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. November 6, 2017

Owner Operated Companies

Berkshire Hathaway Inc. – Bad weather hurt Warren Buffett's Berkshire Hathaway in the third quarter, as insurance losses tied to Hurricanes Harvey, Irma and Maria and an earthquake in Mexico contributed to a 43% drop in profit. Berkshire said it lost $3 billion before taxes, or $1.95 billion after-tax, from the disasters, leaving its Geico auto insurance, General Re reinsurance and Berkshire Hathaway Reinsurance units with underwriting losses for the year. Insurance typically accounts for about one-fourth of Berkshire's overall profit. Overall net income fell to $4.07 billion, or $2,473 per Class A share, from $7.2 billion, or $4,379 per share, a year earlier. Operating profit, which excludes investment and derivative gains and losses and which Buffett says better reflects company performance, fell 29% to $3.44 billion, or $2,094 per Class A share, from $4.85 billion, or $2,951 per share a year earlier. Profit rose at the Berkshire Hathaway Energy unit, while "improving economic conditions" helped boost shipping and profit at the BNSF Railway Company. A better economy may also have persuaded more people to buy cars and trucks, as higher financing activity at the Berkshire Hathaway Automotive car dealership unit helped boost pre-tax retail profit by 22%. Book value per Class A share, measuring assets minus liabilities, rose 2.5% in the quarter to $187,435, and was up 8.9% from January to September. Berkshire also ended September with $109.3 billion of cash and equivalents, more than five times the $20 billion minimum Buffett has said he prefers, and investors are waiting to see what he does with it. Some of Berkshire's cash hoard will eventually be used to buy 80% of Pilot Travel Centers LLC (Pilot Flying J), the largest U.S. truck stop operator. Buffett announced that investment on Oct. 3.

The Kraft Heinz Company marginally missed Wall Street sales estimates in the third quarter and warned it would be hampered in the fourth by many U.S. consumers working through emergency hurricane stores of its packaged goods. Excluding items, net profit at North America's third-largest food and beverage company, came in at 0.83, marginally better than a consensus of 0.82. "There's no question that the retail environment, particularly in the United States, will remain both dynamic and challenging," Chief Executive Bernardo Hees said. The company said it would make efforts in partnering with retailers to attract consumers from non-traditional channels including e-commerce. Kraft, which at the start of this year targeted a $1.7 billion cut in costs by the end of 2017, said selling, general and administrative expenses fell about 19% to $653 million in the reported quarter.

Liberty Global PLC LiLAC reported its Q3 results, including rebased Operating Cash Flow (broadly earnings before interest, tax, depreciation and amortization - EBITDA) was guided lower for 2017, at $1.35 billion from $1.5 billion, on account of hurricane impact in Puerto Rico and at headquarters of Cable & Wireless Communications (C&W). LiLAC has property and business interruption insurance and expects recoveries which would offset the impact of the hurricanes. Aside from the hurricane impact, business performed well, in particular in Chile. Company-wide LiLAC added 40,000 revenue generating units (subscribers) during the quarter, driven by C&W and Chile.

Energy Sector

U.S. land rig count decreased by 9 rigs to 879 rigs week/week, the 5th week in a row of consecutive declines and is 55 units off of the early August peak. The rig count was driven by declines in Horizontal Oil (-4), Vertical Oil (-4), Horizontal Gas (-1), Vertical Gas (-1), and Directional Gas (-1), slightly offset by gains in Directional Oil (+2). Total horizontal land rig count is down 5% since the peak in August 2017. The Permian currently makes up 53% of all oil rigs.

U.S. horizontal oil land rigs decreased by 4 rigs week/week to 626, as declines in "Other" (-4), Williston (-1), and Woodford (-1) were partially offset by gains in DJ-Niobrara (+2) with Permian, Eagle Ford, Granite Wash, and Mississippian remaining flat week/week.

Canadian rig count increased by 2 rigs week/week, and is up 26% from the level this time last year.

U.S. Gulf of Mexico offshore rig count declined 2 rigs week/week at 18 rigs and is down 67% since June 2014.

