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. May 21, 2019

Owner Operated Companies

Alphabet Inc. – Google LLC announced an expansion of its advertising real estate to boost revenue from mobile shoppers. It will feature ads on the homepage of its smartphone app worldwide, show more ads in Maps and place ads with image galleries in search results. The changes come as choppy revenue growth prompt questions from some Alphabet investors about whether services such as Amazon.com Inc. and Facebook Inc.'s Instagram are drawing online shoppers and in turn, advertisers away from Google. Google executives said the latest features were a response to how users behave, not competition. The ads on the Google homepage appear on what the company calls its Discover feature, a Facebook-style news feed that users swipe through to view an algorithmically personalized set of links to articles, videos and other online content. Google tested ads on Discover last year, when it said more than 800 million people were using the feature monthly. The gallery ads are part of an effort to make search results more visual. Ads with several images are expected to garner more clicks, which could lead to them being shown in more results, executives said. In Maps, ads will now appear in recommended search queries, on routing pages and during navigation. Google - which announced the changes at its Marketing Live conference for advertisers - also said it would begin showing personalized content on its Google Shopping home page. That offers only a search box in most countries at present.

Brookfield Asset Management Inc. – Vodafone Group PLC agreed to sell its New Zealand business for NZ$3.4 billion ($2.23 billion) to a consortium comprising of New Zealand-based Infratil Ltd. and Canada's Brookfield Asset Management, in a deal the telecom giant says would help reduce its debt. Vodafone has been trying to shrink its businesses in Australia and New Zealand to focus on European markets, and is fighting regulators that last week moved to block a A$15 billion ($10.4 billion) deal to merge its Australian joint venture business with TPG Telecom Ltd. For Brookfield, which will co-own the business in equal 49% stakes alongside Infratil, the acquisition represents a small venture into a relatively new sector that could be scaled in other jurisdictions. "This is a unique opportunity for Brookfield," said Stewart Upson, Brookfield chief executive officer of Asia Pacific. "Data has been one of the fastest growing commodities in the world. We expect this rapid growth to persist for the foreseeable future, driven by greater smartphone penetration, increasing video consumption, the advent of 5G networks and new and evolving uses." Vodafone New Zealand Ltd., one of the largest mobile operators in the country, has about two million mobile customers, compared to about 700 million for parent Vodafone Group as of December 31, 2018. On completion of the sale, Vodafone said it would enter into a deal with Vodafone New Zealand to allow it to use its brand name and certain services. The sale is still contingent on regulatory approvals, including clearance from the Commerce Commission and the Overseas Investment Office, the companies said in separate statements. Deal completion is expected by August 31. The deal is expected to be funded with a NZ$1 billion contribution from each party, with Infratil appointing UBS Group AG to raise NZ$400 million in new equity. It will use NZ$400 million in new acquisition debt to fund its part of the deal, the company said. Brookfield has engaged about 5 lenders to back its purchase, including MUFG Bank, Ltd. and Australia and New Zealand Banking Group Limited, according to market sources.

Energy Sector

Bonterra Energy Corp. announced that following the annual review of its credit facilities, its management and Board of Directors have determined, along with the bank syndicate, that amending the credit facilities will better reflect the company's current operating needs and strategy. The amended credit facilities are comprised of a $300 million syndicated revolving credit facility (previously $330 million), a $40 million non-syndicated revolving credit facility (previously $50 million) (Bank Facility) and the addition of an accordion feature which allows the company to obtain future funding of up to $40 million for opportunities outside of normal operations, such as acquisitions, subject to unanimous lender approval. Bonterra has prudently set its capital expenditure budget for 2019 with flexibility to adjust spending based on commodity prices. Based on the company's assumptions regarding commodity prices using current strip pricing, as well as budgeted production levels for the balance of the current year, funds flow is expected to be approximately $110 to $115 million for 2019. Therefore, with capital expenditures currently budgeted for $57 million and annual dividend payments of $4 million, the Company anticipates generating approximately $49 to $54 million of free funds flow for 2019. With strengthening commodity prices and declining debt levels, Bonterra's sustainability can be further enhanced, enabling the company to consider increased capital spending levels or possible dividend increases.

