News Highlights

Owners. Operators. And Insightful Investors.

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PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. February 29, 2016

Energy Sector

Whitecap Resources Inc. – has entered into a $95 million bought deal equity financing, as a result of the increase of its working interest at Boundary Lake in northeast British Columbia. The company has also increased its 2016 production guidance. Whitecap's Boundary Lake asset which is currently under waterflood was originally acquired in May 2014 and was producing 1,150 barrels of oil per day (boe/d) at that time. The property is a conventional waterflood asset which requires lower capital cost open-hole completions resulting in excellent capital efficiencies. The waterflood has been maintained since 1965 resulting in a very low and predictable annual decline rate of less than 5%. In late December of 2015, Whitecap consolidated its interest at Boundary Lake for total consideration of approximately $93.4 million, which increased its average working interest to 90% and added 1,700 boe/d of low decline, high netback production, 8.6 million boe of total proved reserves and 11.5 million boe of total proved plus probable reserves which are included in Whitecaps independent year end reserves report as at December 31, 2015 and 29 net locations, increasing our drilling inventory at Boundary Lake to 100.3 net locations.

Since Whitecap completed the Boundary Lake acquisition, its drilling program results have exceeded expectations. The net proceeds from the financing will be used to initially reduce indebtedness, which was partially incurred to fund the Boundary Lake acquisition. Whitecap remains disciplined in its approach to acquisitions as reflected in the results at Boundary Lake with a focus on consolidating assets within its core areas which meet the company's strict criteria towards long term shareholder value creation within the current commodity price environment. As a result of the recent results at Boundary Lake, Whitecap has increased its production guidance for 2016, by 5% to 38,800 boe/d from the previous 37,000 boe/d. Based on West Texas Intermediate (WTI) US$37.65, CAD/USD exchange rate of 0.72, and Alberta Energy Corporation (AECO) CDN$2.00/GJ the company anticipates generating $253 million of funds flow on an unchanged aggregate capital program of $70 million. Pro-forma the acquisition and financing its total payout ratio is 86% and free funds flow after capital spending and dividend payments is $34 million. Whitecap anticipates having $455 million of unutilized credit capacity on its current bank lines of $1.2 billion. Whitecap remains well positioned to not only weather the current low commodity price environment with our strong balance sheet and high quality suite of lower decline high netback production and inventory but to also provide our shareholders with significant upside when commodity prices improve.

U.S. land rig count fell 14 units to 473, led by horizontal oil (-15), horizontal gas (-3), directional oil (-2), partially offset by gains in vertical oil (+4) and vertical gas (+2), while directional gas remained flat week/week. Total horizontal land rig count has declined 71% since the peak in November 2014.

U.S. horizontal oil land rigs decreased by 15 to 316 and down 21% over the last 5 weeks led by the Eagle Ford (-6), Permian (-5), and "Other" (-5), slightly offset by the Woodford (+1). This is the ninth consecutive week of declines for horizontal oil land rigs. Additionally, vertical oil rigs were up 4 in the Permian.

U.S. offshore rig count increased by 2 units to 27 and is down 50% over the last 18 months.

Canadian rig count was down 31 rigs and remains 47% off the level this time last year.

