advance in two years). Overall, sales increased in 8 of the 13 categories surveyed. In real terms, retail sales were up 0.7% (using CPI as a proxy for retail prices).

U.S. consumer price index dropped 0.1% month/month in March, below consensus expectations calling for a flat print. The price of energy dropped 2.8% in the month. Meanwhile, food prices edged up 0.1%. Excluding food and energy, prices rose 0.2% on gains in services ex-energy (+0.3%) more than offsetting the slight pullback in commodities ex food & energy (-0.1%). Among services, medical care (+0.5%), shelter (+0.4%) and transportation services (+0.2%) contributed to the rise. Among commodities, medical care and alcoholic beverages were on the rise but were more than offset by declines in apparel (-0.6%) and used cars (-0.3%). Year over year, headline inflation increased two ticks to 2.4% while the core measure rose three ticks to 2.1%.

The U.K. Report on Jobs, a survey of recruitment consultants, for March indicates very few areas of improvement but many examples of growth rates slowing to some degree. The rate of growth in permanent placements edged up fractionally since February, while the rate of growth in temporary billings reached a 13 month low. Average starting salaries continued to increase, although the rate of increase in permanent salaries was the slowest in 10 months while the pay for temporary staff rose at the quickest pace since September 2017. The report's Vacancy Index, a measure of demand for staff, saw growth ease to a 15 month low. Demand remains higher for permanent staff than temporary placements and stronger in the private sector than the public sector.

Financial Conditions

The U.S. 2 year/10 year treasury spread is now .47% and the U.K.'s 2 year/10 year treasury spread is .55% - 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 4.42% (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 17.09 (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:

- Bay and Scollard Development Trust
- 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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