News Highlights

Owners. Operators. And Insightful Investors.

Phone: 1-888-710-4242
Web: www.portlandic.com
Email: info@portlandic.com

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PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. March 25, 2019

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Owner Operated Companies

Alphabet Inc. - Google was fined €1.49 billion ($1.7 billion), its third large European Union antitrust penalty in two years marking the company's decade-long regulatory battle in Europe. The E.U. antitrust chief, however, gave a cautious welcome to Google's measures to boost competition and give Android users a choice of browsers and search apps, suggesting the company's regulatory woes may be coming to an end. The European Commission, which said the fine amounted to 1.29% of Google's turnover in 2018, said that the case focused on the company's illegal practises in search advertising brokering from 2006 to 2016. The case concerned websites, such as of newspaper or travel sites, with a search function that produces search results and search adverts. Google's AdSense for Search provided such search adverts. The AdSense advertising case was triggered by a complaint from Microsoft Corp in 2010. Both companies subsequently dropped complaints against each other in 2016. Google said it was taking action to comply with E.U. orders in two previous cases, one of which concerned its Android mobile operating system that resulted in a record €4.34 billion fine last year while the shopping comparison case led to a €2.42 billion fine. "We've always agreed that healthy, thriving markets are in everyone's interest. We've already made a wide range of changes to our products to address the Commission's concerns," Kent Walker, senior vice-president of global affairs, said in a statement.

BlackRock, Inc., the world's biggest asset manager, said it would buy French investment software provider eFront S.A. from private equity firm Bridgepoint Advisers Limited and eFront employees for $1.3 billion in cash. BlackRock plans to integrate eFront with its investment platform Aladdin, which is used by more than 225 institutions around the world. Aladdin began as an internal tool at the company before becoming the cornerstone of BlackRock's plan to increase revenues from technology. It is used by investment managers to help to oversee risks and make investment decisions. Europe's largest bank, HSBC Europe BV, signed a deal to offer BlackRock's Aladdin investment management software to its wealthy customers. Separately, BlackRock said it would buyback about 3.1 million of its shares at $412.84 apiece under its existing repurchase program.

Energy Sector

Cardinal Energy Ltd. announced its operating and financial results for the fourth quarter and year ended December 31, 2018. Production for 2018 averaged 20,858 boe/d, an 11% increase over 2017. Fourth quarter production averaged 20,365 boe/d, after the company voluntarily curtailed sales volumes due to low pricing, which impacted production by approximately 1,100 boe/d. Earnings increased to $84.8 million and $60.5 million for the fourth quarter and year ended December 31, 2018, respectively, predominantly due to a reversal of prior period impairments which was the result of positive reserve additions from the company's 2018 drilling program and well performance. Significantly reduced Canadian oil pricing resulted in challenges for the oil and gas industry in the fourth quarter of 2018. While West Texas Intermediate (WTI) oil prices decreased by 15% over the previous quarter, oversupply concerns and a lack of egress optionality impacted Canadian oil price differentials drastically. The Western Canadian Select (WCS) average benchmark price decreased by 59% while the Edmonton Light (MSW) price decreased by 48% over the third quarter of 2018. These pricing decreases were the major contributors to a 48% decrease in Cardinal's fourth quarter oil and natural gas sales revenue compared to the third quarter of 2018. During the fourth quarter, in response to the challenging environment, the Company cut administrative and cash compensation costs resulting in a decrease of 43% of general and administrative ("G&A") costs to $1.99/boe as compared to $3.50/boe in the same period in 2017. The result of these proactive measures was a year over year 3% decrease in net bank debt. In December 2018, the Alberta Government announced an oil production curtailment initiative in order to stabilize the discount of WCS and MSW oil prices to WTI prices. While Cardinal does not believe this is a long-term solution to the egress options facing Western Canada, it had an immediate impact on oil price differentials in the first quarter of 2019 narrowing them to historical levels. This has allowed Cardinal to continue with its well and production reactivation program and although Cardinal's 2019 oil production growth will be limited by curtailment in the year, it expects its adjusted funds flow will normalize to pre-fourth quarter 2018 levels. The company's top decile production decline rate continues to support its capital program, dividend and debt repayment initiatives during challenging times.

