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. April 25, 2016

Energy Sector

U.S. land rig count fell 8 units to 401, led by vertical oil (-3), horizontal oil (-2), directional oil (-1), horizontal gas (-1), and vertical gas (-1), while directional gas remained flat w/w. Total horizontal land rig count has declined 76% since the peak in November 2014.

U.S. horizontal oil land rigs decreased by 2 to 267 led by the Permian (-2), Eagle Ford (-2), and Woodford (-1), partially offset by gains in "Other" (+3), while Williston, DJ-Niobrara, Granite Wash, and Mississippian remained flat. This is the 17th consecutive week of declines for horizontal oil land rigs, but the 4th week of single digit declines as the trajectory of decline has begun to slow.

U.S. offshore rig count decreased 2 units to 25, and is down 54% since June 2014.

Canadian rig count was up 1 rig and remains 49% off the level this time last year.

Total SA has presented a new organization to achieve "its ambition of becoming the responsible energy major" stating that as well as responding to short-term imbalances, it must also prepare for the medium- and longer-term challenges. The "One Total" project sees three new initiatives that focus on the creation of a new Gas, Power & Renewables business, a Global Services Segment focused on improving efficiency, and a Holding centre refocused on Human Resources and Corporate Social Responsibility. These are meaningful changes in the way that Total operates and, in particular, the creation of a Global Services section should help drive further cost savings. The ambition to become the responsible energy major is understandable in a world where carbon emissions are under scrutiny.

Financial Sector

Ares Capital Corporation – Specialty finance company and middle market lender Ares Capital has amended and restated its US$1.265 billion senior secured revolving credit facility, allowing the company, under certain circumstances, to increase the size of the facility by an amount up to US$632.5 million. As of December 31, 2015, Ares Capital had approximately US$9.5 billion of total assets.

Bank of Nova Scotia – Canadian lender Bank of Nova Scotia said it would sell Roynat Lease Finance, a unit of its subsidiary Roynat Inc., to Meridian Credit Union Ltd. Reuters, citing sources, reported in January that Scotiabank was in talks to sell $1 billion worth of assets within Roynat, which it acquired about 20 years ago. Scotiabank, Canada's No.3 lender, did not provide the financial details of the sale. "Our Roynat business is focused on lending to mid-market companies to propel their growth and this lease finance business is not core to that offering," Roynat President Phil Armstrong said in a statement.

Barclays plc - Carlyle Group and Bob Diamond join forces to prepare a bid for Barclays Africa, the Financial Times reports. According to the article, the alliance with buyout group gives added credibility to the former Barclays chief in his planned bid.

Brookfield Asset Management Inc. – Brookfield said that it had amassed US$9 billion in commitments for a private real estate fund in the latest signal that large investors are hungry for more "real" assets. The fund is a whopping $2-billion larger than its initial target - and more than double the size of the fund's predecessor in 2013. Real estate has a broad appeal to investors hunting for yield and looking for ways to diversify their investments amid volatile equity market conditions. Brookfield's fund is supported by more than 100 institutional investor groups, including sovereign wealth funds and pension plans. The Toronto-based alternative asset manager has itself pledged $2.3 billion to the fund through its related company Brookfield Property Partners LP. The new real estate fund, called Brookfield Strategic Real Estate Partners II, has already begun to invest. About 45% of assets have already been promised to pay for properties in the United States, Europe and Brazil. "This fundraise eclipsed our target and shows that private capital demand for real estate investment with a strong global sponsor has not abated," Brian Kingston, head of Brookfield Property Group, said in a statement. At the same time, Brookfield has been seeking more investors who want a piece of the global infrastructure market, an arena of frenzied bidding for airports, toll roads and shipping hubs all over the world. Brookfield has been seeking capital commitments for a new fund in that asset class, too. The third global infrastructure fund has already raised about $10 billion, according to a source familiar with the fundraising. It is expected to attract about $12 billion in capital by its final closing date expected this summer. That compares with a final close value of $7 billion on Brookfield Infrastructure Fund II in 2013, which started out aiming to raise just $5 billion. High demand for infrastructure assets and commercial real estate in the private market is leading to high asset valuations. Chief executive officer Bruce Flatt's view is that most institutions want to invest a lot more in these two asset classes.