Financial Sector

Ares Capital Corporation (ARCC) released its fourth quarter results last week. Below we highlight the key points from the announcement and the subsequent conference call. Core net operating income (NOI) at $0.40/share, was marginally ahead of the consensus. The loan portfolio increased 4.2% to $9.1 billion, with $972 million committed in the quarter, offset by $569 million of maturing loans. The portfolio has only a 3% exposure to oil and gas loans. Book value decreased by 2% to $16.46, as a result of the mark-to-market of its portfolio of loans. ARCC trades currently at 0.79x its book value, slightly ahead of the rest of the industry, which has been affected by capital constraints as investors have been spooked by the high yield losses over the last months. ARCC maintained its $0.38/share quarterly dividend (yielding 11.7%), but chose not to pay a special dividend for 2015 (usually around $0.05/share) and carried forward $171 million of taxable income as a buffer and for potential acquisitions. The company's portfolio is constituted of 29% first lien senior secured loans, 21% in subordinated certificates to the SSLP (the senior secured loan program ran by Antares Capital, previously owned by GE and recently acquired by Canadian Pension Plan Investment Board (CPPIB), which is to be replaced by a similar program, SDLP (the senior direct lending program, run by Varagon, an entity sponsored by AIG Inc.), with the remainder constituted by second lien secured loans (31%), senior subordinated debentures, preferred equity and common equity. Robust originations continued in the first quarter of 2016, with new commitments of $338 million thus far this year, yielding in average 9.9%. The overall portfolio yield was 10.3%, compared to third quarter's 10.4% and 10.1% in the previous comparative period (4Q14). Non-accruing loans were

1.7% of fair value (2.3% at amortized cost), on par with the prior quarter. Ares remains the largest business development corporation (BDC) by market capitalization and size of the loan portfolio and continues to be one of the more conservative ones, based on the quality and seniority of its loan portfolio, its strong direct origination focus and the conservative approach to its funding. The company expects oil and gas related defaults to continue to increase in 2016. Capital constraints across the mid-market lending industry opens opportunities for portfolio additions and mergers and acquisitions (M&A), though ARCC would be mindful not to issue dilutive equity (trading at 0.79x book value) unless opportunities are truly compelling. All-in, a reassuring announcement and call in a market that has seen a lot of negativity towards lenders of all calibers. ARCC remains a reliable dividend income contributor in our income mandates and should recover as investors turn somewhat more selective towards business development companies.

Bank of Montreal adjusted Earnings Per Share (EPS) of $1.75 looks a bit better than the consensus expectation of $1.72. Adjusted Return On Equity (ROE) was 12.1%, and actual ROE 10.9%, also in line with expectations. Growth was driven by Canadian and US property and casualty (P&C), as well as strength in Capital Markets. Wealth Management results were down slightly on market volatility. The dividend was unchanged. The Basel III Core Equity Tier 1 ratio of 10.1% declined about 70 bps compared to Q4/15, on closing of the GE Capital transportation Finance business. Provisions rose only $20 million to $183 million, as expected increases in Canadian and U.S. consumer and commercial portfolios (energy) were partially offset by recoveries. Assuming a continued low oil price, we anticipate a gradual sequential increase in provisions for credit losses (PCLs) over the coming quarters.

Barclays Plc cut the bonus pool for its investment bank by about 10% to 12%, according to people with knowledge of the matter. (Source:Bloomberg)