Source Energy Services Ltd. - Source reported Q4 2018 financial results following the company's recent release of its fourth quarter sales volume update. As per Source's previous guidance the company sold 373,171 tonnes of proppant in Q4 2018 (down 33% year/year), with 15% of these sales volumes at the mine gate (versus 30% in the prior year). Overall Q4 2018 pricing of $121.82/tonne was in line and up 6% year/year due primarily to reduced main gate sales relative to Q4 2017. Overall the company's 4th quarter sales fell approximately $10 million short of expectations due primarily to lower-than-anticipated Wellsite activity (sand sales were in line). Notwithstanding this revenue shortfall, a stronger-than-anticipated cash gross margin on sand sales kept EBITDA of ($3.2) million in line with expectations. Source deployed $19.1 million in capital in Q4 2018 to exit last year with net debt of $143.9 million (3.4x 2019 expected EBITDA). Source continues to expect Q1 2019 activity to approximate prior year levels and intends to maintain a flexible 2019 capital program that allows the company to live within cash flow.

Financial Sector

'Big Short' star manager raises bets against Canadian Banks - Steve Eisman, a portfolio manager made famous by the book ***The Big Short*** is among a growing number of short-sellers taking positions in the Canadian banks in anticipation that the shares will fall. "I'm calling for a simple normalization of credit that hasn't happened in 20 years" Mr. Eisman told the Financial Times. He said the effects would hurt banks and the real estate sector but would not be as intense as the Great Recession a decade ago. Mr. Eisman is not alone as the Financial Times reports short positions on Canadian Banks has risen 19% since the start of the year to positions worth US$12.3 billion. The activity is largely driven by falls in Canada's property market after years of rapid growth.

DNB Bank ASA finalizes share buy-back programme announced on June 6, 2018 with 15.9 million shares repurchased in the open market. A total of 8.2 million shares will be redeemed from the state of Norway, subject to approval from DNB ASA's Annual General Meeting in 2019, so that its ownership interest in DNB ASA of 34.00% will remain unaffected following completion of the buy-back programme. The weighted average purchase/redemption price for the 15.9 million shares is NOK 160.17.

Fifth Third Banking Corp. (FITB) - In one of the final steps in selling the original FITB payments business, FITB announced the sale of its final 3% interest in Worldpay, resulting in an after-tax gain of approximately $445 million which we believe will be deployed in share repurchases. It is estimated the transaction will be $0.05 accretive assuming loss of revenues from the equity method of their prior 3% ownership but assuming an addition $15 million per year in additional revenue in the fourth quarter. In one of the final steps in selling the original FITB payments business, FITB announced the sale of its final 3% interest in Worldpay. We would expect FITB to potentially monetize with remaining Tax Receivable Agreements later in 2019 setting up for a cleaner story in 2020. It is estimated following this transaction, FITB has generated approximately $6.5 billion of gains from its processing business.

ING Groep N.V. - Investor Day: Financial targets disclosed so far are broadly unchanged. The bank retains its 10-12% Return on Equity and 50-52% cost/income ratio targets despite flagging Net Interest Income and cost headwinds. No specific information is provided on additional measures to be taken (except that further cost discipline will be required). In our view, management comments so far imply a deterioration of 2019 cost/income ratio consensus expectations. While management is focusing on business fundamentals and provides an update on its digitization plan and targets, there is an upfront effort to dissipate market concerns about Anti-Money Laundering (AML) issues, however no specific information appears to be provided on individual cases (ING Italy, ING Moscow) or on additional compliance costs to be incurred.

Activist Influenced Companies

Nomad Foods Limited reported the closing of its previously announced underwritten public offering of 20,000,000 ordinary shares, including 2,608,695 shares issued pursuant to the exercise, in full, of the option to purchase additional shares granted to the underwriters in connection with the offering. The ordinary shares were issued at a purchase price of $20.00 per share, for aggregate gross proceeds to Nomad Foods of approximately $400 million, before deducting underwriting discounts and commissions and offering expenses payable by Nomad Foods. Nomad Foods intends to use the net proceeds from the offering for general corporate purposes. Goldman Sachs & Co. LLC, Barclays PLC, Citigroup Inc., Credit Suisse Group AG and UBS Investment Bank AG acted as bookrunners, and SunTrust Robinson Humphrey Inc., BTIG LLC, and CJS Securities Inc. acted as co-managers for the offering.