Financial Sector

Citigroup Inc. - In the lean years following the financial crisis, Citigroup Inc. made an unintentional bet on the future of banking and believe it's starting to pay off. While Bank of America Corp. and JPMorgan Chase & Co. were attracting cheap deposits at their thousands of branches around the U.S., Citigroup was shrinking its footprint, focusing on a handful of big cities to right itself after its near-collapse. Now the bank's executives are convinced that many U.S. consumers are finally ready to leave the branch behind and fully embrace digital banking. Citigroup added roughly $1 billion in digital deposits in the first quarter, more than all of last year. About two-thirds of that total came from new customers, and a little more than half don't live near any of the bank's roughly 700 branches. In recent months the bank has re-organized its consumer unit, knocking down walls between banking and cards. It rolled out a new account through its mobile app aimed at credit-card customers. And it is targeting potential customers with mobile-banking offers tied to the rewards they get for cards. "For the 21st century, we are glad we never got the ballast of an extra 4,000 branches," said Stephen Bird, the bank's CEO of global consumer banking. "I'm certain it's going to turn out to be a very fortuitous thing." Other big banks are ramping up their digital offerings too, but they are doing it alongside their giant branch networks. Citigroup is wagering that many of those locations — more than 4,000 each for JPMorgan and Bank of America — will become burdensome. (Source: The Australian)

HSBC Holdings PLC produced a strong set of Q1 results with underlying income +4% year/year and underlying expenses -2%. This compares with Standard Chartered (income & costs -2%) and is a marked turnaround from the disappointing Q4 (income & costs +1%). One quarter is clearly too short a period to suggest a seismic shift in trajectory for a business the size of HSBC (underlying income ex "non-recurring" +1%). However, in the context of very poor results from the UK centered banks, there is much to like about HSBC in our view. Geographic diversification, a robust funding model, higher Q2 Hong Kong Inter-bank Offered Rate (HIBOR), stablizing HK volumes & house prices, limited litigation risk, a 6% dividend yield, etc. However, on a forecast 2021 price/earnings of 10.9x the value in our view is pretty much reflected in the current price - particularly given the growing risks to their core HK franchise.

Barclays, Citigroup, JP Morgan, MUFG and Royal Bank of Scotland were fined a combined 1.07 billion euros (US$1.2 billion) by the European Union last week for rigging the multi-trillion-dollar foreign exchange market. Banks have been hit with billions of dollars in penalties worldwide over the last decade for the rigging of benchmarks used in many day-to-day financial transactions, further damaging the industry's fragile reputation after the financial crisis. The European Commission said individual traders at the banks involved formed two cartels to manipulate the spot foreign exchange market for 11 currencies, including the dollar, the euro and the pound. "These cartel decisions send a clear message that the Commission will not tolerate collusive behavior in any sector of the financial markets," European Competition Commissioner Margrethe Vestager said in a statement. (Source: Reuters)

Activist Influenced Companies

Brookfield Business Partners L.P. – Teekay Offshore Partners L.P. announced that it has received an unsolicited non-binding proposal from Brookfield Business Partners L.P. and certain of its affiliates and institutional partners (collectively, the Brookfield Consortium), pursuant to which the Brookfield Consortium would acquire all of the issued and outstanding publicly held common units representing limited partnership interests of the Partnership that the Brookfield Consortium does not already own in exchange for $1.05 in cash per common unit. Teekay Offshore will retain advisors and evaluate the proposed offer on behalf of the owners of the non-Brookfield owned limited partnership interests. The proposed transaction is subject to a number of contingencies, including the approval of the Conflicts or Special Committee and the satisfaction of any conditions to the consummation of a transaction set forth in any definitive agreement concerning the transaction.

Dividend Payers

Compass Group PLC – First half results - Strong organic revenue growth of 6.6%. Excellent performance in North America with broad based organic revenue growth of 7.9%. Strong Europe organic revenue growth of 5.5% driven by UK Defence contract wins and continuing good growth in Continental Europe. Rest of World growth of 3.2% with continuing good performance in developing markets. Operating profit up 5.8% at £951 million. Operating margin maintained at 7.5%. Operating efficiencies offset higher mobilization costs and investments to support strategic execution. Strong cash generation, earnings and dividend growth. FCFincrease of 14% to £530 million. Interim dividend up 6.5% in line with constant currency EPS growth. Simplified portfolio – completed several disposals and spent £370 million on bolt-on acquisitions during the period.

