News Highlights

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PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. February 16, 2016

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Energy Sector

Oil output discussions – Top producers Russia and Saudi Arabia tempered expectations of an outright supply cut by agreeing only to freeze output at January levels if other big exporters joined them. Qatari energy minister Mohammad bin Saleh al-Sada told a news conference that the step would help to stabilise the oil market. The oil ministers of Russia and Venezuela attended the meeting in the Qatari capital, together with Saudi oil minister Ali al-Naimi, who said the group's next steps would be assessed over the coming months. The drop in crude oil prices has eroded the finances of even the more affluent oil-producing nations, forcing governments to cut spending, increase deficit forecasts, borrow more and push through politically unpopular reforms. Sources familiar with Iranian thinking on supply, quoted by Reuters, said Tehran would be willing to consider a freeze once its output had reached pre-sanctions levels.

TOTAL SA reported 4th quarter 2015 adjusted Net Income of $2.1 billion, 15% above consensus of $1.8 billion, overall a strong result in our view. It's clear not having such a large North American gas/shale business is a key advantage versus peers these days. The dividend is maintained at €0.61/share for the quarter and €2.44/share for the full year, as well as a scrip option at 10% discount. Upstream net operating income of $748 million was 6% below consensus of $800 million. For the full year production was 2,347kboed (thousands of barrels of oil per day), which was +9.4% compared to 2014. Downstream net operating income of $1.5 billion was 14% ahead of consensus at $1.4 billion. Cash Flow from Operations was $4.8 billion in 4Q 2015 and $20Billion for the full year, compared to $7.4Billion in 4Q 2014 and $25.6Billion for the year in 2014. Gearing (Net Debt/Net Debt+Equity) of 22% is up slightly from 21% in 3rd quarter 2015. Group Return On Average Capital Employed (ROACE) in 2015 was an impressive 9.4%, down from 11.1% in 2014. Upstream ROACE decreased to 4.6% from 5.3%, offset by an increase in Refining & Chemicals (41% compared to 33% in 2014) and Marketing & Services (20% vs. 16% in 2014). TOTAL reiterated its key targets at its strategy day in September 2015: Capital expenditure is expected to fall to $19 billion in 2016 from $23 billion in 2015 and then to $17-19 billion from 2017 onwards; operating expenses reduction targets of $3 billion by 2017 reiterated with $2.4 billion achieved by 2016; divestments expected to be $4 billion in 2016; and TOTAL's high-growth, long-life portfolio is on track to deliver 4% in 2016 and 5% average annual growth to 2019.

Financial Sector

Ares Capital Corporation's convertible bond matured last week, with $575 million in principal left to redeem at maturity. The company had previously indicated its intent to use its revolving credit facilities to redeem the debt.

Barclays plc - Hires JPMorgan Chase and Company's Paul Compton as chief operating officer. Compton starts in May and reports to CEO Jes Staley. He replaces Jonathan Moulds, who is leaving the bank "to pursue other opportunities".

Berkshire Hathaway Inc. – has bought an additional $1 billion of stock in The Phillips 66 Company this year, and now owns roughly 14.1% of the oil refiner. The conglomerate run by Warren Buffett has purchased about 12.98 million Phillips 66 shares this year, including nearly 2.18 million shares in February, according to regulatory filings. Berkshire has paid just over $77 per share for its added stake. Phillips 66 is Berkshire's sixth-largest common stock holding, according to regulatory filings. The larger holdings are American Express Company, Coca-Cola Company, IBM Corporation, Kraft Heinz Company and Wells Fargo & Company, the filings show.

Fifth Street Floating Rate Corp. (FSFR) reported core earnings of $0.24/share, above expectations of $0.23/share, as interest income exceeded our estimates. However, Net Asset Value (NAV) fell 6% quarter/quarter to $11.36/share, largely the result of credit markets volatility along with some issues with specific credits, including one that was moved to non-accrual. Net originations increased approximately 0.6% quarter over quarter which management indicated was less volume growth than historic performance would suggest given the weakness in middle markets. Furthermore, FSFR anticipates even lighter volumes in 2nd Quarter 2016 in-line with seasonality. Dividend coverage remains adequate but we think FSFR's NAV could continue to come under pressure given weakness in the credit markets. As of the end of 1st Fiscal Quarter 2016, FSFR's Glick JV had roughly $199 million of assets, up from $190 million the prior quarter that generated a 10.5% return on investment for the quarter, though slightly lower than the 12.4% in the prior quarter. Management has previously mentioned that the JV should generate a low-teens return on equity (ROE) as the fund reaches its targeted investment capacity of $300 million. Following the December quarter end, FSFR closed on a $25 million senior secured revolving credit facility with East West Bank that matures in January 2021. The facility was priced at LIBOR plus a variable margin. This facility supplements FSFR's existing $175 million credit facility with Citi.

