# News Highlights

*Owners. Operators. And Insightful Investors.*

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PORTLAND INVESTMENT COUNSEL®

*Established in 2007*

*Our views on economic and other events and their expected impact on investments.* September 18, 2017



## Owner Operated Companies

**Berkshire Hathaway Inc.** – Home Capital Group Inc.'s shareholders rejected a proposal for Warren Buffett's Berkshire to raise its stake in the company, voting against the board's recommendation in a third defeat for the U.S. billionaire this year. Proxy advisory firm Institutional Shareholder Services last month recommended shareholders vote against the proposal, which called for Berkshire to increase its shareholding from 20% to 38.4%. Home Capital Chairwoman Brenda Eprile told a special meeting of shareholders that 88.79% of votes cast were against the proposal, with 11.21% in favor. The deal would have allowed Berkshire Hathaway to buy new shares in the company at a price of C$10.30 per share, a deep discount to Home Capital's closing price of C$14.08 on Monday, which would have impacted the overall value of Home Capital shares. Home Capital and Berkshire agreed in June to a deal worth up to C$400 million ($329 million) for an initial stake of 20% in the business. The agreement enabled Berkshire to increase its stake subject to shareholder approval. Buffett took his stake in the company and provided a C$2 billion credit facility after investors withdrew more than 90% of funds from Home Capital's high-interest savings accounts earlier this year. Home Capital said the terms of the credit facility, on which it does not currently have funds drawn, remain unchanged.

**Linamar Corporation** – GF Linamar, a joint venture between GF (Georg Fischer) Automotive and diversified manufacturing expert Linamar, has been awarded a large order from a U.S. manufacturer to produce lightweight magnesium components. The value of the contract amounts to a total of around $300 million over a period of five years. The major order consists of cross car beams for a new pickup model and underlines GF Automotive's expertise in lightweight components. The components made of magnesium will be produced from 2020 onwards at the new plant in Mills River, North Carolina (U.S.). This plant which GF will operate together with Canadian joint venture partner Linamar will officially be opened in October 2017. The order is another important milestone in the expansion of GF's presence in the North American market and consequently for implementing its 2020 strategy.

**Oracle Corporation** reported market-beating revenue and profit for the first quarter of its fiscal year. However, the company forecast current-quarter adjusted profit largely below Wall Street's estimates and indicated to slowing growth in its soaring cloud business. Oracle said it expected adjusted profit to be between 64 cents per share and 68 cents per share for its second quarter ending November. Analysts on average were expecting 68 cents per share, according to Thomson Reuters I/B/E/S. Oracle - a late entrant to the cloud market - has been aggressively pushing into the business as more and more clients ditch the costlier software licensing model.

The company, however, is facing strong competition from other big cloud players such as Amazon.com Inc., Salesforce.com Inc. and Microsoft Corporation. Oracle forecast total cloud revenue to increase 39% to 43% in the second quarter, lower than the 51.4% growth it reported in the latest quarter. Still, Oracle expects cloud bookings to grow. "I expect Q2 cloud booking growth to be strong or stronger than our Q1 growth rate," co-CEO Mark Hurd said on a post-earnings call.

Oracle said in late August it would hire more than 5,000 engineers, consultants, sales and support people this year to boost the fast-growing business. Earlier this month, the company linked the equity package of its two CEOs, Mark Hurd and Safra Catz, and Chief Technology Officer Larry Ellison to performance targets that include $20 billion in total cloud revenue in a fiscal year. The company reported revenue of about $4.57 billion for the business in its financial year that ended on May 31. Total cloud business revenue rose to $1.47 billion in the three months ended Aug. 31, while it increased to $5.92 billion in the company's traditional software licensing business. Total adjusted revenue rose about 7% to $9.21 billion, handily beating expectations of $9.03 billion. On an adjusted basis, Oracle earned 62 cents per share, beating estimates by 2 cents, helped by new software license outperformance and lower foreign exchange impact.