Baytex Energy Corp. reported third quarter results which were slightly ahead of the expectations. Its reported loss of C$9.22 million on sales of C$254.43 million was an improvement compared to a loss of C$39.43 million on sales of C$197.64 million in Q3 of 2016. During the quarter, the company produced 69,310 boed in the third quarter of 2017 and 70,473 boed for the first nine months of 2017. Also during the quarter, Baytex delivered funds from operations (FFO) of C$77.3 million (33 cents per basic share) in the third quarter of 2017 and C$241.8 million (C$1.03 per basic share) in the first nine months of 2017. Of note, the company established average 30-day initial gross production rates of approximately 1,500 boed per well from 22 gross (5.8 net) wells in the Eagle Ford that commenced production in the third quarter. The company reduced net debt by C$70.6 million in the third quarter of 2017 through excess FFO, a non-core asset sale and the strengthening of the Canadian dollar relative to the U.S. dollar. During the quarter, Baytex achieved a 35% reduction in operating expenses on the company's recently acquired Peace River lands, which contributed to a further 5% reduction in annual guidance to $10.50/boe. Baytex tightened its 2017 production guidance range to 69,500 to 70,000 boed (previously 69,000 to 70,000 boed) despite the impact of hurricane Harvey in the third quarter.

Royal Dutch Shell PLC - Adjusted earnings of $4,103 million were 13% ahead of consensus, mainly due to a stronger than expected operating result. Adjusted EBIT of $4,512 million was 10% ahead of consensus, driven mainly by a stronger than expected downstream performance in particular oil products were 12% ahead of consensus. Upstream production of 3,657kboed was 4% ahead of forecast, up 2% year/year. Reported cash flow from operations of $7.6 billion was down 11% year/year with a build of working capital of $2.5 billion. Excluding working capital movements, it's estimated underlying cash flow of $9 billion and up 24% year/year. With cash capex of $5.1 billion and dividends payments of $3.1 billion, there was a positive Free Cash Flow post capex and dividends of $0.9 billion. Adjusting for scrip, its estimated cash breakeven of $51/barrel, down $5/barrel year/year. Net debt of $67.7 billion was broadly flat quarter/quarter with gearing (net debt to capital) of 25.4% in Q3.

Total SA - Adjusted net income of $2.7 billion was in-line with the company compiled consensus estimate. Net operating profit of $3 billion was in-line with expectations, with stronger than expected Marketing & Services profitability performance in part offset by a weaker than expected upstream contribution. Upstream production of 2581kboed was in-line with forecasts, up 6% year/year. On a divisional basis, upstream net operating profit of $1.4 billion was 4% below consensus. Marketing & Services net result of $506 million was 27% above consensus. Refining & Chemicals and Gas, Renewables & Power were in-line. Reported cash flow from operations of $4.4 billion was down 8% year/year with an implied build of working capital of $0.8 billion. Excluding working capital move, reported underlying cash flow of $5.2 billion was up 26% year/year. With organic capex of $3.1 billion and no dividends paid in the quarter, there was a positive Free Cash Flow post capex and dividends of $2.1 billion. Adjusting for scrip, it is calculated that organic cash breakeven is at about $47/barrel. Net debt of $19.9 billion was 9% lower quarter/quarter. Hence, gearing (net debt to equity) of 18% was down 2 percentage points quarter/quarter.

Financial Sector

Ares Capital Corporation reported Q3 2017 core net investment income per share of $0.36 (which excludes roughly $0.01/share of costs related to the American Capital, Ltd. (ACAS) acquisition, but includes a $0.02/share benefit from fee waivers), slightly higher than the consensus of $0.35. Interest income came in below estimates, but was partially offset by higher dividend income on the quarter. Book value per share was $0.05/share lower quarter/quarter at $16.49. Core earnings fell below the dividend level for the third straight quarter, but there are some transition costs to rotate out of lower yielding ACAS investments. Ares had $1,546 million of new commitments during Q3, of which ~51% were in first lien, 36% were in second lien securities, 9% were in senior subordinated loans, 3% in subordinate notes of the Senior Directing Lending Program (SDLP), with the remainder in other equity and preferred securities. Against that, Ares had $1,644 million of exits. The portfolio mix at quarter end was 41% first lien (vs. 25% previously), 35% second lien (vs. 33%), 0% in certificates of the Senior Secured Loan Program (SSLP) (22% prior) due to the wind-down of the Joint Venture, and 4% in certificates of the SDLP (vs. 3% previously). Overall yield on debt and income producing securities increased 20bps to 9.6%. Leverage of ~0.66x debt to equity, down from 0.69x the prior quarter.