Dividend Payers

CRH Medical Corporation delivered solid results in 2018, topping our forecasts despite having to deal with reimbursement cuts (approximately 15%) that began in January 2018 and an approx. 5% commercial rate headwind in Q4 2018 as recent acquisitions re-contract with payers. We are encouraged that the company expects to spend approx. $35 million in acquisitions in 2019, which is an acceleration from $27 million spent on deals in 2018. Further, the company reiterated that it has not encountered competition as it executes on its M&A strategy. Revenue grew by 4.8% to $32 million and exceeded consensus by 2.0%. Adjusted EBITDA declined 7.3% to $10.7 million but surpassed consensus by 13.3%. CRH spent $27 million to complete 5 acquisitions during 2018. This was below the $30-35 million originally targeted. In 2019, management believes the pace of transactions could accelerate and expects to spend $35 million. In early January, the company announced an acquisition in the state of Indiana with Anesthesia Care Associates (approx. $2.6 million annual revenue). Bigger picture, the lack of competition for acquisitions is encouraging and should enable the company to continue completing transactions in the targeted range of 4-5x EBITDA. CRH ended 2018 with approx. $10 million in cash and $30 million available on its $100 million credit facility. We expect the company to generate $32 million in free cash flow in 2019. A major concern throughout the healthcare industry is related to out-of-network vs. in-network contracting.

GEA AG announced on Friday that its new CEO Stefan Klebert has purchased another €800 thousand worth of GEA shares (35,000 shares at an average price of €22.9). This is in addition to his €2 million purchase of GEA shares in Oct-Nov 2018, and brings his total investment in GEA shares to €2.8 million.

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Novartis AG announced, that it had obtained approval for listing of Alcon Inc. on SIX Swiss Exchange and New York Stock Exchange. Alcon will enter the Swiss SMI and SPI indices on first trading day that is planned for April 9, 2019. The transaction will be completed by way of a distribution of a dividend in kind to Novartis shareholders and ADR holders. In the distribution, each Novartis shareholder will receive 1 Alcon share for every 5 Novartis shares/ADRs they hold on April 8, 2019, close of business.

Economic Conditions

Canada Budget: Last week, Bloomberg highlighted housing-related measures announced in the Federal government's latest budget. As part of the Liberal government's budget proposal announced last Tuesday, Canada's housing agency, the CMHC, will spend up to $1.25 billion over three years to take equity positions in homes bought by first time buyers. According to the federal documents, the CMHC will provide up to 10% funding for new homes and 5% for existing homes to reduce mortgage costs for low- to middle-income buyers. The financing would apply to insured mortgages, which are required if the buyer puts less than a 20% down payment on the property. The article notes that the equity plan borrows a page from smaller non-profit groups in Canada that already offer similar loans for low-income people. The new program, called the 'First-Time Home Buyer Incentive,' will be launched in September and be available to first-time buyers with annual household incomes of as much as $120,000. The amount of the insured mortgage would be capped at four times income, or up to $480,000. As an equity owner, the CMHC would benefit from any gain in the house price, or potentially absorb a fraction of any loss. It's not clear if the homeowner would repay the amount of the loan or the equity stake based on the home value when the property is sold. Those details will be worked out in coming months, according to finance department officials. The article notes that while the budget made no changes to mortgage stress tests or amortization terms -- changes industry groups had called for -- it did provide other forms of housing relief. The limit on tax- free withdrawals from registered retirement savings plans for first-time buyers will be raised to $35,000, from $25,000, the first change to the limit in a decade. The Financial Post highlighted that the Liberal government's new First Time Home Buyers Initiative (FTHBI) will pit qualifying households, who will only pay 90% or 95% of the eventual price, against families who do not qualify and will be forced to pay full price. The article notes that in the late seventies, shared equity and shared appreciation mortgages were tested by private lenders in the U.S. However, such mortgages failed to take off because private lenders were not keen on waiting for undetermined years to claim their share of the capital gains. The lack of private interest is perhaps the reason that the Liberal government has asked CMHC, a crown corporation, to extend credit for the initiative

Canada's consumer price index was up 0.7% (not seasonally adjusted) in February 2019, taking the year-on-year inflation rate up to 1.5% (from 1.4%). In seasonally adjusted terms, CPI was up 0.3% as rises in food, shelter, clothing, transportation, healthcare and alcohol/tobacco/cannabis more than offset by declines in household operations. Recreation/education was flat.