**Walgreen Boots Alliance, Inc.** is seemingly willing to change the number of Rite Aid Corporation stores it plans to purchase in order to placate Federal Trade Commission (FTC) antitrust regulators who are reviewing the sale. The FTC is reportedly close to ending its review process for the deal and could either make a decision or request more information before concluding its review. Walgreen would become the country's largest pharmacy chain if the deal is allowed to proceed. The company first announced its plan to purchase Rite Aid for $9.4 billion in 2015, but has run into regulatory roadblocks since then.

## Energy Sector

**U.S. land rig count** decreased by 8 rigs to 915 rigs week/week, which is the largest weekly decline since April 2016. The rig count was driven by declines in Vertical Oil (-8), Directional Gas (-3), and Horizontal Oil (-1), partially offset by gains in Horizontal Gas (+3) and Directional Oil (+1), with Vertical Gas remaining flat week/week. Total horizontal land rig count is down 42% since the peak in November 2014. The Permian currently makes up 52% of all oil rigs.

**U.S. horizontal oil land rigs** decreased by 1 rig week/week to 642, marking 6 consecutive weeks of declines, with declines in Woodford (-2), Williston (-1), Eagle Ford (-1), and DJ-Niobrara (-1), offset by gains in "Other" (+4), with Permian, Granite Wash, and Mississippian remaining flat week/week.

**Canadian rig count** increased by 10 rigs week/week, and is up 62% from the level this time last year.

**U.S. Gulf of Mexico offshore rig count** increased by 1 rig to 17 rigs week/week and is down 69% since June 2014.

**Baytex Energy Corporation** provided an update to the impact on production due to Hurricane Harvey. As previously disclosed on August 25, 2017, the company's Eagle Ford operations were shut-in and drilling and completion operations were suspended. During the week of August 28, 2017, field operations were inspected, drilling and completion operations resumed and the safe start-up of field operations was initiated. With very little damage to production facilities on Baytex lands, the company's production in the Eagle Ford has steadily increased as market access has improved. Baytex is currently producing at or near full capacity compared to pre-Hurricane Harvey levels. The company has 4 drilling rigs and 1 to 2 completion crews working on its lands, which is consistent with its expected pace of development during the second half of 2017. Baytex estimates the impact on its third quarter production to be approximately 2,500 boed (625 boed on an annualized basis). This represents less than 1% of its anticipated corporate production for 2017. As a result, the company is maintaining its annual production guidance of 69,000 to 70,000 boed.

## Financial Sector

**Barclays PLC** plans to step up financing in its corporate and investment bank (CIB), particularly in fixed income and equity, as part of its plan to improve returns in the business. Chief executive Jes Staley said he does not plan to increase capital allocated to CIB, but to make use of about £20 billion from its corporate loan book that is delivering inadequate returns and by leveraging up its balance sheet after years of shrinking it. "With our leverage ratio at 4.8% as at June 30, we are no longer leverage constrained." (Source: Reuters)

**Barclays** won the dismissal of U.S. class-action litigation by investors who bought its stock just months before the 2008 global financial crisis, and accused it of concealing its exposure to risky debt and an inability to manage credit risks. U.S. District Judge Paul Crotty in Manhattan said investors failed to show that Barclays and underwriters led by Citigroup Inc deceived them when the British bank sold $2.5 billion of American depositary shares in April 2008. Though the shares lost 80% of their value by the following March, Crotty said much of that decline could have reflected fallout from the collapse of Lehman Brothers Holdings Inc, the bailout of U.S. insurer American International Group Inc, and government capital injections into other British banks. (Source: Reuters)

**Executives from JPMorgan Chase & Co., Bank of America Corporation and The Goldman Sachs Group Inc.** warned last Tuesday that trading conditions during the third quarter were likely to be poor for their banks. Revenue from trading of stocks and bonds continues to suffer from decreased market activity and volatility, the executives said, speaking at a conference in New York sponsored by Barclays. Bank of America sees revenue from trading stocks and bonds likely to decline around 15% in the third quarter compared with the year-ago period, its chief financial officer, Paul Donofrio, said. JPMorgan Chief Executive Jamie Dimon gave an even more downbeat forecast for his bank, predicting a 20% drop in trading revenue. Dimon said he may stop giving trading guidance because investors were too focused on short-term results. Goldman President Harvey Schwartz said conditions for fixed-income trading have not improved much since the beginning of the year, but he declined to be specific. (Source: Reuters)

