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. March 11, 2019

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Owner Operated Companies

Berkshire Hathaway Inc. – Amazon.com Inc., Berkshire Hathaway Inc. and JPMorgan Chase & Co. said their joint healthcare company would be called Haven and will focus on better primary care access, simpler insurance benefits and more affordable prescription drugs for their employees. Haven will be tasked with improving healthcare for the three companies' 1.2 million employees and family members in the United States, but will also share its findings with outsiders, according to its website. The three companies announced plans for a new venture in January of 2018. Haven Chief Executive Atul Gawande, who has been running the company since July, said in a news release that the company plans to start small and expand. Haven said it is "interested in working with clinicians and insurance companies to improve the overall health care system," according to the website. Haven is based in Boston and has offices in New York.

Energy Sector

Baytex Energy Corp. reported fourth quarter and full year 2018 results. The company generated production of 98,890 boe/day (83% oil and Natural Gas Liquids) during Q4 2018, an increase of 42% over Q4 2017, and 80,458 boe/day for full-year 2018, exceeding the high end of guidance, with capital expenditures of $496 million, in line with annual guidance. Baytex delivered adjusted funds flow of $111 million ($0.20 per basic share) in Q4 2018 and $473 million ($1.35 per basic share) for the full-year 2018. Eagle Ford production increased 3% to 38,437 boe/day (78% liquids) in Q4 2018, compared to Q3 2018. Wells that commenced production during the quarter generated 30-day initial gross production rates of approximately 1,800 boe/day per well. The company continued to advance the evaluation of the East Duvernay Shale where it now has five producing wells on its Pembina acreage. Baytex decreased cash costs (operating, transportation and general and administrative expenses) for 2018 by 4% on a boe basis as compared to the mid-point of original guidance. It increased proved developed producing ("PDP") reserves by 35%, from 100 million boe to 135 million boe. Proved plus probable ("2P") reserves increased by 22%, from 432 million boe to 527 million boe. Global benchmark prices have recently improved with West Texas Intermediate (WTI) currently trading at US$57/barrel, as compared to a low of US$42/barrel in December 2018. In addition, Canadian light and heavy oil differentials have narrowed substantially. This combination is expected to have a positive impact to Baytex's adjusted funds flow. Further deleveraging remains a top priority for Baytex. Based on the forward strip, its adjusted funds flow forecast has increased from $605 million in December 2018, to approximately $800 million, which will support up to $200 million of debt repayment while maintaining production at the mid-point of its guidance of 95,000 boe/day.

Crescent Point Energy Corp. reported results for the last quarter of 2018, which included lower fourth-quarter output, as the oil and gas producer sold several production assets in 2018. The company's strategy has been to sell assets to reduce debt and use a part of the money to finance its expansion in production in Viewfield Bakken, Shaunavon and Flat Lake assets in Saskatchewan. The company has set aside 55% of 2019 capital spending to ramp up production in these areas, even as it lowered the spending by 30% to $1.2 billion to $1.3 billion in January in the wake of declining oil prices. Crescent Point's total average production fell 0.4% to 178,198 barrels of oil equivalent per day (boe/day) from a year earlier. The company said average selling prices fell to $48.28 per barrel of oil equivalent from $55.64. For the year ended December 31, 2018, the company's adjusted funds flow totaled $1.74 billion, or $3.16 per share diluted. In fourth quarter, adjusted funds flow totaled $337.3 million, or $0.61 per share diluted. As at December 31, 2018, net debt to adjusted funds flow was 2.3 times, with cash and unutilized credit capacity of approximately $1.62 billion. For the year ended 2018, the company incurred a net loss of $2.62 billion, including a non-cash impairment of $3.71 billion ($2.73 billion after-tax). Post-impairment, Crescent Point's balance sheet reflects a better approximation of the fair value of its asset base in the current environment and incorporates a higher cost of capital. The charge was not related to underlying asset performance and does not impact the company's adjusted funds flow or the amount of credit available under its bank credit facilities.

Financial Sector

Bank of America Corp and **Royal Bank of Scotland Group PLC (RBS)** have been sued by investors in the United States over their alleged roles in a conspiracy among eight banks to rig prices in the $9.4 trillion European government bond market. The proposed class-action complaint accusing the banks of violating federal antitrust law was filed last Monday in U.S. District Court in New Haven, Connecticut. It followed a January 31, 2019 announcement by the European Union's antitrust authority accusing the eight banks of being part of a cartel to distort bond prices from 2007 to 2012. In a "Statement of Objections," the European Commission said it believed bond traders may have illegally shared commercially sensitive information and coordinated trading strategies, mainly through online chatrooms. While the commission did not identify the eight banks, media reports said Bank of America and RBS are among them. Bank of America spokesman Bill Halldin declined to comment. RBS also declined to comment. (Source: Reuters)