Citizens Financial Group Inc. reported 1Q 2016 Earnings Per Share (EPS) of $0.41. Consensus was $0.39. Relative to consensus, a higher than expected net interest income (net interest margin (NIM) driven) and a lower than forecast tax rate more than compensated for weaker than anticipated fee income. A card reward accounting change reduced both fee income and expenses by $7 million. Securities gains were $9 million. Citizens also announced a $0.02 (+20%) increase in its quarterly dividend to $0.12 (2.1% yield). Operating revenues increased 4% and were relatively stable sequentially. Tangible book increased 2% to $25.21 (trading at 0.9x). Its Return On Tangible Common Equity was 6.6%. On March 7, it repurchased $125 million of subordinated notes and on March 14, it issued $750 million in bank senior notes. Its reserve/loan ratio declined 2bps to 1.21%. Its oil & gas loans totaled $1.8 billion, while its total exposure was $2.7 billion. Roughly 30% of its loans are criticized and 11.5% are on non-accrual status. Its reserve was $61 million. It said this represents 6.3% of more price-sensitive portfolios (3.4% of total loans).

Fifth Third Bancorp reported EPS of $0.40; however, after excluding warrant gains, severance expense, branch gains, securities gains and mortgage servicing rights net hedging gain, it's estimated a core result of $0.35, in line with consensus. Core revenues held up on better NIM and corporate banking revenues. However, this benefit was partially offset by higher than expected provisions largely due to the energy portfolio. Provisions were $119 million for the quarter, or $0.02 higher than estimates largely due to deterioration in the energy portfolio.

The Goldman Sachs Group Inc. reported 1Q 2016 EPS of $2.68. Excluding a preferred dividend gain and a lower than expected tax rate, its estimated like for like EPS was closer to $2.31 (compared to consensus of $2.42). At the core, the lower earnings was largely revenue driven (Fixed Income, Currency & Commodities was down 47% year over year (YoY) compared to peers being down 24% on average and lower earnings from Investing & Lending); non-compensation expense discipline was a highlight. Given the challenging quarter, return on equity was a muted 6.4% with a share buyback of $1.55 billion in 1Q 2016. Oil gas total exposure $10.7 billion (vs. $10.6 billion in 4Q 2015); non-Investment Grade exposure $5 billion vs $4.2 billion in 4Q 2015 due to ratings migration - the latter driving increased credit costs in Investment & Lending division. Go forward tax rate should be similar to last year (31% for Full Year 2015). Fully phased-in advanced Core Equity Tier 1 ratio of 11.7%, stable quarter over quarter (QoQ).

Activist Influenced Companies

Cable & Wireless Communications plc (CWC) – Liberty Global plc announced that at the general meeting of shareholders, its shareholders approved all proposals put to a vote in connection with the acquisition of all outstanding and to be issued shares of CWC. The proposals garnered overwhelming support with over 99% of the votes cast, representing over 86% of all outstanding votes, in favor of the proposals. On April 28, 2016, CWC will hold another general meeting of its shareholders to consider resolutions relating to the proposed acquisition. If those resolutions are approved, Liberty Global expects to complete the acquisition on May 16, 2016.

Pershing Square Holdings Ltd./Zoetis Inc. – Zoetis received notice from Pershing Square Capital Management, L.P. and certain of its affiliates that Pershing Square would not be exercising its option to have Mr. William Doyle serve on the Company's Board of Directors through the 2017 Annual Shareholders Meeting, and that Mr. Doyle's term would accordingly expire at the Company's 2016 Annual Shareholders Meeting pursuant to the terms of the Letter Agreement.

Canadian Dividend Payers

Northland Power Inc. announced that installation of all 54 foundations, including monopiles and transition pieces, for the 332 MW Nordsee One offshore wind project located in the North Sea, was successfully completed six weeks ahead of schedule on April 16, 2016. The foundations are up to 70 metres tall, and each one weighs approximately 900 tons- the weight of about 750 cars. Installation was performed by Nordsee One's installation contractor GeoSea, and the foundations were manufactured by Ambau. Installation of the inter-array cables and the offshore substation will begin in the coming months; wind turbine installation is anticipated to begin in early 2017. The Nordsee One wind farm will consist of 54 wind turbines with an overall installed capacity of 332 megawatts. Once commissioned in 2017, the wind farm is expected to produce an annual output of more than 1,300 gigawatt-hours of electrical energy, enough to supply the equivalent of approximately 400,000 German households. Nordsee One is owned by Northland (85%) and RWE International SE (15%).

