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. October 23, 2017

Owner Operated Companies

Alphabet Inc. – Lyft Inc. has raised $1 billion in fresh financing in a round led by one of Alphabet's investment funds, further complicating the convoluted world of ride-hailing alliances and dealing a blow to rival Uber Technologies Inc. The round was led by CapitalG, the growth investment fund of Alphabet that has also backed large private tech companies such as home-renting platform Airbnb, Inc. and payments firm Stripe. Six months ago, Lyft raised $600 million from a conglomeration of investors. Lyft said the latest round boosts its valuation to $11 billion from $7.5 billion. Alphabet also has ties to Uber through its second investment arm, GV. GV invested in Uber in 2013, but then Uber began to develop autonomous cars and compete directly with Alphabet. GV could have the opportunity to sell at least some of its stake in Uber in a highly anticipated deal between Uber and SoftBank Group Corp., which may be finalized in the next week. SoftBank wants to buy between $7 billion and $10 billion in shares from Uber employees and investors.

Canada has tapped Google parent Alphabet to help plan a mixed-use development along Toronto's Lake Ontario waterfront using cutting-edge digital technologies and urban design. Alphabet's Sidewalk Labs unit, which is developing new technologies for use in "smart cities," said it would invest $50 million in the initial planning and testing phase of the project, which will create a new neighborhood called Quayside. Google said it would move its Canadian headquarters and some 300 employees to the district once it is completed.

Danaher Corp. broke through $90 per share for the first time in its storied history on account of a solid earnings announcement for its third quarter. The company's top line moved higher by 3% in organic terms, despite a drag of about 30 basis points (bps) caused by the impact of hurricanes on the company's operations in Puerto Rico and Florida. The drag was shipping related, as orders for the division remained strong. The company's Dental segment saw a reprieve in destocking trends across its channels and recorded a 1% organic revenue advance. Danaher saw a 50 bps expansion in its operating margin during the quarter, ahead of expectations. The company raised its earnings guidance to $3.96-$4.00, up 1% at the midpoint. Management guided for accelerated organic growth for the 4th quarter of '17, implying an overall growth of roughly 3.0%.

Energy Sector

U.S. land rig count decreased by 15 rigs to 892 rigs week/week. This is the largest weekly decline since February 2016 and is now 42 units off of the early August peak. The rig count was driven by declines in Horizontal Oil (-10), Horizontal Gas (-5), Directional Gas (-3), and Vertical (-1), partially offset by gains in Directional Oil (+4), while Vertical Gas remained flat week/week. Total horizontal land rig count is down 4% since the peak in August 2017. The Permian currently makes up 53% of all oil rigs.

U.S. horizontal oil land rigs decreased by 10 rigs week/week to 628, as declines in "Other" (-8), Permian (-3), and DJ-Niobrara (-1) were slightly offset by gains in Eagle Ford (+1) and Woodford (+1) with Granite Wash and Mississippian remaining flat week/week.

Canadian rig count decreased by 10 rigs week/week, and is up 42% from the level this time last year.

U.S. Gulf of Mexico offshore rig count remained flat week/week at 22 rigs and is down 63% since June 2014.

Financial Sector

The Bank of Nova Scotia is reportedly exploring options for its gold business ScotiaMocatta, including a possible sale of the world's oldest gold trader. The Financial Times reported that Scotiabank had made a decision to sell the business following a massive money laundering scandal centered on a U.S. refinery that involved smuggled gold from South America. It said JPMorgan Chase & Co. had been appointed to oversee the sale. ScotiaMocatta is one of London's main gold trading banks with a history dating back to the 17th century. It was acquired by Scotiabank from Standard Chartered in 1997 and the Canadian bank has since expanded its operations.

Citizens Financial Group Inc. reported Q3 2017 EPS of $0.68, consensus was $0.64. Relative to its guidance, its net interest margin (aided by interest recoveries) and provision (higher level of commercial recoveries) were better than expected, while average loan growth (like other banks) was light. Both fee income and expenses were modestly higher than anticipated. While its cost of interest-bearing deposits increased 9bps (was +6bps in Q2 2017, +5bps in Q1 2017 and +2bps in Q4 2016), average balances grew as it funded continued loan growth (expects average loans to increase 1% plus in Q4 2017). Revenues increased 10% year/year and rose 2% linked quarter to $1.4 billion. Tangible book increased 1.7% to $27.05 (1.4x). It posted a ROE of 6.9%, and Return On Tangible Common Equity of 10.1%. Its CET1 ratio was 11.1%, down 10bps. It repurchased 6.5 million shares for $226 million. Average diluted share declined by 1.0%. Net interest income increased 4% reflecting the benefit of loan growth, day count and an 8bps improvement in net interest margin. Period-end loans grew 1.0% with both commercial and retail 1% higher. Its net interest margin increased 8bps to 3.05% (+6bps ex. interest recoveries vs. guidance of +3bps). Its Non-Performing Assets ratio improved 8bps to 0.88%. Its Reserve/Loan ratio declined 1bp to 1.11%.