Berkshire Hathaway Inc. – Warren Buffett used his annual letter to Berkshire Hathaway shareholders to launch vigorous defenses of an aggressive private equity partner and a troubled mobile home unit, as his conglomerate recorded robust profits. The Omaha, Nebraska-based company reported a record full-year profit of $24.08 billion, up 21%, while operating profit rose 5% to a record $17.36 billion. Fourth quarter profit was up 32% and operating profit rose a larger-than-expected 18%. Berkshire owns roughly 90 businesses in areas as insurance, railroads, energy, food, apparel and real estate. Buffett spent about 10% of his roughly 18,000-word letter defending 3G Capital, a Brazilian firm in which Berkshire owns 51% of Kraft Heinz Co., and Berkshire's Clayton Homes mobile home unit. Many shareholders questioned Buffett's compatibility with 3G, an aggressive cost cutter led by Brazilian billionaire Jorge Paulo Lemann. Berkshire and 3G teamed up in 2013 to buy H.J. Heinz Co. and last year merged it with Kraft Foods. Buffett also helped finance 3G's merger of Burger King with Canadian donut chain Tim Hortons, creating Restaurant Brands International Inc. Following these mergers, 3G slashed thousands of jobs. Buffett acknowledged that while he and 3G "follow different paths" in running businesses, 3G has been "extraordinarily successful," and more ventures are possible. "Jorge Paulo and his associates could not be better partners," Buffett wrote. Clayton Homes has been faulted in articles in the Seattle Times for predatory lending and discrimination. But Buffett called Clayton a careful lender, and said it has escaped major regulatory fines despite 65 state and federal reviews in the last two years. Management delivers "industry-leading performance," Buffett said. Buffett praised Berkshire's earnings power, saying that only a catastrophic cyber, biological, nuclear or chemical attack on the United States posed a "clear, present and enduring danger" to the company. Buffett touted the BNSF railroad and its leaders Matt Rose and Carl Ice, calling their $5.8 billion of capital spending to improve customer service after a poor 2014 "money well spent." Though Buffett did not mention falling oil prices in his letter, Berkshire's annual report said low oil prices may reduce BNSF's profit in 2016 as industrial freight volumes decline. The report also noted Buffett's $2.6 billion loss as of Dec. 31 in his investment in IBM Corp, but said Berkshire has no intention of selling the stock. Buffett also lauded the work of top insurance executives Ajit Jain and Tad Montross, and called the hiring of Todd Combs and Ted Weschler, who each handle $9 billion of investments, "one of my best moves." Combs was a driver of Berkshire's $32 billion purchase last month of industrial parts maker Precision Castparts Corp.

Brookfield Property Partners LP – U.S. real estate investment trust Rouse Properties Inc. said Canadian asset manager Brookfield Asset Management Inc. agreed to buy the company in a sweetened deal valued at about $2.8 billion, including debt. Brookfield Asset's latest cash offer of $18.25 per share represents a premium of 2.82% to Rouse's Wednesday close and values the real estate company at $1.06 billion. Brookfield, which is already Rouse's biggest shareholder, had made an all-cash unsolicited offer last month to buy all of the company's shares it did not already own for $17 each. The Canadian company, which has about $225 billion in assets under management, owned 33% of Rouse as of Jan. 16. Rouse owns 35 malls and retail centers in 21 U.S. states.

First National Finance Corporation reported core Q4 2015 earnings per share of $0.65 about in line with expectations. Mortgage production was up 11% year over year (YoY). Management attributed robust mortgage volumes to low interest rates, especially following the Bank of Canada's rate cuts last year. The dividend payout remains well supported in our view by servicing income, robust mortgage production and limited credit risk. The 7.6% yield in our view provides valuation support.

Goldman Sachs Group Inc. has scaled back its estimate of the legal costs it may face, beyond what it has set aside, by more than half to $2 billion. The bank had estimated in November legal expenses of up to $5.3 billion in excess of what it had set aside. (Source: Reuters)

JPMorgan Chase & Co. signaled a rough first quarter on Tuesday with double-digit declines in investment banking revenues and a $500 million increase in provisions for expected losses on energy loans. Plummeting oil prices, volatile markets, stubbornly low interest rates, pressure from regulators and a slowdown in China have combined to hurt banks worldwide over the past few months. "There is no doubt that so far it has been a very tough quarter," Pinto said during a presentation at the bank's investor day in New York. JPMorgan will increase provisions for expected losses on bad energy loans by more than 60% in the first quarter. (Source:Reuters).

National Bank of Canada - Q1 2016 net income fell to $261 million, from $415 million in Q1 2015, mostly from the expected write-off of its interest in Maple Financial Group. Adjusted Earnings Per Share of $1.17 was a bit better than Street expectations for $1.14. The Core Equity Tier 1 ratio dipped to 9.7%, from 9.9% last quarter, due to both the write-off, and an increase in Risk Weighted Assets, which was driven by organic growth and FX. Provisions ticked up to $63 million, from $54 million a year ago, though provisions remain low at 0.11% of assets, up marginally from 0.10% in Q1 2015. Adjusted ROE was 16.4%, and the actual ROE was 9.5%, reflecting the write-off. The dividend increased to $0.54 per share, from $0.52 last quarter.