Dufry AG Investor day - Dufry showed its initiatives to react on the current challenges and to focus on accelerating growth in the coming years with focus on adaption of strategy in the changing travel retail environment - new business operating model supported by digital concepts will accelerate growth. Travel retail as a growing channel: Dufry has a 20% share in the global airport retail market (USD 38 billion); overall travel retail market is USD 76 billion which includes alternative channel like downtown, cruise ships (Dufry started in Fiscal Year 2017), border/seaport stores. Dufry will benefit from the increase in number of passengers at airports (+4-6% per annum) and the expansion of retail space but has also an impact from lower spent/pax from low cost carriers. In mid-term Dufry expect organic growth of +3-4% per annum Digital ("e-motion") initiatives with a strong start: Dufry's launch of the "RED" app was well received and is now available in already 200 airports, presenting 95% of Dufry's sales. In Fiscal Year 2018, already 4% of sales have been generated (Brazil already has 13%, UK 7%) together with the RED app. Small/mid-sized acquisitions mainly in Asia or Food and Beverage (F&B) in U.S.: Dufry has some acquisitions opportunities on the table, which will have a size of CHF 200-500 million in revenues and should be mainly in Asia (other ones possible too) but also F&B in the U.S. is a possibility. For Fiscal Year

2019, Dufry confirmed its target to reach an equity FCF of CHF 350-400 million and a dividend of at least CHF 4.00/share (yield 4.6%).

Walmart Inc. reported Q1 results, EPS of $1.13 vs consensus of $1.02. U.S. e-commerce profitability is improving and 1-day free shipping was already contemplated in guidance. Walmart is maintaining or widening its pricing gaps vs. competitors. Guidance for Flipkart Online Services Pvt. Ltd. dilution was maintained, and Walmart grew core U.S. EBIT +5.5% with an increase in gross margin of 6 basis points despite 37% e-commerce growth and continued price investments, and SG&A leverage of 10 basis points.

Economic Conditions

Canada manufacturing shipments jumped 2.1% in March following a 0.2% decline in the prior month. That result was above the 1.5% increase expected by consensus. Sales were up in 12 of the 21 broad industries surveyed including transportation equipment (+4.5%, helped by increases in motor vehicles and aerospace products), petroleum/coal products (+8.2%) and primary metals (+5.3%). The rise in these industries were more than enough to offset declines for paper manufacturing (-2.2%), electrical equipment (-4.6%) and plastics/rubber products (-1.3%). With the price effect removed, total factory sales surged 1.6% on a monthly basis, while inventories progressed 0.6%. As a result, the real inventory-to-sales ratio fell two ticks to still-elevated 1.48.

U.S. housing starts jumped for the second month in a row, up 5.7% in April to 1.235 million units, annualized, the highest since January. March saw a nice upward revision, and instead of being down 0.3%, was actually up 1.7%. February's drop was also trimmed a bit. Ground was broken to make way for more single-family homes (2nd month in a row) and multis as well, while on a regional basis, all of the gains were in the North East and the Mid West; but, the South and the West slipped. More importantly, there were more signals that starts would continue to climb. Building permits rose for the first time December, up 0.6% in April to 1.296 million units, annualized, the highest since the beginning of the year. Note that permits exceeded starts…. That's the key point here. And with supplies still lean, housing affordability at its highest in over a year (thanks to the big drop in mortgage rates and rising incomes), and judging by the better mood of homebuilders these days, in analysts' views, we can at least look to the housing market to be supportive of broader growth.

Employment in Australia grew strongly for the month of April, rising by 28,400, close to double the 15,000 increase expected. March's reading of 25,700 was revised higher to 27,700. However, full-time employment fell by 6,300, offset by a 34,700 increase in part-time employment. Whilst the labour force participation edged up slightly to 65.8%, from 65.7% in February; the unemployment rate now sits at the highest level since August 2018, moving further away from the eight-year low of 4.94% set in February this year.

Financial Conditions

The U.S. 2 year/10 year treasury spread is now 0.19% and the U.K.'s 2 year/10 year treasury spread is 0.34% - 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 2 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 4.07% (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 15.29 (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 Fund
- 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) per unit 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, 'GDP' gross domestic product, 'netback' is a measure of oil and gas sales revenues net of royalties, production and transportation expenses and is used to compare performance in the oil and gas industry, 'ROE' return on equity, 'ROTE' return on common equity, 'ROTCE' return on tangible common equity.

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