HSBC North America Holdings Inc. has reached a national mortgage settlement (NMS) with the Department of Justice, the Department of Housing and Urban Development, the Consumer Financial Protection Bureau, various other federal agencies, and attorneys general from 49 states and the District of Columbia. Under the NMS, HSBC will provide $470 million in financial commitments. As part of the agreement the participating federal parties and state attorneys general have agreed to release HSBC from civil claims related to past residential mortgage loan origination, servicing and foreclosure practices. Additionally, the Federal Reserve board issued a Civil Money Penalty Assessment Order in conjunction with its Aprill11 foreclosure Consent Order. The $131 million civil money penalty will be satisfied by HSBC's financial commitments under the NMS. HSBC announces the settlement will not cause it to take any additional charges to income.

IGM Financial Inc. announced operating earnings for the last quarter of 2015 of $198.2 million or 81 cents per share compared to $208.1 million or 83 cents per share in 2014. Net earnings $173.9 million or 71 cents per share compared to $148.9 million or 59 cents per share for the comparative period in 2014. Operating earnings for the full year 2015 were $796.0 million or $3.21 per share compared to $826.1 million or $3.27 per share in 2014. Total assets under management at December 31, 2015 were $133.6 billion compared to $141.9 billion at December 31, 2014. Mutual fund assets under management at December 31, 2015 were $127.5 billion compared to $126.0 billion at December 31, 2014. "The growth in our Consultant Network continued in the quarter, reaching an all-time high of 5,320," said Murray J. Taylor, President and Chief Executive Officer of Investors Group Inc. "Mutual fund sales for the year also reached a record high of $7.9 billion." Mutual fund sales for the fourth quarter of 2015 were $1.8 billion, consistent with the prior year. Mutual funds sales were equal to redemptions for the fourth quarter of 2015 and compared to net sales of $194 million a year ago. Mutual fund sales for the year ended December 31, 2015 were $7.9 billion, an increase of 5.7% compared to $7.5 billion in the prior year, and mutual fund net sales were $754 million compared to net sales of $651 million a year ago. "Mutual fund gross and net sales improved during the quarter, with gross sales up 6% over the prior year," said Jeffrey R. Carney, President and Chief Executive Officer of Mackenzie Financial Corporation. "The strength of gross sales in the quarter was led by solid performance in the global equity category, which saw a sales increase of 42%, and was also supported by the launch of the Mackenzie Diversified Alternatives Fund." The board of directors has declared a dividend of 56.25 cents per share (flat) on the company's common shares.

European Union Banks – Wall Street Journal reports last Friday that while there are legitimate reasons to be concerned about the outlook for the European banking system, a closer look suggests the group is not on the brink of a meltdown. The article surveys the various challenges facing European banks, including China's economy, anxieties about bank business models adapting to a world of higher capital requirements, energy-related exposures, and negative interest rates eating into bank margins. The article argues that the biggest risk the market faces is that the recent panic becomes self-fulfilling, where rattled investors continue to dump bank shares, spooking depositors and credit markets, which may cause banks to rein in lending and push up loan prices. However, the article observes that the industry today has far more capital, much more stable funding, greater access to central-bank facilities, and a more stable regulatory system than at any time in the past seven years. It adds that the solvency of the overwhelming majority of banks isn't in question, and the prospect of well-capitalized banks at low valuations may ultimately generate investor interest and end a correction in the group.

