News Highlights

Owners. Operators. And Insightful Investors.

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

PORTLAND INVESTMENT COUNSEL®

Established in 2007

Our views on economic and other events and their expected impact on investments. June 26, 2017

Owner Operated Companies

Alphabet Inc. – As reported this morning by Bloomberg, Waymo, the self-driving car unit of Alphabet Inc., has reached an agreement for Avis Budget Group Inc. to manage its fleet of autonomous vehicles. It is the first such deal in a field that's still fledgling but exploding with partnerships. The rental car firm will service and store Waymo's Chrysler Pacifica minivans in Phoenix, where the parent of Google is testing a ride-hailing service with volunteer members of the public. Waymo will own the vehicles and pay Avis for its service, an arrangement that is set for multiple years but not exclusive. The new deal is limited to Waymo's vehicles in Phoenix, where it started its first pilot service in April after nearly a decade of research. Waymo and Avis said the Phoenix service arrangement will begin later this year.

Carnival Corporation announced its second quarter results, adjusted net income of $378 million, or $0.52 adjusted earnings per share (EPS), was higher than adjusted net income of $370 million, or $0.49 adjusted EPS, for the second quarter of 2016. Revenues for the second quarter of 2017 of $3.9 billion were higher than the $3.7 billion in the prior year. Carnival Corporation President and Chief Executive Officer Arnold Donald noted, 'Strong execution drove significant operational improvements,[…] over five percent improvement in cruise ticket prices, affirming our efforts to increase demand by building positive word of mouth through the delivery of exceptional guest experiences as well as our innovative marketing and public relations programs.' Gross revenue yields (revenue per available lower berth day or ALBD) increased 2.7%. Gross cruise costs including fuel per ALBD increased 3.2%. Highlights from the second quarter include the delivery of Princess Cruises' Majestic Princess, the first ship tailored for the China market, as well as the addition of AIDAperla to the company's German brand, AIDA Cruises. Cumulative bookings for the next three quarters are higher at prices that are well ahead of the prior year. During the quarter, booking volumes for the next three quarters have been running in line with last year, also at prices that are well ahead. The company expects full year 2017 adjusted EPS to be in the range of $3.60 to $3.70 compared to March guidance of $3.50 to $3.70 and 2016 adjusted EPS of $3.45.

Oracle Corporation quarterly profit handily exceeded Wall Street estimates and the business software maker forecast an upbeat current-quarter earnings, indicating that the company's transition to cloud is starting to pay off. A late entrant to the cloud market, Oracle has been doubling down on efforts to bolster its cloud-based services as customers increasingly shun the costlier licensing model. As part of the efforts, the company and AT&T Inc. signed in May a deal under which the U.S. telecom provider agreed to move some of its large-scale databases to Oracle's cloud platform. "In the coming year, I expect more of our big customers to migrate their Oracle databases and database applications to the Oracle Cloud," Oracle founder and Chief Technology Officer Larry Ellison said in a statement. Total cloud revenue surged 58.4% to $1.36 billion in the fourth quarter ended May 31. The success in the cloud business was highlighted by company executives on a post-earnings call. "We sold more than $2 billion in cloud annually recurring revenue. This is the second year in a row that we sold more cloud annualized run rate than Salesforce.com," Ellison said on the call. Buoyed by the growth in cloud, the company forecast first-quarter adjusted profit of between 59 cents and 61 cents per share on a constant currency basis, while analysts' were expecting 59 cents. On a constant currency basis, Oracle said it expected revenue to grow between 4% and 6% in the current quarter. Meanwhile, Oracle's hardware revenue declined 13.2% to $1.11 billion and new software licenses fell 5.1% to $2.63 billion in the latest quarter. Net income rose to $3.23 billion, or 76 cents per share, in the fourth quarter, from $2.81 billion, or 66 cents per share, a year earlier. The company reported an adjusted revenue of $10.94 billion.

Restaurant Brands International Inc. vowed to cut the use of antibiotics in its chicken supply, joining other major fast-food chain operators in the battle against the rise of dangerous antibiotic-resistant bacteria known as superbugs. The company said it intends to switch its Burger King and Tim Hortons chains in the United States and Canada to chicken raised without the use of antibiotics important to human medicine by the end of 2018. The company, which bought Popeyes Louisiana Chicken this year, said it intends to apply the new policy to all brands over time. It did not share additional details about the new antibiotic rules. McDonald's Corporation, Wendy's, KFC and Chick-fil-A are among the companies that have made commitments to reduce the use of antibiotics in the poultry they buy.