Brookfield Property Partners L.P. (BPY) remains extremely active on capital recycling and the large volume of asset sales in the office sector weighed on growth. For Q3 2017, BPY reported FFO per diluted unit of $0.34, up 2% from $0.33 in the year-ago period and in line with consensus of $0.34. So far this year, Brookfield Property Partners has generated more than $1.5 billion of net equity from asset sales. We expect this number to grow considerably as mature office properties being marketed are sold. Importantly, asset sales continue to occur at, or above, net asset value (NAV) and we believe this provides evidence that the IFRS NAV is realistic, and possibly conservative. The reported IFRS NAV was essentially unchanged at $30.52 per diluted unit at quarter-end Q3 2017, compared to $30.24 at Q2 2017. BPY's units currently trade at a 23% discount to IFRS NAV. During Q3 2017, BPY repurchased 1.0 million units at an average price of U.S. $23.64 per unit, for a total investment of $23.7 million. Year to date, BPY has repurchased $136 million of units. Considering the substantial spread between the unit price and NAV, we believe that repurchasing units is an extremely attractive use of capital.

HSBC Holdings PLC - Underlying Profit Before Tax (PBT) of $5.4 billion was broadly in line with expectations with revenues (+2%) and impairment (22%) better whilst costs were worse (-6%). Reported PBT was impacted by $0.8 billion of significant items in the quarter in line with consensus leaving reported PBT at $4.6 billion. Volumes were up 1% quarter/quarter to $920 billion with good growth in Hong Kong and UK mortgages. Tangible NAV was $7.29 or $0.02 ahead, whilst CET 1 capital ratio was in-line at 14.6%. Overall the cost miss is disappointing although the reiteration of 2017 cost guidance suggests the impact will be limited.

ING Groep N.V. – Net Interest Income (NII) beat consensus by 3% but a large part of the beat was related to the decision to end some hedge relationships. This led to a €91million increase in NII vs. a similar decrease in other income in Q3 2017. Excluding this, NII is a 1% beat vs. consensus. Fees missed consensus by 3% driven by weaker Wholesale Banking and Retail Belgium after a very strong Q2 2017. Costs were in line. Loan Loss Costs are lower driven by a benign credit environment. PBT is a 9% beat vs. consensus and net profit is a 4% beat. CET 1 capital ratio is flat and in line at 14.5% while net interest margin (NIM) increases 6bps quarter/quarter to 1.57% but due to the aforementioned end of hedge relationships, so excluding that the NIM is 1.51% which is flat quarter/quarter and vs. cons at 1.52%. Overall, a solid set of results in our view with resilient NIM.

The Royal Bank of Scotland Group PLC - Q3 attributable profit of £392 million; Adjusted ROTE 8.2%. Management state that cost, capital and lending targets on track for fourth consecutive year and that the bank is targeting a bottom line profit in 2018 subject to providing substantially for Department of Justice investigation into historic Retail Mortgage Backed Securities related activities in 2017. 2020 financial targets unchanged - unadjusted 12%+ ROTE, sub-50% cost to income ratio, 13% CET 1 capital ratio.

Standard Chartered PLC released its Interim Management Statement for the three months ended September 30, 2017. Income of $3.6 billion in the quarter was up 4% year/year and income year-to-date was up 5%; Expenses of $2.5 billion in the quarter were 4% higher largely as a result of accelerated investments which is raising fears of a longer timeline to get back to cost of capital return in our view; Loan impairment of $348 million was 42% lower year/year reflecting improved credit quality; Underlying PBT of $814 million in the third quarter was up 78% year/year; Net loans and advances to customers of $277 billion increased 3% since June 30, 2017; Customer accounts of $418 billion increased 5% in the third quarter; CET 1 ratio of 13.6% (H1 2017: 13.8%) remains above the target range. It is estimated that IFRS 9 will reduce the CET 1 ratio by 10 to 20bps phased in over five years.