Activist Influenced Companies

Cable & Wireless Communications PLC (CWC) – third quarter results were broadly in-line with the expectations, missing slightly on revenues, but reporting solid progress on synergy realization, in its third quarter after the acquisition of Columbus. Revenue was up 1% as reported and 3% in constant currency terms, while earnings before interest, taxes, depreciation and amortization (EBITDA) was up 16% to $238 million in the quarter, for a 40% EBITDA margin, up 500 bps year-on-year on a pro-forma basis. CWC realized $62 million (2/3 labour) of the $70 million in synergies budgeted for its 2016 fiscal year, with three more months to go. By segments, mobile revenue was up 1%, driven chiefly by an 18% increase in data revenue, while voice revenue was down 8%, impacted by over-the-top (OTT) applications. Most of the Caribbean wireless business has been converted to the Flow brand. Revenue in Caribbean mobile was up 7%, including up 16% in Jamaica, where the company has currently 950,000 subscribers. Revenue in Panama was up 2%. Broadband revenue was up by 5%, with 6% coming out of Caribbean, while video revenue was up by 7%, driven by Panama, up by 23% from a very small base, while Caribbean provided 3% growth. Flow IPTV (streaming TV) is to be soon launched in Panama, Turks & Caicos and Bahamas, in addition to existing presence in Trinidad, Barbados and Jamaica. Fixed voice revenue was down by 8%, impacted by OTT. In its managed services division, the company is moving towards recurring business and away from large one-offs which currently makes up the bulk of the business, in particular in Panama. Latin American business grew 15%, despite a 33% drop in the Colombian peso. Wholesale networks' revenue was up by 1%, despite falling prices per gigabyte. CWC has passed its peak capex moment as Project Marlin is finishing its second year and, as a result, its $135 million capital spend in the quarter was only 23% of revenue down from about 30% the year before. All-in, an in-line quarter, with outlook for the year now weaker in term of revenue (although no specific guidance was provided), on account of the strategic shift in managed services (which could be code for loss of Panamanian governmental business), lower fixed voice revenues and a delay in the rollout of IPTV. However, the company expects to reach its EBITDA target for the year, which means that the amount of synergies extracted is likely to exceed the budgeted $70 million for 2016. The trading update, however, was of little consequence for CWC's stock price, of course, given the outstanding Liberty Global PLC offer.

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Restaurant Brands International Inc.– Restaurant Brands, the owner of Burger King and the Tim Hortons coffee and doughnut chain, reported a better-than-expected quarterly profit as menu items such as Burger King's new flavors of chicken fries boosted sales. Comparable sales - sales at established stores - at Tim Hortons rose 6.3% in the fourth quarter, excluding currency impact, helped by strong demand for products such as Nutella pockets and grilled wraps. Burger King comparable sales increased 3.9%, excluding currency impact, helped by new flavors of chicken fries, a new "2 for $5" offer and a pitch-black burger that the company launched for Halloween. Net profit attributable to Restaurant Brands' shareholders, of which the largest is the Brazilian 3G Group, was $51.7 million, or 25 cents per share, in the quarter ended Dec. 31, compared with a loss of $510.8 million, or $2.50 per share, a year earlier. The year-ago quarter was impacted by merger costs. Excluding items, Restaurant Brands posted a profit of 35 cents per share, beating the average analyst estimate of 29 cents, according to Thomson Reuters -consensus estimates. In the latest fourth quarter, revenue more than doubled to $1.06 billion. Restaurant Brands closed 27 underperforming stores in New York and Maine, but continued its US expansion with growth in Indiana.

In a separate announcement, Restaurant Brands revealed that hot dogs will hit the permanent menu at Burger King restaurants in the United States this month, in one of the chain's biggest menu updates in years. Burger King is going back to its fast-food roots with the new menu item after its salads and healthier offerings struggled to tempt diners. Hot dogs are an American favorite for baseball matches and summer barbecues but Burger King, best known for its Whopper burger, says its version will be available in all seasons. Fast food chains are engaged in a war of menu innovation to win the loyalty of diners. Extending its breakfast menu all day helped McDonald's win back customers in the last quarter, with Dunkin' Donuts admitting the intense competition has hit its sales. The Classic Grilled Dogs will be available for $1.99 and the Chili Cheese Grilled Dog for $2.29, Burger King said in an emailed statement.