Northland also released details of the Ontario Court of Appeal's decision related to an appeal by the Ontario Electricity Financial Corporation (OEFC) related to the interpretation of Northland's and other industry participants' power purchase agreements with OEFC as they relate to the price escalator for power sold under the agreements. As previously disclosed, Northland's wholly-owned subsidiary, Iroquois Falls Power and Northland's managed facilities, Cochrane Power and Kirkland Lake Power, along with a number of other power producers in Ontario, had been successful in having their interpretation of the agreements upheld by the Superior Court. In a decision released Tuesday, the Appeal Court confirmed the ruling of the Superior Court in favour of Northland and the other power producers. Northland estimates its share of past and future lost revenue over the life of the relevant agreements would have been approximately $225 million had the Court found in favour of OEFC. Since the original decision by the Superior Court, the OEFC has made increased contractual payments of approximately $25 million for the period starting February 2015, consistent with the Superior Court's interpretation of the contracts. Subject to the right of appeal, Northland anticipates that its share of the remaining lost revenue from the period prior to the original decision, approximately $90 million including interest, will be paid in the coming months, and going forward, rates under the contracts will be indexed according to the interpretation confirmed by the courts, consistent with the rates that have been applied since February 2015.

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Global Dividend Payers

ABB Limited - 1Q 2016 sales were US$7,903 million (down 7.6% YoY), with organic sales decreasing by 2%. Sales were 1% better than expected due to a less negative organic sales. By division on a like-for-like basis (excluding FX and structure), Electrification Products sales were flat and Power Grids sales were down 2%. Process Automation sales were down by 3% on a like-for-like basis, due to weak activity in the process industries. Operational Earnings Before Interest Tax, Depreciation and Amortization (EBITDA) was at US$943 million, equating to earnings margin of 11.9%, which was 6% better than we expected. However Operational earnings included a US$50 million from an elimination of certain intercompany insurance reserves, after deduction of which earnings were more in line with forecast. Order intake in Q1 2016 amounted to US$9,253 million, -11% YoY (organically -7% and FX -4%). Large orders amounted to US$1,619 million, -32% YoY and -30% organically. Base orders decreased by 5% to US$7,634 million but were flat organically. Compared to forecasts, orders were 9.4% better than expected mostly from large orders being 34% stronger than expected while base orders were 5.3% better than expected. Order backlog was at US$26 billion, an increase by 2% YoY and +4% organically (+7.8% sequentially). In Europe, orders decreased 7% on a like-for-like basis (excluding FX and divestments) and Americas increased -13%. Finally, in Asia, Middle East and Africa, orders fell 2%. ABB repeated its near-term outlook of a mixed macro environment with increasing uncertainty, and stated that the long-term demand outlook for utilities, industry and transport remains favourable. Some macro signs remain positive in the US and growth in China is set to continue, albeit at a slower pace. Foreign exchange and the Oil & Gas sector will continue to influence the company's results. In summary, 1Q orders were better than expected from both large and base orders. Base orders were flat organically which was an improvement from 4Q were organically orders were down 6%.

BHP Billiton plc reported a mixed March quarter (3Q 2016) production report, but overall the impact on earnings is probably broadly neutral – petroleum and copper volumes exceeded expectations, but this was offset by weaker iron ore and energy coal volumes; metallurgical coal was in line with expectations. The company also commented that it was on track for a 14% average unit cost improvement across its major assets in 2016.

Bunzl plc - 1Q trading posts constant currency growth of 10% (13% at actual rates) - benefiting from a 5% contribution from the £324 million of acquisitions made through 2015 and 5% from increased trading days in the period. Consistent with the past three quarters (since 2Q 2015), underlying organic growth is flat. The trading days impact is a function of the 5/5/4 management accounting schedule through 1Q - resulting in an increase once every six years. By the reporting of half year results to June there will be no net impact versus 2015. As a result, the net growth for the quarter comes in at approx. 5% in constant currency driven by Mergers & Acquisitions and in line with expectations. No further acquisitions are announced today (compared to four this time last year) but the acquisition of Bursa Pazari in Turkey has now closed, slightly ahead of schedule (approx. £25 million revenue), and we would expect further deals to be announced in the short term. Regionally the outlook remains much as it was when 2015 numbers were reported in February with pricing pressure on resin-based products in North America continuing to provide a drag on organic growth numbers. Margins are anticipated to remain stable with no further material impact from transactional foreign exchange.

