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 11, 2019

Owner Operated Companies

Alphabet Inc's fourth-quarter revenue and profit beat Wall Street's expectations, but included sharply higher spending, as it added data centers and marketed its services heavily during the holidays. Partly because of the higher spending, Alphabet reported an operating margin of 21% in the fourth quarter, down from 24% a year ago. Facebook Inc.'s better-then-expected fourth-quarter results last week had lifted expectations for Alphabet as they suggested that concerns about a global economic slowdown may be overblown. Alphabet's fourth quarter revenue rose 22% from a year ago to $39.28 billion, compared to the average expectation of $38.93 billion among analysts tracked by Refinitiv. About 83% of the revenue came from Google LLC's ad system. A run-up in spending has reflected Google's efforts to boost staffing on its cloud computing division, promote its consumer devices and YouTube subscription packages and acquire office buildings in Silicon Valley and New York. Quarterly profit was $8.95 billion, or $12.77 per share, compared with a $3 billion loss a year ago. That compared to analyst estimates of $7.69 billion, or $10.87 per share.

Fortive Corp announced results for the fourth quarter 2018. For the fourth quarter ended December 31, 2018, net earnings from continuing operations attributable to common stockholders were $222.8 million. For the same period, adjusted net earnings from continuing operations were $325.1 million. Diluted net earnings per share from continuing operations for the fourth quarter ended December 31, 2018 were $0.66. For the same period, adjusted diluted net earnings per share from continuing operations were $0.91. For the fourth quarter of 2018, revenues from continuing operations increased 11.4% year-over-year to $1.8 billion, with core revenue growth of 7.4%. James A. Lico, President and Chief Executive Officer, stated, "The fourth quarter provided a strong finish to what was another transformational year for Fortive, as we generated high single-digit core revenue growth and 30% adjusted net earnings growth. This performance demonstrated strong execution by our team as we continued to leverage the power of the Fortive Business System to reposition our portfolio in higher growth end-markets, while delivering continued share gains and driving innovation to enhance our long-term competitive advantage." For the first quarter of 2019, Fortive anticipates diluted net earnings per share from continuing operations to be in the range of $0.40 to $0.44 and adjusted diluted net earnings per share from continuing operations to be in the range of $0.64 to $0.68. For the full year 2019, Fortive expects diluted net earnings per share from continuing operations to be in the range of $2.56 to $2.66. For the full year 2019, Fortive expects adjusted diluted net earnings per share from continuing operations to be in the range of $3.40 to $3.50, which excludes any contribution from the pending acquisition of the Advanced Sterilization Products business from Johnson & Johnson. Jim Lico added, "The fundamentals across our enhanced portfolio remain strong and we expect to deliver another year of double-digit adjusted net earnings growth for our shareholders in 2019. We believe our businesses are well positioned to sustain continued out-performance in the year ahead, and we particularly look forward to welcoming ASP into the Fortive family and discussing the attractive opportunities ahead when the transaction closes."

Energy Sector

Total S.A. reported slightly better than expected Q4 2018 results at the Profit & Loss line, while cash flow had a strong support from working capital. The Q4 2018 clean net income of approximately $3.2 billion beat consensus of approx. $3.1 billion (with a range of $2.8-3.5 billion). Divisionally, the performance varied; both upstream and refining and chemicals (R&C) beat, while the other divisions missed and net interest expense came in higher than expected. Overall, the quality of Total's Q4 2018 is in analysts' view less exciting than its Super Major peers, who have all beaten consensus comfortably for Q4 2018. Admittedly, its European peers had stronger trading and Canadian or Canada-fed U.S. refining earnings, whereas for Total weak Canadian oil prices left it exposed (i.e., it is more exposed to the upstream and trading does not tend to contribute substantially like its European peers, Royal Dutch Shell PLC and BP PLC). Whilst this was a headwind in Q4 2018, it is so far a tailwind in Q1 2019 for Total following the Alberta (Canada) mandated production cuts, which has raised prices and thus supports upstream realization for the firm. **In terms of 2019 guidance**, it guides to a buyback plan of approx. $1.5 billion in a $60/barrel Brent oil price environment and expects upstream growth in 2019 of >9% (CS at >7%), albeit this needs to be viewed in the context that production was slightly behind our expectations for the Fiscal year 2018 (approx. 8%). 2019 capital expenditure is guided to $15-16 billion (vs. its guidance range of $15-17 billion per annum over the medium term). Funds from operations pre-Working Capital (WC) of approx. $5.7 billion and on a post WC basis, this was approx. $10.6 billion (Total tends to be good at managing working capital into the year-end in our view). This meant net debt moved down more than expected to $21.7 billion, down from $27 billion in Q3 2018 (excluding the incorporation of hybrid bonds as debt). There was some update on the distribution policy. In early 2018, Total provided a three-year outlook on Dividends Per Share growth (approx. 10% growth over that time) and share buyback program. The company has plans to buy back up to $5 billion in shares over 2018-20 (the program not linked to the scrip offset); having delivered approx. $1.5