Royal Bank of Canada has passed Goldman Sachs Group Inc. to become North America's fifth-largest bank by assets. The Canadian lender's assets jumped to US$ 872 billion, based on Wednesday's conversion rate, compared with Goldman Sachs's US$ 861.4 billion. (Source Bloomberg) However, RBC suffers fresh hit from oil collapse. Provisions for credit losses came to $ 410 million (US$ 298 million) in the bank's first quarter to the end of January, 49% more than the previous quarter. RBC said provisions for credit losses could rise to 40 or 50 basis points of total loans — up from 31bp now, and about double the rates the bank saw throughout last year. (Source: Financial Times). Q1/16 adjusted earnings per share $1.64 compared to consensus of $1.67. The earnings miss was due to weak Insurance earnings, $0.04 lower YOY, higher Provisions for Credit Losses and weak Canadian Banking earnings due to margin compression of 3 bps quarter over quarter (QoQ). FX added $0.04 year on year. Earnings growth was driven by Wealth Management, which increased 32% YoY, benefiting from the City National acquisition (+9% YoY ex-City National), Canadian Banking +1% YoY, while Investor & Treasury Services was flat and Wholesale declined 4% from the prior year. Return On Equity 15.3%, Core Equity Tier 1 ratio 9.9%; Oil & gas impaired loans rose to $310 million from $156 million last quarter. If RBC were to take a 10% provision on its energy portfolio, it would cost RBC $0.32, slightly less than 1% of book value.

Royal Bank of Scotland Group plc – 'Clean' operating profit of £686 million was down 15%/£120 million compared to consensus. The differences were £203 million lower income, £156 million higher costs and £239 million better impairment. After £614 million restructuring costs, £2124 million litigation costs and -£898 million of other items, the reported loss before tax was -£2950 million (consensus -£2628 million). Core Equity Tier 1 ratio was 15.5%, +0.5% vs. the pre-release with Tangible Net Asset Value at 352p. Current trading in the bank's Corporate & Investment Bank (CIB) is described as having had a 'difficult start to the year' (no surprise). The group targets a further £800 million cost saves in 2016, a stabilisation in its retail banking business income and further modest erosion in CIB and anticipates a move-back to impairment charge in 2016. 'Significant challenges' are being faced in the Williams & Glyn separation process meaning that it will not be disposed until after 1Q 2017 (committed to full divestment by end-2017). As a result of the Williams & Glyn delay and subject to the timing of Retail Mortgage Backed Securities settlements, capital distributions are now expected to resume later than 1Q 2017.

Standard Chartered plc on Tuesday reported its first annual loss since 1989 after the number of bad loans on its books soared and it embarked on a costly restructuring program. The bank posted a net loss of US$ 2.36 billion for 2015, down from a net profit of US$ 2.51 billion the previous year. It is a dramatic reversal for the emerging markets-focused bank, which hired former JPMorgan executive Bill Winters last year to overhaul its operations. (Source: Business Spectator)

The Toronto-Dominion Bank (TD) Q1 2016 adjusted Earnings Per Share $1.18, +5% YoY, slight miss vs. consensus of $1.19. Earnings were driven by U.S. Retail +20% (+3% USD), Canadian P&C +5%, Canadian Wealth +5% while Insurance declined 2%, Wholesale declined 16% and the loss in the Corporate segment increased 24%. A stronger USD added $0.06 per share Year on Year. Return On Equity 13.5%, and Core Tier 1 Equity ratio of 9.9%. Provisions for Credit Losses (PCL) increased to 45 bps from 40 bps in Q4/15 representing a $0.06 drag on EPS. Higher Provisions for credit losses reflect: 1) a reserve build in the Corporate segment for portfolios impacted by low oil prices; and 2) higher U.S. Retail PCLs to reflect volume driven reserve increases in cards and commercial lending as well as FX. U.S. Retail PCLs are expected to remain relatively stable for the balance of the year. As expected, the dividend was increased 8% (recall that TD has switched to a single annual dividend increase). It is worth noting that due to the bank's business and geographic mix it has a lower exposure to oil and gas than its peers.