Activist Influenced Companies

Brookfield Business Partners L.P. (BBU) reported net income attributable to unitholders for the quarter ended September 30, 2017 of $9 million compared to $20 million in the third quarter 2016. Net income per unit was a loss of $0.15, including the impact of the incentive distribution. Company FFO totalled $46 million for the quarter compared to $50 million in 2016. The FFO benefited from strong results in the company's business services and industrials segments, which were offset by a $16 million loss on the sale of an oil and gas producer in Western Canada in its energy segment, previously disclosed. Results benefited from positive contributions from the acquisitions of Greenergy International Ltd, a road fuels distributor that BBU acquired in May 2017, and the Loblaw Companies Limited gas station operations, a fuel marketing business, acquired in July 2017. Its facilities management business posted strong results and the company completed a small tuck-in acquisition to further its growth strategy. Results in this segment were partially offset by lower results at BBU's financial advisory service business, which tends to have variability in its results. Marginally improved results from the company's Australian and U.K. construction operations relative to prior year were partially offset by lower activity in the Middle East. The backlog of orders has increased to $8 billion as BBU secured seven projects during the quarter. The company's industrial operations benefited from a full quarter contribution from BRK Ambiental, BBU's Brazilian water services operation acquired in May 2017. In addition, the company's graphite electrode and palladium mining operations generated stronger results in the third quarter compared to 2016, primarily due to an increase in sales volumes and higher realized prices at both operations.

Dividend Payers

BCE Inc. added more wireless subscribers than analysts had expected, helping it beat profit estimates for the third quarter and putting it on track to meet its financial targets for the year. The company said it added nearly 200,000 subscribers across its broadband post-paid wireless, internet and Internet Protocol Television (IPTV) services in the third quarter, up more than 8% from a year earlier. BCE's net income attributable to its shareholders rose to C$770 million in the third quarter from C$752 million a year earlier. Excluding one-time items, the company reported a profit of 88 Canadian cents per share, beating analysts' average estimate of $0.85. BCE's operating revenue rose 5% to C$5.68 billion.

Dufry AG - Organic growth +7.6% in Q3 (9 Months +7.9%): After a strong 1st Half 2017 (org. growth +8.1%), Q3 2017 was with +7.6% just slightly lower despite a more difficult comparison. Southern EU/Africa saw growth acceleration (Q3+10.1%, 9 Months +7.7%), mainly due to Turkey, whereas UK/Central & Eastern Europe was as expected weaker (Q3 +5.0%, 9 Months +8.4%); but Asia turned around (Q3+4.4%, 9 Months +0.5%) and Latin America continued with double-digit growth (Q3 +13.2%, 9 Months +12.7%); and North America continued the trend (Q3+5.4%, 9 Months +6.0%). As already seen in 1st Half, gross profit margin was +100bps to 59.4% and EBIT was +20bps to 11.9%; FCF in Q3 CHF 337 million bringing net debt/EBITDA to 3.45x. 9 Month 2017 results were fully in line with expectations; also gross-/EBITDA margin improvement were in line and Q3 showed a strong cash flow generation. IPO of Hudson Group still an option and expect it in Q4 2017.

GEA Group AG- Q3 EBITDA of €135 million (ex. bottling charges) was 2.2% below consensus of €138 million and Q3 EBITDA margin of 11.9% compares with consensus of 12.2%. Q3 orders of €1,057 million were 4.3% below consensus of €1,104 million and Q3 revenues of €1,130 million were 0.2% below consensus of €1,132 million. **Guidance reiterated at lower end and covers consensus:** The sales growth is now expected at the lower end of the outlook scenario due to lower service volumes in Q317 with a softer growth outlook for Q4 2017. GEA's lower end of EBITDA guidance is €600 million, which is above current consensus of €590 million. We also note that despite a 2.2% miss on underlying EBITDA ex. the bottling contract, GEA has to deliver 40% of its EBITDA and a 17.7% margin in Q4 to meet current consensus, which is broadly in-line with historic Q4 seasonality of 38% and 17.4% margin on average over the last three years. On the cautious side from the results, we note: 1) working capital stepping up sequentially by €25 million, 2) dairy processing growth turning negative sequentially in Q3 and 3) a 4.3%

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miss on orders driven primarily by weaker base orders business. 91% of €450 million buyback is completed as of October 27th and no update was provided for potential of another buyback program for the next year.