Energy Sector

U.S. land rig count increased by 7 rigs to 915 rigs, which is the 23rd week of consecutive gains. The rig count was driven by gains in Horizontal Oil (+12) and Directional Oil (+2), offset by declines in Vertical Oil (-3), Horizontal Gas (-2) and Directional Gas (-2) as Vertical Gas remained flat week/week. Total horizontal land rig count is down 42% since the peak in November 2014. The Permian currently makes up 50% of all oil rigs.

U.S. horizontal oil land rigs increased by 12 rig to 648 as gains in Woodford (+5), Permian (+3), Williston (+2), Granite Wash (+2) and DJ-Niobrara (+1) was offset by Mississippian (-1) as Eagle Ford and Utica remained flat week/week.

U.S. horizontal gas land rigs remained flat week/week at 146 as gains in “Other” (+2) were offset by declines in the Haynesville (-2).

Canadian rig count increased by 13 rigs, and is up 125% from the level this time last year.

U.S. GoM offshore rig count held flat week/week at 21 and is down 61% since June 2014.

Cardinal Energy Ltd. has completed its previously announced bought deal financing of 30.91 million subscription receipts at a price of $5.50 per subscription receipt for gross proceeds of approximately $170 million through a syndicate of underwriters led by RBC Capital Markets. Each subscription receipt entitles the holder thereof to receive, without payment of additional consideration or further action on the part of such holder, one common share of Cardinal upon closing of the previously announced acquisition of certain high-quality, low-decline light oil assets located in the Weyburn/Midale area of southeast Saskatchewan and in the House Mountain area of Alberta. The acquisition is expected to close on or about June 30, 2017.

Financial Sector

Barclays PLC has been charged by Britain’s Serious Fraud Office together with four former executives last Tuesday with conspiracy to commit fraud (false representation in capital raising documentation) and the provision of unlawful financial assistance contrary to the Companies Act 1985 (lending money to be used to acquire capital) over undisclosed payments to Qatari investors during a £12 billion pound emergency fundraising in 2008. The bank, whose top management has changed since then, said it is considering its position over the charges which add to pressure on Chief Executive Jes Staley less than three months after regulators put him under investigation. He has repeatedly described its legal cases as being ‘legacy issues’ that the bank is seeking to put behind it. We note that whilst the former CEO John Varley is included, the CFO at the time, Chris Lucas, is not. (Source: Reuters)

Berkshire Hathaway Inc. - Warren Buffett has handed a lifeline to Home Capital Group, Canada’s stricken subprime mortgage lender, producing a C$2.4 billion (US$1.8 billion) financing package which has eased immediate fears over its future. The company, Canada’s largest provider of home loans to the newly arrived and the self-employed, has battled to stem an outflow of customer deposits as a result of a long-simmering fraud scandal that culminated last week in a settlement with the Ontario Securities Commission. Last Wednesday the Toronto-based company announced that Mr Buffett’s Berkshire Hathaway had agreed to inject up to C$400 million of equity, while providing a new C$2 billion line of credit to replace high-interest financing that it arranged at a low ebb in April. (Source: Financial Times)

BNP Paribas S.A. said it will cut 640 jobs by end-2020 in its French retail bank via natural attrition, as part of a wider management reshuffle for a business grappling with low interest rates and stringent regulation. French banks in general have been closing down retail branches and cutting staff, while investing more in the faster-growing online banking sector. “The objective of this reorganization is to reduce the number of decision-making chains and to concentrate decision-making powers closer to the needs of the customers,” said a BNP Paribas spokesman on Thursday, following a report on the plan by French newspaper Le Monde.