billion in 2018, the company stated that it expects to do another approx. $1.5 billion in 2019 in a $60/ barrel environment. The company now plans to cancel the scrip offering following the Annual General Meeting in mid-2019; an update that provides confidence.

Financial Sector

DNB ASA - The Q4 2018 report showed total income of NOK 13,502 million versus consensus at NOK 13,038 million. Commission income was the largest positive surprise at NOK 2,660 million versus consensus at NOK 2,122 million due to higher net commissions and fees together with a strong quarter on investment banking activities in DNB Markets. We also saw a strong beat on Net Interest Income, which came in at NOK 9,611 million versus consensus at NOK 9,390 million and reflected increased margins and effects from amortisation of fees and strong support from volume growth. Impairments remained at a low level of NOK 235 million versus consensus at NOK 322 million. Costs were elevated at NOK 6,180 million versus consensus at NOK 5,488 million, but reflected a non-guided level of non-recurring costs of NOK 464 million. The tax expense was NOK 124 million only, due to transitional effects from new tax rules for life insurance Companies, which had been announced ahead of the report. DNB realized an annualized Q4 2018 Return On Equity (ROE) of 12.1%. DNB announced a Dividend Per Share of NOK 8.25 (consensus at NOK 7.83). DNB is expecting 3-4% lending growth for 2019-2020. Higher growth is expected for Small & Medium Enterprises, which we believe is supported by the macroeconomic development in Norway. The group is expecting a slower pace in lending to large corporates and international clients in cyclical industries. The target for a ROE of 12% in 2019 is unchanged as well as the Cost /Income ratio target of below 40% in 2019.

Nordea Bank Abp - Q4 2018 operating profit was 11% lower than consensus on disappointments in Trading income and higher costs. Total revenues amounted to EUR 2,103 million compared to consensus at EUR 2,153 million. Net interest income was better and amounted to EUR 1,126 million compared to consensus at EUR 1,086 million. Lending margins were negative in the quarters but volumes contributed positively. The main positive driver is lower regulatory costs. The CEO commented that the year was challenging and Nordea was not satisfied with the revenue development. Commissions amounted to EUR 720 million compared to consensus at EUR 751 million. Savings and investments commissions are weak for being the fourth quarter but Assets under Management is affected by the divestment in Private Banking. Trading income was weak at EUR 182 million. Like we have seen in the other banks there was an unfavourable trading environment but Nordea was weaker than their Swedish peers. Costs came in at EUR 1,384 million compared to consensus at EUR 1,293 million and was the negative deviation. Costs did though include a EUR 141 million goodwill impairment in Russia and transformation costs of EUR 24 million. Nordea reported loan losses of 5 basis points in the quarter compared to consensus forecast of 8 basis points but still comfortable ahead of the long-term historical average of 16 basis points. Nordea reported a Core Equity Tier 1 ratio of 15.5% compared to consensus at 15.5%. Dividend proposal of EUR 0.69 is below the expected EUR 0.7.

Activist Influenced Companies

Pershing Square Holdings Ltd. – Element Solutions Inc. has signed a definitive agreement to repurchase 37 million shares from Pershing Square Capital Management, L.P. at a price of $11.72 per share. These shares represent more than 90% of Pershing Square's holdings in Element Solutions and this transaction takes their position from approximately 13% of the Company's outstanding shares on a fully diluted basis to approximately 1%. In the context of this transaction, Ryan Israel has elected to resign from the Board of Element Solutions Inc. Executive Chairman Martin E. Franklin said, "[…] Bill Ackman and Pershing Square as a firm have been great supporters of the Company over the last five years and we are grateful for Ryan Israel's contribution as a Director over this period. We believe this opportunistic repurchase is by far the most efficient and earnings accretive approach for our remaining shareholders, all while keeping our leverage ratio below our stated goal of 3.5x net debt to adjusted EBITDA. […]"