Johnson & Johnson (J&J) beat quarterly earnings forecasts on strong prescription drug revenue and a weakening dollar, and it reassured investors that it did not expect its blockbuster Remicade arthritis drug to face U.S. competition this year. The company also said that it remained on track to boost profit margins significantly this year, in part from cost cuts. In a possibly encouraging signal for other drugmakers that will be reporting results in coming weeks, J&J said the strong dollar took a 3.3% bite out of global sales in the first quarter - half the impact in the prior period - as the currency's value eased somewhat. J&J has recently introduced a number of fast-growing medicines. Pharmaceutical sales rose 5.9% to $8.2 billion in the first quarter, with increased demand for the Imbruvica cancer drug and Invokana diabetes treatment. Sales of Remicade, J&J's biggest product, jumped 11.2% to $1.78 billion. J&J Chief Financial Officer Dominic Caruso said that strong patents should shield Remicade from biosimilar competition in 2016 and potentially for years to come. The company is upgrading plants that make its consumer medicines, including Tylenol, to address longstanding quality control problems. J&J is also restructuring its struggling medical device business to focus on areas like artificial knees and devices for trauma surgery. Medical device sales slipped 2.4% to $6.1 billion in the quarter, while sales of consumer products fell 5.8% to $3.2 billion. Total sales rose 0.6% to $17.48 billion, matching the analysts' average estimate compiled by Thomson Reuters. Net earnings fell to $4.29 billion, or $1.54 per share, from $4.32 billion, or $1.53 per share, a year earlier. J&J said that based on current exchange rates, it expected sales of $71.2 billion to $71.9 billion in 2016, up from its January forecast of $70.8 billion to $71.5 billion. It raised its earnings outlook to between $6.53 and $6.68 a share from a prior range of $6.43 to $6.58.

Novartis AG - 1Q Operating income fell 5% to $2.45 billion and margins declined by 1.3% despite $0.5 billion being pulled out of costs illustrating the squeeze on margins from the loss of high-margin drug sales to generics. The generic hit in 2016 is expected to run to $3.2 billion (and will continue to run through 2017). Despite pulling on average $2 billion to $2.5 billion out of operating costs Novartis' margins declined through its 2011-2014 patent cliff and it will have its work cut out to stabilise margins through the current cliff. However, core EPS was a 3 cent beat ($1.17 vs consensus $1.14). Full year guidance was reiterated for both group sales and core operating income as being broadly in line with the prior year

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but down 2% and 3% respectively, as reported. Group Sales and Pharma were up 1% (-3% in USD) but flattered by GSK oncology sales which won't wash out of comparisons till 2nd quarter 2016. Excluding the contribution of GSK oncology products underlying drug sales fell 2%, in constant currencies, -6% as reported. News surfaced on Sunday claiming Novartis is looking to sell its approximate $13 billion stake in Roche Holding AG, which is the equivalent of ~6% of Roche shares outstanding. Roche had accumulated the position more than a decade ago when it was (presumably) attempting to merge with the company. A Swiss newspaper claims that Novartis is already working with investment banks to line up institutional buyers of this stake, preferring not to try and sell it on the open market. If the company were to sell the stake and earn interest income on the cash received, the transaction would be minimally dilutive. If the company were to take the cash and do a share buyback spread over, say, two years, the impact would be very modest, on the order of single-digit percent EPS accretion. Therefore the possibility is whether Novartis take the proceeds from a sale and pursues a Merger & Acquisition, potentially in the biopharmaceutical or ophthalmology space. This is distinctly possible in our view – Novartis is in a time of need, having had setbacks with both Alcon and Entresto, and investor sentiment is languishing. The Roche proceeds would be enough to fund a mid-sized bolt-on, one to which we believe investors might be receptive.

Roche Holdings AG reported decent 1Q sales of CHF 12,414 million (+4% YoY), slightly (1%) ahead of consensus. The beat was helped by a ~200 million+ tailwind for Tamiflu. Both divisions, pharma and diagnostics, were solid. Pharma division growth was driven by the oncology and immunology, with the mix differing by region. Sales growth was helped by Roche's breast cancer franchise consisting of Herceptin, Perjeta and Kadcyla that grew 9% over the quarter. Also Mabthera/Rituaxan and Avastin contributed to growth (+3% and +4%, respectively). Diagnostics performance was driven by Asia-Pacific (+16%) and Latin America (+21%), with the developed markets flat or down. Roche gave the same guidance as each of the past two years: group sales to grow low- to mid-single digit in constant currency; core EPS growth to be ahead of sales growth in constant currency, and an increased dividend in CHF. For 2016, Roche now expects no foreign exchange impact to sales or core EPS, -1% on core operating profit (prior expectations was no impact to sales, but a -5% impact to EPS).