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Activist Influenced Companies

EnTrustPermal conference – We attended EnTrustPermal's eleventh annual investment summit last week. We were not surprised to hear most of the investment themes we have been espousing for years at Portland being reinforced as top mind for some of the world's most renowned (mostly activist) investors. There was a clear sense that the investment environment going forward is likely to be substantially different compared to the past ten years. Although the chance of a repeat of the great financial crisis was given a low value, most investors are concerned with the effect of central banks' actions, in particular their attempt to unwind some of the most accommodative policies in history, the pace of economic growth globally and the impact trade negotiations would have and, more broadly, the U.S. and China struggle for global hegemony. The view is that investing in the equity markets is likely to become a significantly more discerning affair, an environment far more benefiting active management and value-focused investors. Of the active managers, activist or engagement investors afford the benefit of taking charge and driving operational (and to a lower extent financial) change in order to navigate the more challenging environment. High levels of alignment are achieved through similar levels of investment stakes (i.e. 'skin in the game') and co-investing with similarly concerned shareholders, including large institutions and even large passive investors (i.e. Vanguard, BlackRock) adds more leverage to the engagement angle. As we've said in the past, we, at Portland Investment Counsel Inc., view activism as a key value creating strategy, a subset (for lack of a better word) of the founder/owner/operator-led businesses. Activist investor's chief avenue for value creation is addressing corporate governance shortcomings and re-instating the owner/operator focus at the companies they target. One point, made repeatedly during the conference, emphasises the need for a long-term perspective (i.e. staying power, patient capital) when it comes to activist/engagement actions, and, we would add, is a key mark of investing versus speculating. In the words of Barry Rosenstein, "market overwhelms catalysts every time", so patience and co-investing with capable teams (activists or owner-operators) is key. Our investment framework pivots around co-investing alongside founder or owner-operators in businesses domiciled in long-term growth industries. The best reflection of this investment stance, in our view, can be found in our Portland 15 of 15 Fund, Portland Value and Portland Value Plus Funds (where we also allocate to activist ideas) and, more recently, Portland Special Opportunities Fund.

Dividend Payers

BHP Group Ltd. - Near-term iron ore price assumptions have been revised up to account for the supply shock in iron ore, stemming from the Brazilian Tailings Dam tragedy at the end of January. While forecast price profile has been raised, a cautious view on Chinese steel demand, coupled with modest supply growth, leads, we believe, the market back to significant surplus by Q4 2019. With less of an exposure relatively to iron ore (approximately 47% of 2019E EBITDA versus Rio at approx. 70%) and what we'd describe as a more obvious pathway to improved valuation through organic growth options, we continue to believe BHP's balance sheet is where it wants it to be, and with a de-risked capex profile and a more favourable commodity mix we think BHP is still well placed to perform at least in line with the market through 2019.

TransAlta Renewables Inc. reported Q4 2018 EBITDA of $133.0 million, above consensus of $120.2 million. However, results included a $6 million insurance payment resulting from a turbine fire. Excluding the insurance payment, EBITDA would have been $127 million with about a 67.0% payout ratio. U.S Wind Projects update: (i) Antrim - Management expects the Antrim acquisition to close by end of March 2019 and project start date is H2 2019; (ii) Big Level: Project construction in on track and expected start date is H2 2019. TransAlta Renewables expects to fund the total estimated construction and acquisition costs of US$240 million for the Big Level and Antrim wind projects by issuing tracking preferred shares or interest-bearing promissory notes. Management expects to fund these costs using existing liquidity and tax equity. TransAlta Renewables provided its outlook for 2019E, summarized as: Comparable EBITDA ($425 - $455 million); Sustaining Capital Expenditure ($30 - $40 million); and Productivity Capital Expenditure $4 million.

Economic Conditions

Canadian employment soared 56K in February 2019 according to the Labour Force survey, well above 1K increase expected by consensus. But the jobless rate remained unchanged at 5.8% as the participation rate rose from 65.6% to 65.8%. February's job gains were driven by the private sector (+32K), although government (+9K) and self-employment (+15K) also rose. Employment in the goods sector rose 10K as gains in manufacturing, agriculture and resources more than offset declines in construction and utilities. Services-producing industries increased employment by 46K as declines in health care, transportation and accommodation were dwarfed by solid gains in other categories including finance/insurance (+7K). Full time employment soared 67K, offsetting the 12K decline for part-timers. Hourly earnings rose to 2.3% year/year, the highest in five months.