Canada's retail sales shrank 0.3% month/month in January 2019, marking the fifth decline in the last six months for that indicator. That result was significantly below the median economist forecast which called for a 0.4% progression. Adding to the bad news, the previous month's print was revised down to -0.3%. Sales were down in 4 of the 11 subsectors surveyed in January, including general merchandise stores (-2.4%) and motor vehicles/parts (-1.5%). Excluding the latter category, sales edged up a consensus-matching 0.1%. In real terms, retail sales fell were flat.

EU and U.K.: The EU granted an extension to April 12th but by then the U.K. Parliament has to decide if it wants to go with Prime Minister May's deal and exit on May 22, 2019 or come up with other alternatives that may include, no-deal Brexit, re-negotiate a more detailed exit plan with a longer delay, another Brexit vote or cancelling Article 50 altogether. This week the Prime Minister will try and introduce another vote on her Brexit plan (assuming the speaker of the house lets her) and in the meantime, other members will be introducing legislation to wrestle the Brexit process away from the Prime Minister's Office.

Financial Conditions

U.S. Federal Reserve left the fed funds rate unchanged at 2.25-2.50%. The rate paid on excess reserves was also left unchanged at 2.40%. The Fed acknowledged a slowing economy after a strong 2018, particularly for household spending and business fixed investment, and reiterated that inflation remains low. However, the Federal Open Markets Committee (FOMC) continues to see "sustained expansion of economic activity, strong labor market conditions, and inflation near the 2% objective as the most likely outcomes". The Fed again referred to global economic and financial developments and muted inflation pressures to warrant its decision to be "patient" on rates. The Fed's decision was again unanimous.

The central tendency forecast for real GDP growth (Q4/Q4) was again lowered for 2019 to 1.9-2.2% (versus 2.3-2.5% previously). There was no change for 2020 at 1.8-2.0%, while 2021 was raised a bit to 1.7-2.0% (versus 1.5-2.0% previously). The central tendency projections for the unemployment rate was raised slightly over the forecast horizon reaching 3.7-4.1% in 2021 (3.6-3.9% previously). Personal Consumption Expenditure inflation forecasts were revised down slightly for 2019 but were largely unchanged over the rest of the forecast horizon near the Fed's 2% target. Participants' estimate of the "longer run" or equilibrium interest rate was unchanged at 2.50-3.50%. The median projection now shows no rate hikes in 2019 (versus two in last December's projection), one hike in 2020 and none in 2021.

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In just three months, the Federal Reserve has turned from hawkish to dovish. The slow start to the year prompted the Fed to lower its 2019 forecasts for U.S. GDP and inflation. As such, FOMC participants are now less keen to tighten monetary policy as evidenced by their median projection of no interest rate hikes this year (as opposed to two hikes expected in last December's projections) and the decision to halt balance sheet shrinkage. While low inflation is a problem, the fragile state of the global economy also seems to be influencing the Fed's decision. (Source: National Bank Financial Group)

Bank of England (BoE)'s monetary policy committee (MPC), led by Governor Mark Carney, voted 9-0 to hold interest rates at 0.75% last Thursday. The asset purchase facility remained steady at £435 billion as well. In the minutes of the meeting, the MPC said the economic outlook would continue to depend "significantly on the nature and timing of EU withdrawal", although "predictions contained in its February Inflation Report appear on track". Last month, the BoE sharply downgraded its 2019 economic outlook to 1.2%. As recently as November, the Bank had projected growth of 1.7% this year. For 2020, overall economic growth is expected to slow to 1.5%, from 1.7%.

Norway - Norges Bank has raised its key rate 25 basis points last week to 1%, the highest in almost four years, in a second hike since September aimed at capping inflation. The strength of Norway's economy will allow the central bank to stick to a plan for more increases in the second half, economists forecast.

The U.S. 2 year/10 year treasury spread is now 0.14% and the U.K.'s 2 year/10 year treasury spread is 36% - 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 4.28% (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 16.94 (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.

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.

Portland Investment Counsel Inc., 1375 Kerns Road, Suite 100, Burlington, Ontario L7P 4V7 Tel.:1-888-710-4242 • www.portlandic.com • info@portlandic.com

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