**Goldman Sachs Group** last Tuesday unveiled a growth plan that could add as much as $5 billion in revenue annually, as the bank seeks to reassure investors after two poor trading quarters in a row. The growth initiative, which is not dependent on an overall improvement in the market environment, can be realized in the next three years and could contribute up to $2.5 billion in pre-tax earnings, Goldman president Harvey Schwartz said during a Barclays financials conference in New York (Source: Reuters)

**Unicredit SpA** - The bank completed the placement of its entire stakes in France's Eramet at a price of €57 a share (€169.4 million). Unicredit held 4.062%. In our view it makes sense to sell since its non-core and trading at the highs of the last 12 months, but the deal is modest.

**Wells Fargo & Company** expects to gain better control of costs in relation to revenues, as it works to recover from a sales scandal, its chief executive said last Tuesday. Tim Sloan, CEO of the third-largest U.S. bank, said at an industry conference hosted by Barclays that expenses will likely account for 60% to 61% of revenues in the second half of 2017, down slightly from the previous three quarters. However, Sloan said the expense estimate does not include nonrecurring costs, including litigation costs that exceed the amount the bank has already set aside. (Source: Reuters)

## Activist Influenced Companies

**Pershing Square Holdings, Ltd.** responded to the Automated Data Processing's (ADP) investor presentation, saying ADP's Focused Transformation Strategy "demonstrates a lack of recognition for the enormous value-creation opportunity that exists at ADP" and that the company's projected results "suggest that these initiatives will not drive any meaningful margin expansion." The company had provided a 3-year guidance in its presentation. Pershing stated, "... ADP's projected margin opportunity of 100-200 basis points (bps) over the next three fiscal years (FY18-FY20), or 33-67 bps per annum, represents a decrease in ADP's projected margin expansion opportunity from its historical 50-75 bps of margin per annum target set out in its 2015 analyst day. Moreover, this de minimis result is driven almost entirely (70-75% according to management's own estimates) by the inherent operating leverage in the business, with essentially no contribution from initiatives under management's control. This is not the kind of "transformation" that ADP shareholders deserve." Pershing is seeking to replace the three longest-tenured members of the board of directors who presided over ADP as it has underachieved its potential for years. The directors it seeks to replace do not have technology or industry expertise, a criticism ADP has leveled at Pershing's nominees, and include a business school dean, and two former industrial sector CEOs. Pershing has a 2% stake in ADP's common stock.

## Dividend Payers

**Brookfield Infrastructure Partners LP (BIP)** – Canada's BIP took advantage of its imminent inclusion in the S&P/TSX Composite Index to price a US$1 billion bought deal financing late last week. The proceeds will fund a growing backlog of committed organic growth capital expenditure projects and an active pipeline of investment opportunities, the company said. Brookfield Asset Management Inc. separately bought 7.4 million BIP units in a concurrent private placement at the sale price to take total proceeds to US$1 billion. Estimates suggest index inclusion generated demand for 13million-15million BIP units worth US$550million-$630million.

## Economic Conditions

**Canada** – New housing pricing surprised on the upside in Canada for the month of July, advancing by 0.4% against expectations for a 0.3% improvement. Home starts, meanwhile, surprised on the upside as well for the month of August, with the annualized figure of 223,200 units easily exceeding the expected 212,000 units reading, though broadly flat relative to June's 222,300 units print.

**U.S. inflation** picked up in August, with the headline consumer price index (CPI) year on year rate of change moving two tenths higher to 1.9% from 1.7% in July, ahead of the expected 1.8% rate. The core CPI reading, which excludes the most volatile price series, in particular energy and food, was also higher than expected, at 1.7% relative to 1.6%.