Dividend Payers

Bell Canada Inc. (BCE) reported Q4 2018 with consolidated revenue of $6,215 million up 3.0% year/year. Adusted EBITDA was $2,394 million up 2.8% year/year, higher than consensus of $2,385 million due to Media beating expectations. Adjusted EPS of $0.89 was up from $0.82 last year and above consensus of $0.86. In terms of guidance, Bell's forecast is at 2-4% EBITDA growth excluding the impact of International Financial Reporting Standard (IFRS) 16 and Free Cash Flow guidance of 3-7%. With IFRS 16, it is 5-7% EBITDA growth and 7-12% FCF. As expected, BCE reduced its capital expenditure intensity for Fiscal Year 2019 to 16.5% vs. 17% in Fiscal Year 2018.

Brookfield Property Partners L.P. (BPY) reported Q4 2018 funds from operations (FFO) per unit of $0.43, up 4.8% year/year, above consensus of $0.38. The growth was largely due to additional Net Operating Income (NOI) from the recently acquired GGP Inc. and same-property NOI growth from core-office (offset slightly by negative impact of foreign currency). A large gain from the sale of the U.S. industrial portfolio was achieved in the quarter and including realized gains, FFO per unit was $0.86. BPY raised the annual distribution per unit from $1.26 to $1.32, an increase of 4.8%, effective with the March 2019 distribution. We understand that management has guided to consistent annual increases, and we do believe that BPY is well positioned to grow cash flow over the long term. Along with reporting its year-end results, BPY announced its intention to launch a Substantial Issuer Bid to repurchase up to $500 million of BPY units and Class A shares of Brookfield Property REIT Inc. at a price of at least $19.00 and not more than $21.00 per unit.

Compass Group PLC's organic revenue for the three months to December 31, 2018 grew by 6.9% driven by strong levels of new business wins, continued good retention rates and bolstered by the impact of the new U.K. Defence contracts and a positive sporting events calendar. Compass continues to generate efficiencies through its management and performance programme to offset inflationary headwinds. Organic revenue in North America increased by 8.0%. Growth was very good across all sectors particularly in Business & Industry and Sports & Leisure, the latter of which benefited from the timing of certain events. In Europe, organic revenue grew by 6.4% reflecting continued momentum from new business wins, notably the significant impact of Defence contracts in the U.K. mobilized in the second half of 2018, a beneficial Sports & Leisure calendar and continuing good growth in Continental Europe. Organic revenue in Rest of the World increased by 2.8%, with ongoing good performance in developing markets partially offset by the run-off of the last Offshore construction project in Australia. Currency movements, compared to the same quarter last year, had a positive translation impact on revenues and profit in the quarter of £107 million and £10 million respectively. If current spot rates were to continue for the remainder of the year, foreign exchange translation would positively impact 2018 revenue by £508 million and operating profit by £43 million. In the first quarter the Group spent £197 million on acquisitions in North America. Targeted and disciplined bolt-on acquisitions, focused on our core food offering, strengthen our capabilities and there is a good pipeline of opportunities across the Group. Compass states it had an excellent start to the year and now expects to be slightly above the middle of its target 4-6% organic growth range for the full year, with modest margin progression. In the longer-term, it remains excited about the significant structural growth opportunities globally and the potential for further revenue growth and margin expansion.

Dufry AG - HNA Investment Group Co. Ltd. announced that its shareholding in Dufry is <3% and therefore its original 20.9%, which was held in an equity collar structure is finished. Out of this stake Compagnie Financière Richemont SA (Richemont) got a 7.5% stake and the Government of Singapore got a 5.1% stake in Dufry. Franklin Resources Inc. has a stake of 5.4%. Travel Retail Investments SCA has a 17.9% stake (and 5.1% sales position). Due to collar structure it was already clear that HNA was not involved anymore but with the expiration of the options, it is now an official confirmation and therefore the discussions on this topic will come to an end.

GEA Group AG has issued a major profit warning guiding to 2019 operating EBITDA of €400-480 million. That's against consensus at €550-560 million. That should see 2019 operating EBITDA cut by 15-20%. 2018 earnings also came in below guidance – operating EBITDA in 2018 at circa €495 million against the guided €540 million. The company has discontinued its mid-term guidance launched at the Capital Markets Day in March 2018. We see this profit warning for what it would appear to reflect (in part at least) – a "kitchen sinking" of 2019 earnings from a new CEO who joined on November 15, 2018 and officially takes over on February 18, 2018. At €22 the stock trades on 1.0x Enterprise Value/Sales, in line with its 13-year average and at a 50% discount to the European machinery sector (versus 35% discount historically). New CEO Mr. Klebert bought €2m worth of GEA shares in late 2018 – a first step to addressing current management's lack of "skin in the game". Current management has been clear that it is in no rush to execute on the buyback mandate renewed at the 2018 Annual General Meeting (authorization to buy back 10%).