The Goldman Sachs Group Inc. reported Q3 2017 EPS of $5.02. Consensus was $4.17. Relative to consensus, Investing & Lending provided the largest source of upside (highest quarterly performance in over 3 years) followed by Fixed Income Currency and Commodities (FICC), advisory and Debt Capital Markets. Equities trading, Equity Capital Markets and investment management were lower than expected. On a year to date (YTD) basis its compensation ratio was 40.0%, down from 41.0% a year ago. Its provision for litigation and regulatory proceedings was $18 million ($0.03), down from $22 million last quarter. This was its lowest quarter in recent memory (5+ years). Revenues increased 6% year/year and rose 2% to $8.33 billion. Tangible book increased 1.8% to $180.42 (1.3x). Its ROE was 10.9% (10.3% year to date (YTD)). Its CET1 capital ratio (transitional, advanced approaches) was 12.0%, down a full 50bps from Q2 2017. Total assets were $930 billion, up $23 billion (+3%). During the quarter, it repurchased 9.6 million shares for $2.17 billion. This is above Q2 2017's level when it repurchased 6.6 million shares for $1.5 billion. Average diluted shares declined 1.8%.

JPMorgan Chase & Co. said last Tuesday it would acquire online payment provider WePay as the bank looks to integrate payments into software used by small businesses. WePay's technology, popular among small businesses, helps online software service providers like FreshBooks and crowdfunding websites such as GoFundMe process payments without impacting the user experience designed by developers. The terms of the deal were not disclosed. Wall Street Journal reported the price was above the roughly $220 million valuation that WePay achieved in a 2015 fundraising. (Source – Reuters)

Morgan Stanley reported Q3 2017 EPS of $0.93. Consensus was $0.81. The effective tax rate was 28.1% (down from 32.0% in Q2 2017) reflecting the impact of a recurring-type of discrete tax benefit of $11 million related to employee share-based payments and other net discrete tax benefits of $83 million primarily resulting from the re-measurement of certain deferred taxes. Excluding the impact of re-measurement of certain deferred taxes, EPS was $0.05 lower to $0.88. Relative to consensus, FICC advisory, wealth management and investment management revenue were higher than expected, while equity trading and Debt Capital Markets was below. Expenses looked to approximate expectations, though its wealth management pre-tax margin was better than expected, aided by better than feared net interest income. Revenues increased 3% year/year but declined 3% linked quarter to $9.2 billion. Tangible book increased 1.9% to $33.86 (1.5x). It posted a ROE of 9.6% (or 9.1% ex. $83 million from the re-measurement of certain deferred taxes). Its CET1 ratio was 16.3%, up 20bps. Period-end assets increased 2%, while deposits rose 7%. During the quarter, it repurchased $1.25 billion of its common stock or 27 million shares. Average diluted shares declined by 0.6%.

State Street Corp. reported Q3 2017 operating-basis EPS of $1.71. Consensus was $1.61. Still, its operating-basis results included a pre-tax gain of $26 million ($0.04) on the sale of an alternative trading system, while its tax rate was 28% compared to guidance of 30-32% (added $0.05 from 30%). Relative to consensus expectations, net interest income/margin and asset management fees were better than expected, while FX trading was light. GAAP EPS was $1.66 and included $33million in restructuring charges related to Beacon. Operating-basis revenues increased 7.7% year/year and rose 0.9% linked quarter. Expenses increased 4.1% year/year and gained 1.4% sequentially. Its ROE was 13.4% and its Return On Tangible Common Equity was 19.0%. Its CET1 capital ratio was 11.3%, up 40bps. In Q3 2017, it purchased $350 million of its common stock. Average diluted shares declined by 0.6%. Asset servicing increased 4% linked quarter to $32.1 trillion, due to strength in equity markets and new business. New asset servicing mandates totaled $105 billion (down from $135 billion at Q2 2017). Assets under management increased 3% $2.7 trillion, driven by strength in equity markets.