Novartis AG announced the potential $3.9 billion acquisition of Advanced Accelerator Applications (AAA). AAA's lead product Lutathera, is a radiolabeled somatostatin analogue approved for use in Europe and under review in the U.S. for advanced mid-gut gastro-enteropancreatic neuroendocrine tumors (GEP-NETs). We believe this is a good strategic fit for Novartis as they are the leaders in treatment for 1L neuroendocrine tumors (NETs) with Sandostatin LAR. AAA estimates that the annual incidence of new U.S. patients is c. 3,750. Drugs used for advanced NET today include Afinitor and Sutent with average annual costs in the range of $125-140,000. This supports global peak sales of c. $500-750 million in our view. Novartis has the current leading product for treatment of NETs in the first-line setting, Sandostatin LAR, and also the leading therapy in the last-line setting with Affinitor. Acquisition of Lutathera will add to this portfolio in our view and utilize the current NET sales force and strengthen Novartis' position with doctors. In addition, AAA has a number of companion diagnostics for the detection of NETs (NETSPOT and SomaKit TOC) which should benefit from Novartis' experience.

WPP PLC – Q3 2017 organic growth was in line with company-compiled consensus and represents an improvement over Q2 2017. Full year 2017 guidance of around flat implies another sequential improvement is expected for Q4 2017 in our opinion.

Economic Conditions

U.S. payrolls snapped back 261,000 in October. While this was less than expected given an assumed sharp rebound in hurricane-related losses September, net upward revisions of 90,000 in the prior two months actually imply a better result than had been anticipated (330,000) and also provided another nice silver lining as September was revised higher to a positive 18,000 (from previous estimate of -33,000). This means that the U.S. economy maintains the unblemished record of creating monthly job gains since October 2010. The 3 month average (162,000) is close to the 12 month mean (167,000), suggesting little loss of momentum despite weather-related disruptions. The hospitality sector more than retraced its big storm-led drop, and most other industries reported solid gains. Manufacturing remains on a roll, up three straight months. Household survey employment retraced only about half of September's massive increase. A sharp 0.4% pullback in the participation rate reduced the labour force by 765,000, trimming the unemployment rate to a 17-year low of 4.1%. The "all-in" U6 jobless rate fell to an 11-year low of 7.9%, suggesting ebbing slack in the labour market. The duration of unemployment continued to recede. For a Fed that still subscribes to the Phillips curve theory, this won't go unnoticed even as wages remain sedate.

Financial Conditions

The Bank of Japan (BOJ) kept its monetary policy steady and left its 10 year government bond yield target unchanged. The short-term interest rate stays at -0.1% and the 10 year bond target stays at zero percent. The BOJ also said it was maintaining its forecast to see inflation hit 2% in the fiscal year 2019/2020 but now expects core consumer prices to grow at +0.8% in the fiscal year 2017/18, lower than the previous projection of 1.1%. With the recent Abe win, most believe the controversial Abenomic policies will continue.

The Bank of England (BOE) raised rates 25bps to 0.50%, erasing last year's emergency rate cut, in a 7-2 vote and it is the BOE's first hike in 10 years. The accompanying statement offered little support of future rate hikes, saying that the BOE assumed 2 further hikes by 2020, which would leave inflation "close to" 2%. The bank kept its bond programs unchanged and the forecasts were accompanied by a gloomy section that there are "considerable risks" to the outlook. Brexit featured prominently in the warning, with policy makers saying they're ready to respond if it affects households, businesses and inflation.

The U.S. 2 year/10 year treasury spread is now .71% and the U.K.'s 2 year/10 year treasury spread is .80% - 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 3.94% (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 9.52 (a post-recession low) and while, by its characteristics, the VIX will remain volatile, we believe a VIX level below 25 augurs well for quality equities.

And finally....

Costco is helping out both doomsday preppers and those just interested in stocking up in case of a disaster. The major wholesale retailer has rolled out three emergency kits – costing $1,000, $3,999.99 and $5,999.99. The cheapest option has a one-year supply of food and is made up of nearly 100 1-gallon cans of wheat, rice, granola, apples, bananas, peaches, strawberries, potatoes, carrots, beans, onions, corn, beef, chicken, milk, sugar and salt. The cans have 6,200 servings of food and will last up to 25 years. The more expensive kits provide food for larger families for one year – for groups of four and more. (Source: New York Post)

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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