Activist Influenced Companies

Hertz Global Holdings Inc. (HTZ) – Avis Budget Group's (CAR) fourth quarter announcement and weak profit forecast impacted trading in HTZ early last week, with the stock recovering most of the lost value since. We are noting the following read-through points from CAR's announcement:

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- CAR expects revenue per transaction day to be flat in 2016, despite per-unit fleet cost increases of 3% to 5%.
- While leisure travel has been decent, commercial traffic slowed down, which also has some negative margin mix effects.
- Players across the industry, including HTZ, CAR and the privately held Enterprise Holdings Inc. have struggled to take price recently, despite increased fleet costs (in the past there was a direct relationship between fleet costs and revenues per transaction days) and positive dynamics in other parts of the travel industry (i.e. airlines), which is causing many analysts and investors to question the benefits of the recent industry consolidation.
- CAR announced it plans to repurchase $300 million in stock and we would expect HTZ to act similarly, given their previously announced $1 billion share repurchase plan.

Insofar as activist HTZ related actions are concerned, Carl Icahn increased its stake to 14.3% in December (he continues to be the largest shareholders), likely a vote of confidence for the management team which he instated, which effectively offsets Jana Partners exit (used to be the second largest shareholder) in the last quarter of 2015; Glenview Capital and Fir Tree Partners, also activist investors, are the fourth and the sixth largest HTZ shareholders, respectively. We'll continue to watch HTZ related developments with great interest, in particular industry-wide pricing dynamics and HTZ management's (who, in all fairness, pointed at 2015 as a transition year) planning and execution in this tough industry environment.

Canadian Dividend Payers

Brookfield Infrastructure Partners LP – Canada's Brookfield Asset Management Inc and its Australian rival are weighing a joint AUD$9 billion bid for Australia's biggest rail and port operator, an unusual measure aimed at ending the fiercest takeover battle now raging in the Asia Pacific after seven months. Target firm Asciano Ltd. revealed that Brookfield and the company it has been bidding against, Australian cargo handler Qube Holdings Ltd., have entered talks about a possible joint offer. The ceasefire, if it leads to a concrete offer, would deny the rival firms full control of the Australian freight giant but would spare further delays in clinching a deal as they outbid each other. Reuters previously reported that Brookfield has partnered with the Qatar Investment Authority and the Canadian Pension Plan Investment Board, while Qube has teamed up with government-owned China Investment Corp. The proposal would also distance Brookfield from Asciano's railways, as Brookfield already has rail assets in Australia. Asciano said the discussions remained preliminary and that it would continue to recommend Qube's proposal in the absence of a higher bid.

Global Dividend Payers

BHP Billiton plc has cut its long-held progressive dividend policy in order to preserve its credit rating. Management are opting for a minimum 50% payout ratio on underlying earnings. The 1st Half 2016 results were mixed relative to expectations: EBITDA (earnings before interest, tax, depreciation and amortisation) was in line with consensus, but EPS missed consensus by 30%. In absolute terms EBIT and earnings declined 62% and 81% Half year on Half year; its estimated the dividend will fall 82% Year on Year 2016 (2.2% yield); capex guidance was reduced 18% and 29% for 2016 and 2017 respectively; and net debt/EBITDA rose to 2.2x (1st Half annualized).