Activist Influenced Companies

Nothing new to report.

Dividend Payers

AT&T Inc. extended by a "short period" the deadline to close its proposed deal to acquire Time Warner, Bros. Entertainment Inc., to buy time to get the required regulatory approvals for the deal. The deal had a termination date of Oct. 22. AT&T's $85.4 billion acquisition of Time Warner is expected to give it control of cable TV channels HBO and CNN, film studio Warner Bros. Entertainment Inc. and other coveted media assets.

Barrick Gold Corp. announced that a framework agreement has been reached for Acacia Mining PLC's operations (63.9% owned by Barrick) with the Government of Tanzania. The proposal remains subject to review and approval by the Independent Committee of Acacia's Board of Directors, and Acacia shareholders. Under the proposal, economic benefits from Bulyanhulu, Buzwagi and North Mara will be distributed on a 50/50 basis between a new operating company to be established (that will hold the operating assets) and the Government. The economic benefits would be delivered in the form of a new 16% free carried interest to the Government, increased royalties (our estimate of between a 6% and 12% Net Smelter Return (NSR), the net revenue a mining property receives less transportation and refining costs) depending on the operation) and typical taxation rates. Under the proposed agreement Acacia would also need to make a $300 million payment to the Government to resolve outstanding tax claims ($190 billion). It appears that Barrick management have fallen victim to resource nationalization again,

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this time in Tanzania, which furthers the dangerous precedence set from management's dealings with the Government of the Dominican Republic (Pueblo Viejo). We question whether all foreign jurisdictions will now also request a new "21st century partnership" as management has referred to the proposed framework. It is estimated the proposed framework has lowered Barrick's attributable operating net asset value (NAV) (for Acacia) by $418 million or $0.36/share and lowered Barrick's attributable production between 60 and 80kozs. The lifting of the ongoing concentrate ban could result in the restart of operations at Bulyanhulu and allow Acacia to sell its large inventory which it is estimated could lift Barrick's Q4 results by ~$6c per share.

BHP Billiton PLC delivered a solid set of production numbers for Q1 2018 with guidance unchanged for all divisions. Iron ore (40% of EBITDA) had a softer Q1 as guided with production down 8% quarter/quarter due to port debottlenecking activity. Copper (26% of EBITDA) improved as Escondida project ramped up, offsetting weakness at Olympic Dam due to smelter maintenance. U.S. onshore oil production was impacted by hurricanes (-12% quarter/quarter) but higher rig count should lift production going forward, while promising exploration results were reported in the Gulf of Mexico. The only area of guidance vulnerability appears to be New South Wales (NSW) energy coal (-25% quarter/quarter) but is of peripheral importance to the group (2% of 2018 EBITDA). Overall then we would expect no change to consensus earnings as a result of the report.

Nestlé SA a broadly in-line quarter for Nestlé with like-for-like sales growth at +3.1% coming c.20bp ahead of consensus expectations and volume growth at +2.6% coming c.60bp ahead. On a positive note, there was a marked sequential improvement in Zone Europe, Middle East and North Africa (from +1.0% in H1 to +3.6% in Q3) and Other Businesses (from +3.7% in H1 to +7.9% in Q3). On a less positive note, Waters Corporation (at -0.9% in the quarter) saw growth slow (H1 +4.0%) as a consequence of comparisons to earlier sales, poor weather in Europe and North America, and competitive pricing pressures in several markets.

Pattern Energy Group Inc., the Canadian yieldco, dipped into the public equity markets to raise U.S. $187.2 million from an overnight stock sale, its first public stock sale in more than a year. The all-primary offering follows the recent acquisition of a minority interest in one renewable energy project, the sale of another project to fund that acquisition and a recalibration of the parent's development pipeline for future acquisitions. As part of an earlier investment agreement, the company last month acquired a 51% interest in the 179MW Meikle Wind facility for U.S. $68 million, a 10 times multiple of the expected cash to be generated from the project. Canadian pension plan PSP Investments has a co-investment agreement with Pattern and purchased the remaining 49% stake. Separately, Pattern and Riverstone Group laid the groundwork for future development by co-investing in Pattern Development 2.0. The yieldco invested U.S. $60 million initially, with a right to invest up to U.S. $240 million total for a 20% stake, and with Riverstone committing U.S. $724 million to the funding vehicle. Once operational, the power projects would be sold to Pattern. If all goes according to plan, Pattern will double the capacity of its renewable fleet from 2,644MW currently to 5,000MW by 2020.