South32 Limited delivered a decent production quarter in 3Q with all key assets tracking in line or ahead of estimates. The company reiterated production guidance for all operations, as well as controllable cost reductions and capital expenditure. The only material operational change was the ramp up of manganese ore production in South Africa in response to very strong market conditions. Importantly, the company reported a US$134 million decline in net debt since December 2015, reaching a net cash position of US$18 million as of end March. This was despite a $30 million foreign exchange related increase in finance leases and $23 million of one-off redundancy costs. The implied underlying Free Cash Flow (FCF) generation is therefore $748 million annualized, or ~11% FCF yield.

Syngenta AG 1Q Group sales of $3.7 billion including Lawn and Garden which was unchanged at constant exchange rates compared with the first quarter of 2015. Reported sales were 7% lower, with the dollar remaining strong for most of the quarter. Volumes were 2% lower. Prices were 2% higher. Sales in Europe, Africa and the Middle East rose by 6% compared with a strong first quarter in 2015. Growth was achieved despite subdued grower sentiment, notably in France, as a result of low crop prices. Sales in South East Europe were also robust. In North America, sales were 2% lower. Seeds sales increased with a strong performance in corn, largely due to trait licensing revenue. Crop protection sales were lower, partly due to the deliberate reduction in glyphosate. Fungicides showed broad-based growth with a significant contribution from new products. Full year performance in crop protection will be driven by innovation, with 16 new products scheduled for launch. Sales in Latin America were 12% lower. Excluding glyphosate and the change in sales terms implemented in 2015, sales were 1% lower. This is a resilient performance in the context of continuing credit constraints in Brazil and Argentina and delayed sales in Venezuela. In addition, insecticides sales were affected by low pest pressure and the consumption of prior year channel inventories. In Asia Pacific sales were 10% lower as a number of countries continued to be affected by adverse weather effects resulting from El Niño. The rice market in Thailand remains depressed as rice stocks are drawn down and government support for growers is reduced.

Economic Conditions

U.S. Housing Starts - American homebuilders started just 1.089 million units (annualized) in March, the fewest since October. The 8.8% drop more than retraced the prior month's gain. Both singles and multiples plunged. Apart from a sharp snapback in the Northeast (after February's blizzard), starts fell across the nation, with only the pullback in the Midwest blamed on bad weather. Starts in the South (which account for over half the nationwide total) declined for the third time in four months. Still, housing starts are a long way from estimated long-run requirements (1.4 million). This suggests the intense upward pressure on home prices will only continue…unless sales also begin to sag.

U.S. existing home sales jumped 5.1% in March, the largest monthly gain since the end of last year. Although the size of the move beat expectations, and were seen from coast to coast, March's sales of 5.33 million units did not erase February's decline (in other words, March is just a 2-mth high). For the first time since December, both single-family homes and condos saw more sales in the month. And, the months' supply remained pretty tight at 4.5 months. The median sales price was up nearly 6% YoY last month. Finally, as far as who was buying, the first-timers' share of homebuyers was steady at

30%, which is still low and still far from the normal range of 40%-to-45%. (Not enough lower-price homes on the market.) Repeat homebuyers continued to step it up, accounting for 56% of homes sold.

Canada – Retail sales in Canada advanced by 0.4% in February, exceeding expectations for a 0.85 retreat for the month. Sales of vehicles were up 1% in the month, driving the broad sector growth, but retail sales excluding autos were also higher than expected, at 0.2%, relative to negative 0.5%. Other strong retail categories included clothing, sporting goods, furniture and home furnishings. Headline inflation, as measured by changes in the consumer price index (CPI) was one tenth higher than expected in March, at 1.3%, though one notch below February's 1.4%.

Financial Conditions

The U.S. 2 year/10 year treasury spread is now 1.07% and the UK's 2 year/10 year treasury spread is 1.09% - 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 3.59% (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 4.5 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 14.40 (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 Focused Plus Fund
- Portland Private Income Fund
- Portland Global Energy Efficiency and Renewable Energy Fund LP
- Portland Advantage Plus Funds
- Portland Private Growth Fund

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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