Bunzl plc - Full year results are ahead of consensus while the outlook statement is lukewarm. Revenue of £6.5 billion is 1% ahead of consensus of £6.4 billion, EBITDA of £455 million is 1.5% above expectations and EPS of 91p is 3% ahead due to lower interest. Net debt of £1.107 billion is 2% better than estimated. The group has also announced two further small acquisitions in Brazil (a dental supplies sector with revenues of BRL $29.2 million in 2015) and the U.S. (a re-usable bags supplier with revenues of $18 million in 2015). Management outlook: The group expects good performance from North America despite deflationary pressures, Continental Europe to benefit from recent acquisitions, with the UK & Ireland likely to be held back by pressures in the business serving the grocery and retail sectors. Rest of the World likely to benefit from acquisitions but uncertain outlook in countries such as Brazil could pose as a challenge. The shares are trading on approximately 21x 2016 estimates price/earnings with an approximate 4% Free Cash Flow (FCF) yield and a 2% dividend yield.

South32 Limited reported 1st Half 2016 EPS of approximately US$ 0.5/share. While EBITDA at US$542 million was +22% vs. consensus, higher than expected depreciation and tax led to a miss on underlying net income for the year. The remainder of the year will be challenging for the company in our view and with negative EPS likely in the 2nd half 2016. However, operating challenges from lower commodity prices appear well recognized in management actions, with an acceleration of cost and capital reductions designed to remove $300m of operating expenses this year (6.2% of H1 annualised opex base) and a 21% cut in capex guidance ($150m). Meanwhile there was no maiden dividend declared given net income of $26m and no major growth projects approved. The balance sheet remains strong with net debt falling to US$ 116 million (0.1x Net Debt/EBITDA) and $1.5 million revolving credit line undrawn.

Economic Conditions

U.S. – U.S. personal income growth accelerated in January, at 0.5%, compared to December's 0.3% and expectations for a 0.4% advance. Equally, personal consumption grew by an identical 0.5%, exceeding the expectations calling for a 0.3% improvement. Part of

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the same report, the core personal consumption expenditures (PCE) price index, the US Fed's favourite inflation gage, added a couple of tenths to 1.7% for the month of January, helping assuage some worries about deflationary tendencies in the US economy. The US consumer sentiment, as measured by the University of Michigan, was mildly lower in February, at 91.7 points, compared to January, at 92.0 points, but ahead of the consensus expectations, pegged at 91.0 points. The 'current conditions' component of this composite index actually improved in the month, while the 'expectations' component drove the overall index lower.

U.S. Real GDP growth was surprisingly revised up to 1.0% annualized in Q4 from the advance estimate of 0.7%, though this was still half of Q3's rate. Unfortunately, the better showing stemmed from an upward revision to inventory investment (another sizeable $81.7 billion build in the quarter) and a downward adjustment in imports (to an outright decline of 0.6%). Non-residential construction was cut further (-6.6%), and even government spending was lowered to show a slight decline. Consumer spending growth was trimmed to 2.0%, down from 3.0% in Q3 and slowing to a 2.6% y/y rate. Exports fell even more than first tallied, by 2.7% in Q4, and, according to the advance goods trade release, plunged 2.9% in January (in nominal terms)—the fourth consecutive monthly decline. This lifted the goods trade deficit moderately to $62.2 billion in January, tempered only by a decline in imports. The toll from the mighty dollar and weak global demand persists, as net exports carved 0.3 ppts from Q4 growth and look to weigh more heavily in Q1.

U.S. durable goods orders jumped 4.9% in January, the first increase in three months and the largest since last March. But the ever-turbulent aircraft sector has a big influence (nondefense aircraft & parts flew 54% higher after plunging 29% in December). Excluding transportation, orders were up a more modest but still decent 1.8%, also the first increase in three months and the most since June 2014. (Revisions were also higher, ie. December was less negative.) All of the major sectors recovered from the broad declines in the prior month…….machinery, computers, and transportation equipment.

Financial Conditions

The U.S. 2 year/10 year treasury spread is now .94% and the U.K.'s 2 year/10 year treasury spread is .96% - 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 U.S. 30 year mortgage market rate has increased to 3.62% (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 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 20.35 (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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