Roche Holding AG reported Q3 sales in line with consensus. Strong momentum in the Ocrevus launch offset disappointing sales progress for both Tecentriq (IO) and Gazyva (Rituxan follow-on). In Europe, the first biosimilar entries for Rituxan led to a 16% decline year/year. In our opinion Roche needs to replace eroding sales for Rituxan and Herceptin. In the next 6-9 months, we will see eight P3 readouts for Tecentriq in lung (5 trials), renal, breast and colorectal cancer. Given the lacklustre sales progression for Tecentriq in approved indications, we need to see success. We assume Ocrevus continues to ramp strongly in multiple sclerosis. We assume rapid contribution from Alecensa (ALK-lung) and ACE910 (hemophilia).

South32 Ltd. delivered a solid Q1 production release with all the key assets delivering production run-rates broadly in-line with estimates and guidance maintained. The well-known "problem child" assets at Illawarra, Cannington and to a lesser extent South Africa energy coal are tracking below guidance/expectations so far but are expected to recover during the balance of the year. In the case of Illawarra this reflects the ramp up of a single longwall at Appin in October (zero production in Q1) and at Cannington the new crusher chamber will commission in Q3 returning the operation to capacity. Unit cost performance remains in line with expectations, although the company flags USD weakness and some raw material input costs as exerting upward pressure on guidance if current rates are maintained. South 32's net cash balance continued to swell by $33 million during the quarter to reach $1673 million (12.5% of market capitalization). The rate of surplus cash generation was lower than prior quarters and below expectations. It is net of $47 million of stock buyback (constrained around results blackout), prepayment for Arizona forward contract ($41 million at current share price) and working capital build (undisclosed) as prices rose. It implies underlying free cash flow generation of just $121 million pre-working capital. Overall we see the investment case unchanged predicated on strong cash flow generation, exposure to aluminum/alumina, a rapidly building net cash position, management willingness to return it to shareholders and very cheap valuation metrics relative to peers on Enterprise Value/EBITDA and Free Cash Flow yield.

Economic Conditions

U.S. industrial production increased 0.3% in September, in line with the consensus call. There was a net upward revision to August (now -0.7% vs. -0.9% before) but this was more than offset by downward revisions to prior months.

China's President Xi Jinping in a three and half hour speech outlined China's direction for the next five years. Xi promises a "New Era" for

Socialism in a modernizing China. He touched on a diverse range of domestic and foreign issues from the One Belt, One Road initiative on overseas infrastructure to financial market regulation and reform and the ongoing anti-corruption campaign. He also sent a warning to Taiwan independence advocates. The president said the party will work towards more market-oriented interest rate and foreign exchange reform and guard against systematic risks. Markets did not react in any material way.

Japan's 48th general election over the weekend (22 Oct) saw incumbent Prime Minister Shinzo Abe's gamble for a snap election pay off handsomely as he delivered a strong election win and retained the super-majority (two thirds of) in the 465-member lower house. The sterling election results puts Abe in a strong position to win another term in 2018 as the head of his Liberal Democratic Party, which could allow him to be Prime Minister (PM) to lead Japan through 2021, making him Japan's longest serving leader. (Recall that the ruling Liberal Democratic Party (LDP) congress approved on March 5, 2017 a proposal that extends the limit to 3 consecutive three-year terms for its leaders (from 2 terms previously), meaning that PM Shinzo Abe could stand for re-election instead of needing to step down as party leader and PM in Sep 2018). The strong election results signals to the market that there will be continuity of Japan's ultra-easy monetary policy (and potentially even more?) which likely means a weaker yen and higher Japanese stock prices in our view.

Spain/Catalonia – Prime Minister Rajoy to oust Catalan leaders and take control. Catalan's local leader, Puigdemont may call Catalan elections, however the Senate will approve intervention despite this. Catalan separatists are hoping for guerilla action against export companies and critical infrastructure (Source – Bloomberg report).

Financial Conditions

The U.S. 2 year/10 year treasury spread is now .81% and the U.K.'s 2 year/10 year treasury spread is .87% - 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 3.88% (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 10.20 (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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