HSBC Holdings PLC will create 500 new jobs in Scotland in its Global Risk and Customer Contact units, the bank said last Tuesday, its third expansion in the country in the last three years. The new roles, which also include jobs in other parts of the bank, will increase the total number of HSBC staff in Scotland to 4,500, the bank said in a statement. “HSBC’s expansion with the creation of 500 new jobs across Scotland is fantastic news for the economy”, Scottish First Minister Nicola Sturgeon, who visited HSBC’s Global Risk operations in Edinburgh on Tuesday, said in the bank’s statement. HSBC has also announced a fund of £500 million ($632.35 million) for lending to small businesses in the country. (Source: Reuters)

JPMorgan Chase & Co. - The Federal Reserve on Tuesday said it dropped an enforcement action against JPMorgan in a 2011 bid-rigging matter and the bank will no longer have to submit compliance paperwork, the central bank said last Tuesday. JPMorgan paid $211 million in a six-year-old settlement with federal regulators after the Wall Street bank admitted to rigging derivatives bids sold to clients. The bank also agreed to regularly report on how it would prevent future bid-rigging abuse and that additional paperwork is no longer required after the Tuesday announcement. **Bank of America Corporation** had been part of a similar agreement and the Fed dropped its extra oversight of that lender in a move announced last week. (Source: Reuters)

Italy has moved to shore up confidence in its fragile banking system after agreeing to pump €5 billion of taxpayers’ money into two failed mid-sized banks while handing their good assets to Intesa Sanpaolo, the country’s strongest lender. Pier Carlo Padoan, Italy’s economy minister, said on Sunday that the state would offer additional guarantees of up to €12 billion — meaning a possible total of €17 billion — to cover losses from the two banks’ bad loans. He said the initial €5.2 billion included €4.8 billion for Intesa to maintain its capital ratios following the acquisition of the Veneto banks, as well as a further €400 million in guarantees against the risk that some of the credits acquired by Intesa turn sour. Italy’s financial system has already put €3.5 billion into the Veneto banks in the past year via the government-sponsored backstop fund Atlante. (Source: Financial Times)

Activist Influenced Companies

Nestlé SA - Activist investor Dan Loeb's hedge fund Third Point announced it has built a stake of more than $3.5 billion (1.4% stake) in the world's biggest food company. The fund intends to encourage management to "pursue change with a greater sense of urgency" by selling its stake in L'Oreal SA, increasing leverage for share buybacks and reviewing its portfolio, among other suggestions. Key sentence: "We believe Nestlé is positioned to create enormous value for shareholders over the next several years if the company focuses on: 1) Improving Productivity; 2) Returning Capital to Shareholders; 3) Re-shaping the Portfolio; and, 4) Monetizing its L'Oréal Stake."

Dividend Payers

Diageo PLC: has agreed to pay up to $1 billion for the upmarket tequila brand Casamigos launched 4 years ago by Hollywood actor George Clooney, Cindy Crawford's husband Rande Gerber and real estate developer Mike Meldman. 'Casamigos' loosely translates into 'house of friends'.

Nestlé has been announced as lead investor in a $77 million founding round from Freshly, which is a meal delivery plan in the USA. The business offers a range of fresh meal options which can then be prepared in the microwave. Jeff Hamilton, Head of Nestlé Prepared Foods USA, will join the Freshly board. While immaterial from a Nestle group perspective, to us this is a clear signal that Nestlé is mindful of some of the emerging existential threats to packaged food.

Novartis AG announced last week positive data from:

1) Two Phase III trials of RTH258 (brolucizumab) (HAWK and HARRIER; n>1,800) in patients with neovascular Age-related Macular Degeneration, a leading cause of blindness in the elderly. These studies compared two doses (3mg and 6mg) of RTH258 given every 12 weeks against the current standard of care, Regeneron/Bayer's Eylea (aflibercept), dosed every 8 weeks. The study met key primary and secondary endpoints of non-inferiority in mean change in best-corrected visual acuity (BCVA) from baseline to week 48, and average mean change over weeks 36-48, respectively. RTH258 efficacy when dosed every 12 weeks was maintained in 57% (HAWK) and 52% (HARRIER) of patients versus every 8 weeks for Eylea. The Food & Drug Administration has previously looked for sustained efficacy in the 'majority' of patients in order to justify a label claim on longer dosing interval. We believe that this standard has been met at the 55% level. Novartis still has to complete a pharmacokinetic study with the final manufacturing process to enable filing in 2018 - slightly later than our expected filing still in 2017. Headline data for RTH258 is encouraging, predominantly as more than 50% of patients could be maintained on a quarterly dosing.