Zoetis Inc. – For the fourth quarter of 2015, Zoetis delivered a 6% increase in operational growth in revenue and 29% operational growth in adjusted net income, excluding foreign exchange effects. Reported fourth quarter 2015 revenue was $1.3 billion and reported net income was $22 million, or $0.04 per diluted share. For the full year 2015, Zoetis delivered an 8% increase in operational growth in revenue and 24% operational growth in adjusted net income, excluding foreign exchange effects. Reported full year 2015 revenue was $4.8 billion and reported net income was $339 million, or $0.68 per diluted share. Growth in revenue was driven by the addition of Apoquel, a companion animal product, recently acquired from Abbot Animal Health. Sales of livestock products were lower in the US, due to seasonal buying and 2% higher internationally. Full year 2016 revenue guidance was lowered to a range of $4,650 million to $4,775 million from $4,750 million to $4,875 million, primarily due to updated FX rates. Operational revenue growth is expected to be 2-4% vs. prior guidance of 3-5%. The change was due to the impact of elements from the operational efficiency initiative which will reduce revenue growth.

Canadian Dividend Payers

Transalta Renewables Inc. (RNW) – posted a good set of results for the last quarter of 2015. RNW reported $94.6 million of EBITDA for the quarter and $260.8 million of EBITDA for the full year, both helped by the addition of the newly acquired Australian operations, which contributed $79.6 million of EBITDA since May. Cash flow available for distributions (CAFD) was $79.1 million and $177.5 million for the quarter and for the year, respectively. The company's payout ratio for the year was 75%. With the increase in dividend declared at the same time with the most recent asset drop-down announcement, in November, the company's payout ratio is likely to increase slightly, to mid 80% in 2016, until the commencement of operations at the company's Hedland gas power plant in Western Australia, slated for 2017. The company is guiding for an EBITDA level of $365 million to $390 million for 2016 and CAFD of $210 million to $235 million. The results for the quarter exceeded expectations, driven by higher generation in the company's wind farm business, offset by weaker generation at the company's hydro power plants. RNW announced the extension of a power purchase agreement (PPA) at its Parkeston (Australia) 55 MW facility, a $5 million EBITDA contributor. The construction at the 150 MW Hedland gas fired plant is on schedule, with major equipment, including the three gas turbines delivered during the last quarter of 2015.

Global Dividend Payers

Nothing new to report.

Economic Conditions

US – US retail sales surprised on the upside for the month of January, advancing 0.2%, matching December's rate of growth. Excluding autos, retail sales in the US were up by 0.1%, also in line with December's reading. Car sales were a key driver of growth, up 0.6% in the month, while building materials, electronics, clothing and general merchandise also contributed to growth in the month, offset by weaker gasoline, furniture and restaurant sales. The growth in sales in January is contrasted by a drop in US consumer's sentiment, as measured by the University of Michigan, which dropped to 90.70 index points from 93.30 index points, dragged lower by the 'expectations' component of this composite index. On the US housing front, the just released National Association of Home Builders' (NAHB) housing market index unexpectedly slipped to 58.00 index points from a 61.00 reading in January, revised higher, though still firmly anchored in the 'optimistic' territory (i.e. above 50.00).

Canada – Canada's new housing price index continued to grow in December, though at a slower pace than expected, 0.1% relative to 0.2%, and slowing down from November's 0.2% advance. Existing home sales were 0.5% higher in January nation-wide, though there were pronounced differences between the red hot Vancouver and Toronto markets and the reeling Calgary, Regina and Saskatoon markets.

UK - Unemployment fell 10bps (5.1% for the Sep-Nov period 2015); discretionary income rose (Dec. ASDA income tracker: +7.2%); Consumer confidence reading came in positive (Jan: +4).

Financial Conditions

Sweden's Reserve Bank - Riksbank cut rates an unexpected 15 bps last Thursday to -0.50% (negative 0.5%)

The US 2 year/10 year treasury spread is now 1.07% and the UK's 2 year/10 year treasury spread is 1.08% - 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 their costs of capital.

Influenced by the withdrawal of quantitative easing, the US 30 year mortgage market rate has increased to 3.65% (was 3.31% end of November 2012, the lowest rate since the Federal Reserve began tracking rates in 1971). Existing US housing inventory is at 5.2 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 finally supporting the housing market with housing inventory well off its peak of 9.4 months and we believe now in a more normal range of 4-7 months.

The VIX (volatility index) is 24.91 (compares to a post-recession low of 10.7 achieved in early June) 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 7 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

Private/Alternative Products

Portland also currently offers private/alternative products:

- Portland Focused Plus Fund LP
- Portland Private Income Fund
- Portland Global Energy Efficiency and Renewable Energy Fund LP
- Portland Advantage Plus Funds
- Portland Private Growth Fund

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