U.S. non farm payrolls were up just 20K in February 2019, well below the 180K expected by consensus. There were small upward revisions to prior months which added 12K to payrolls. In February, the private sector added 25K jobs. The goods sector lost 32K jobs due to construction (-31K) and mining which more than offset gains in manufacturing (+4K). Services-producing industries added 57K net new jobs as gains in business services (including temporary help), education and health, more than offset declines in retailing. Government cut 5K from payrolls but only at the state and local levels.

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Average hourly earnings rose 0.4% in the month, taking the year/year print up to 3.4%. The private sector diffusion index fell to 57.2, the lowest since September 2017.

The U.S. household survey suggested 255K new jobs were created in February 2019, with gains in both part-time and full time employment. Those gains, coupled with an unchanged participation rate (at 63.2%), allowed the unemployment rate to drop two ticks to 3.8%.

U.S. nonmanufacturing ISM beat expectations in February 2019, up 3 points to a 3-month high of 59.7. This was the first increase in three months although one could say that it is coming off of a 14-month low in January, a month that was held back by the government shutdown, a powerful winter storm, and lots of uncertainty around trade and tariffs. The rebound comes with solid support from business activity (up 5 points to 64.7, highest since August 2005), and new orders (up 7.5 points to 65.2, also the highest since August 2005). Given that there was more action, supplier deliveries were a bit more delayed (+2 points to a 3-month high of 53.5). Employment slipped a couple of points but was still decent at 55.2 in our view.

The outlook for the U.S. economy has softened and there may be a more persistent slowdown on the cards overseas, bolstering the need for a period of "watchful waiting" on interest rates, a senior Federal Reserve policymaker said. Lael Brainard told an audience in Princeton, New Jersey, that she had revised down her expectations for the economy this year in response to some weakening in consumer spending and other economic data. Even if a sharp drop in December 2018 retail sales is revised in future data releases, the decline points to slower growth in U.S. consumer spending during the first quarter of 2019. Ms. Brainard also highlighted weaker construction data and "indications of softening" in business investment figures. "This softening could be a harbinger of some slowing in the underlying momentum of domestic demand," Ms. Brainard said, according to the prepared text of her remarks. "Overall, the softer spending data in the U.S. and the slowdown abroad, along with earlier financial volatility, are likely weighing on the modal outlook and might in turn warrant a softening in the modal path for policy." (Source: Financial Times)

China lowered its GDP goal to 6-6.5% for 2019 as Premier Li Keqiang warned of a "tough economic battle ahead." The lower end of the forecast would be the slowest pace of growth in almost three decades. Li announced tax cuts worth 2 trillion yuan ($298 billion) for the year as policy makers seek to pull off a gradual deceleration amid a debt legacy and trade standoff with the U.S.

U.K. Jobs - After January 2019 saw the first decline in permanent placements in over two years, the U.K. Report on Jobs for February indicates activity stabilized in February, while growth in temporary placements, having slowed markedly in January, picked up slightly. In absolute terms, demand for staff was the slowest in 28 months as a result of economic uncertainty around Brexit meaning people are reluctant to move jobs and firms are taking a more cautious approach to hiring. Growth in demand for staff in February was the lowest in 28 months and although starting salaries continued to rise the increase was the slowest rate for seven months.

Financial Conditions

Interest rates in the Eurozone will not rise until 2020 at the earliest, the European Central Bank (ECB) has signaled amid evidence of a slowdown in the 19 countries using the single currency. The ECB also unveiled a round of fresh stimulus, offering banks cheap loans to try to help revive the economy. The unexpected moves came as the bank made sharp cuts to its forecasts for both growth and inflation this year. The central bank said rates would remain at their present levels "at least through the end of 2019" rather than its previous guidance of "at least through the summer". Mario Draghi, president of the ECB, said economic data showed a "sizeable moderation" in growth. He said economic growth in the euro area was now expected to be 1.1% this year, as against a previous forecast of 1.7%. Inflation is expected to be 1.2%, down from an earlier forecast of 1.6%. "We are [in] a period of continued weakness and pervasive uncertainty. The near-term growth outlook will be weaker than previously anticipated," Mr Draghi said. (Source: BBC)

The Reserve Bank of Australia as expected held its official cash rate (OCR) at 1.50%. The concluding paragraph of last week's accompanying statement was exactly the same as the one in February, with the central bank saying that: "The low level of interest rates is continuing to support the Australian economy. Further progress in reducing unemployment and having inflation return to target is expected, although this progress is likely to be gradual. Taking account of the available information, the Board judged that holding the stance of monetary policy unchanged at this meeting would be consistent with sustainable growth in the economy and achieving the inflation target over time".

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 0.44% - 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 16.06 (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 bodes 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 & 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:

The Net Asset Values (NAV) of our investment funds are published on our Portland website at www.portlandic.com/prices

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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