2) The phase III CANTOS study met the primary endpoint showing that ACZ885 in combination with standard of care therapy reduces cardiovascular risk in people with a prior heart attack and inflammatory atherosclerosis. The data will be discussed with regulators and will be presented at an upcoming medical congress. Heart attack occurs in about 580,000 people every year in EU5 and 750,000 people in the United States. Despite current treatments about 40% of heart attack survivors remain at increased risk of recurrent heart attack, stroke or cardiovascular death because of high-risk inflammatory atherosclerosis; 25% experience another event within five years. Assuming treatment cost of USD $10,000 per annum, and considering that this injectable drug is likely not suitable for elderly or those at risk for infections, we could see a theoretical market potential of USD $10 billion. Depending on the strength of the data - which we have not seen. As CANTOS started from a positive subgroup analysis from a failed trial, there was no data available to gauge the likelihood of CANTOS working. Thus far, assumptions had been of a probability of success of 30% but this news change the probability to say 60% in our view.

Valeant Pharmaceuticals International, Inc. has announced that John Paulson has been elected to serve as a director of the company effective June 14. Mr. Paulson is the President of Paulson & Co., and we view his addition as positive validation for the company's turnaround strategy under CEO Joseph Papa and our strengthening view of the nearer term debt securities in which we invest. Valeant has stated a goal of repaying $5 billion of debt before the end of Q1 2018. Despite a pro forma ~$4.5 billion net debt reduction over the past 12 months, Valeant's leverage ratio has nonetheless climbed from 7.1x to 7.4x as growth has deteriorated. Although recently announced divestitures are positive, they nonetheless underscore the challenges of achieving accretive multiples without giving up growth-driving assets. Including the recent sale of iNova, it is estimated that Valeant has pro forma net debt of $25.6 billion remaining, representing a still elevated leverage ratio of 7.4x forward EBITDA (earnings before interest, tax, depreciation and amortization). The recent debt refinancing has provided the company with some breathing room in our view, pushing the bulk of Valeant's maturities to 2020 and beyond, while shifting 75% of its debt to fixed versus floating rates.

Economic Conditions

Canada – Canadian retail sales significantly outperformed expectations for a 0.20% advance for the month of April, growing by 0.8%, on top of March's 0.50% strong showing. Core retail sales, which excludes the effect of vehicles and parts sales, were even stronger, up 1.5% for the month. The improvement was broad

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

based, led by building materials, clothing and electronics, partly offset by auto sales. Canadian inflation, meanwhile, posted a lower year one year rate of change than expected in May, at 1.3% for its headline reading, against consensus views for a 1.5% rate and April's 1.6% figure. The core reading, which excludes the effects of eight most volatile price series, including food and energy, was 0.90%, significantly below Bank of Canada's 2.0% target.

U.S. existing home sales unexpectedly rose in May. The 1.1% jump flew against expectations of a like-sized decline, leaving the number of sales at 5.62 million units annualized, the highest in two months. In other words, not enough to erase the prior month's weather-impacted drop. Sales of both single-family and condos picked up in May, as buyers were given a bit more choice. The number of homes available for sale rose 2.1% in the month, but are still 8.4% below a year ago. In other words, still tight inventories. That can be noted in the months' supply, which stands at 4.2, well below 'normal' levels. First-timers' share of sales slipped a smidgen to 33%, well within the range of the last year.

U.S. durable goods orders fell 1.1% in May below consensus. Transportation was a big part of that, with transportation equipment down 3.4%. Excluding transportation, orders managed to squeeze out a 0.1% gain. But fewer industries were putting forth more orders; computers/electronics, computer/related, and communications. The one bright spot was the 0.6% gain in machinery, which more than offset the prior month's decline. There is a great deal of volatility in this report. But that cannot hide the fact that capex is struggling to gain traction. Core shipments rose 0.4%, which is good news but combined with the drop in April, shows a soft Q2 so far. Core orders fell 0.2%, the first decline since December but following a string of just barely over 0.1% gains over the past three months.

Financial Conditions

The Reserve Bank of New Zealand (RBNZ) remained staunchly neutral when they kept their cash rate on hold as expected at 1.75%. New Zealand rates and FX markets are little changed, reflecting the Banks' firmly neutral rate outlook. The Bank is firmly focused on offshore developments so until Mr Spencer takes the RBNZ reins, the odds of a change in bias towards a hint of hawk are low in our view.

The U.S. 2 year/10 year treasury spread is now .79% and the U.K.'s 2 year/10 year treasury spread is .77% - 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.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 3.90% (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 4.2 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 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 9.98 (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 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:

- 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
- Portland Global Aristocrats Plus Fund

Individual Discretionary Managed Account Models - SMA

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.