**U.S. business activity** surprisingly slowed down in August, with industrial production falling 0.9%, against expectations for a 0.1% improvement. Capacity utilization dropped to 76.1% from 76.7% and fell short of the expected improvement to 76.8%. Both industrial production and capacity utilization were heavily affected by the impact of hurricane Harvey.

**U.S. Retail sales** unexpectedly fell 0.2% in August, led by declines in auto sales, clothing and even non-store retailers and building materials (which would be less affected by Harvey or possibly even boosted). The Commerce Department said it could not isolate the effect of the hurricane, though it reported both "positive and negative impacts on sales". This speaks to the diverse impact of a hurricane in both disrupting activity, but also pulling forward purchases (notably building materials and groceries). Indeed, grocery store sales were a bright spot, rising 0.3% and picking up from the prior month's pace. Excluding food, building materials, autos and gas station receipts (which jumped due to both higher prices and drivers fleeing the affected areas), "core" sales also fell 0.2%. Although this followed a strong 0.6% advance in July, it (along with expected further weakness in September due to Irma) suggests consumer spending growth will slow to around 2% in Q3 after accelerating 3.3% in Q2.

**U.K. unemployment** fell by 75,000 in the three months to July, bringing the jobless rate down to 4.3% from 4.4% in the previous quarter. The rate remains at its lowest since 1975, but a squeeze on real incomes continues, according to the Office for National Statistics figures. Wages in the period were 2.1% up on a year earlier, little changed from the previous months' growth rates. With inflation hitting 2.9% in August, wages are failing to keep up. In real terms, wages have fallen by 0.4% over the last year. (Source: BBC)

## Financial Conditions

**While the Bank of Canada's inflation targeting regime has worked well**, the central bank is open to alternatives and wants to communicate in a way that avoid unproductive volatility, Bank of Canada senior deputy governor Carolyn Wilkins said last Thursday. Amid criticism that the bank surprised markets with its rate hike last week, Wilkins said that she will consider ways to improve communication about how the bank makes policy decisions, but said adjusting rates only when the market expects it would lead to bad outcomes. The central bank's monetary policy framework, which includes a 2% inflation target, has come under increased scrutiny in recent months as the bank twice raised rates even though inflation remains well below the target. (Source: Reuters)

**Bitcoin "is a fraud" and will blow up, Jamie Dimon, chief executive of JPMorgan, said last Tuesday**. Speaking at an investor conference in New York, Dimon said, "The currency isn't going to work. You can't have a business where people can invent a currency out of thin air and think that people who are buying it are really smart." Dimon said that if any JPMorgan traders were trading the crypto-currency, "I would fire them in a second, for two reasons: It is against our rules and they are stupid, and both are dangerous." (Source: Reuters)

**The Bank of England** left rates unchanged last week but is clearly signaling rate hikes in the near future. Monetary Policy Committee (MPC) member Gertjan Vlieghe who was previously known as the most dovish on the MPC seems to have switched camps with a

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relatively hawkish speech last Friday and says the MPC is "ready for a hike". The BoE view is that recent developments suggest that remaining spare capacity in the economy is being absorbed a little more rapidly than expected at the time of the August Report, and that inflation remains likely to overshoot the 2% target over the next three years.

The U.S. 2 year/10 year treasury spread is now .83% and the U.K.'s 2 year/10 year treasury spread is .88% - 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 3.78 (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 4.4 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 10.12 (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

**Net Asset Value:**

The Net Asset Values (NAV) of our investment funds are published on our Portland website at http://www.portlandic.com/prices/default.aspx

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.

**Glossary of Terms:** 'boe' barrel of oil equivalent, a measurement of a unit of energy, 'boed' refers to barrel of oil equivalent per day, 'CET' core equity tier, 'EBITDA' earnings before interest, taxes, depreciation and amortization, 'EPS' earnings per share, 'FCF' free cash flow, 'ROE' return on equity, 'ROTE' return on common equity.



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PIC17-063-E(09/17)