Economic Conditions

Canadian employment surged 67K in January 2019 according to the Labour Force Survey, way above consensus calling for a 5K rise. However, the jobless rate rose to 5.8% as the participation rate rose to 65.6%. There were huge job gains in the private sector (+111K), a decent gain for government (+16K) while self-employed experienced major losses (-61K). Employment in the goods sector dropped 32K as losses were observed in all categories (manufacturing, resources, agriculture, utilities and construction). Services-producing industries saw a jump of 99K in employment with trade, professional services and public administration being the top performers. Full time employment was up 31K, while part-time positions increased 36K. Hourly earnings accelerated to 1.8% year/year, increasing from 1.5% the prior month. The Canadian job market starts the year on a very positive note. After a soft patch earlier in 2018, the private sector has boomed recently showing a massive 268K gain since August. This is consistent with the Bank of Canada's Business Outlook Survey indicating rather good hiring intentions over that period. It is reassuring to see that, so far, the recent market turmoil has not negatively impacted business sentiment.

Canadian housing starts declined in January 2019, falling 5.7K to a slightly above consensus 208K in annualized terms. Urban starts weakened 4.1K to 190.9K with a deterioration in the singles category (-5.2K to 44.6K) while the multi segment edged up in the month (+1.1K to 146.4K). Rural starts, meanwhile, decreased 1.5K to 17.1K. At the provincial level, urban starts rose in Ontario (+4.6K to 72.3K) and Alberta (+4.6K to 22.7K) but this was not enough to offset declines in British Columbia (-7.7K to 40.5K) and Quebec (-3.1K to 41.6K). Expressed as a ratio, singles starts were at their lowest portion since data collection began with multiple starts taking the lion's share of the market. The combination of higher interest rates and expensive home prices appear to be tapering demand in Canada's least affordable province (resale market conditions in Vancouver tend to support this as well). That being said, multiple

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starts in Canada continue to trend above their five-year average and should remain elevated due to demand for more affordable housing in our view. Looking at the quarterly perspective, after having increased for the first time in a year for the last quarter of 2018, housing starts in Canada are on track to decline in Q1 2019 after one month of data.

The U.K. Report on Jobs, a survey of recruitment consultants, indicates growth in permanent placements slowed in January, the first time since the Brexit referendum in July 2016, which is a continuation of the slowing trend through the second half of last year. Growth in temporary placements also slowed markedly. In absolute terms, the month/month slowdown in permanent placements is the largest seen in the survey since June 2012 and the slowdown in temporary billings is the largest since November 2008. The slowdown continued to be attributed to economic uncertainty around Brexit, meaning people are reluctant to move jobs and firms are also taking a more cautious approach to hiring. In absolute terms, demand for staff was the slowest in 27 months but remains well above the neutral level. This in conjunction with a shortage in candidate availability means starting salaries continued to rise sharply at the start of the year.

Financial Conditions

The Bank of England expects growth this year to be the slowest since 2009 when the economy was in recession. It is forecasting growth of 1.2% this year, down from its previous forecast of 1.7% made in November. The Bank said it had seen further evidence that businesses were being cautious in the run-up to Brexit, including evidence from its own survey of firms. As expected, the Bank kept interest rates on hold at 0.75%. The Bank put the fall in growth down to a decline in business investment and housebuilding, as well as a halving of the growth rate in exports. The U.K. was also being hit by slower-than-expected growth in the Eurozone and China, the Bank said in its Quarterly Inflation Report. “Growth appears to have slowed at the end of 2018 and is expected to remain subdued in the near term,” it said. The Bank even sees a one-in-four chance of the economy slipping into recession in the second half of this year. (Source: BBC)

The U.S. 2 year/10 year treasury spread is now 0.17% and the U.K.’s 2 year/10 year treasury spread is 0.45% - 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. Also, the narrowing gap between yields on the two-year and 10-year Treasuries is of concern given its historical track record that when shorter term rates exceed longer dated ones, such inversion is usually an early warning of an economic slowdown.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 4.41% (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 15.73 (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 bodes well for quality equities.

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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 & Scollard Development Trust
- ITM AG Investment 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:

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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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