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. February 5, 2018

Owner Operated Companies

Alphabet Inc. – Google parent Alphabet reported fourth quarter results, which included steady ad sales growth offset by increased spending to promote its consumer gadgets, YouTube video app and cloud computing services. The company has moved aggressively to maintain dominance and diversify sales. Expenses jumped 27% to $24.7 billion in the fourth quarter from the year-earlier period. A growing portion of revenue has been spent on having the Google search engine set as the default option on products and services such as Apple Inc.'s iPhone and Mozilla's Firefox browser. Higher marketing costs coincided with holidays and payments to partners such as Apple and Mozilla would steady in coming quarters. Investments are paying off, Google Chief Executive Sundar Pichai said, noting that cloud computing is generating $1 billion in quarterly sales. He said Google's G Suite workplace software package had doubled its customers to 4 million in two years. Fourth-quarter sales increased 24% to $32.3 billion, above the average analysts' estimate of $31.9 billion, according to Thomson Reuters. Adjusted quarterly profit of $6.8 billion, or $9.70 per share, missed estimates of $7 billion, or $10 per share. The profit figure excludes a $9.9 billion tax charge as Alphabet joined much of corporate America in reporting large one-time expenses in the fourth quarter due to U.S. legislation enacted in December that lowers corporate rates. The tax law has given companies more affordable access to overseas profits, and the company's CFO said Alphabet would make a "modest increase" in share buybacks with an additional allocation of $8.6 billion. Alphabet generated $110.9 billion in full-year revenue, up 23% from 2016 and topping $100 billion for the first time. Non-advertising revenue from Google combined with revenue from Verily and the other Alphabet companies was $15.5 billion in 2017, accounting for about 14% of total revenue, compared to $10.9 billion, or 12%, in 2016. Alphabet also said on Thursday that veteran board member John Hennessy took over as chairman the day before from Eric Schmidt, a long-time Google executive who will remain a board member and technical adviser.

Danaher Corporation for the quarter ended December 31, 2017, net earnings were $856.6 million, or $1.21 per diluted share, which represents a 13.0% year/year increase. Non-GAAP adjusted diluted net earnings per share for the quarter ended December 31, 2017 were $1.19. This represents a 13.5% increase over the comparable 2016 period. For the fourth quarter 2017, revenues increased 11.0% year/year to $5.1 billion, with non-GAAP core revenue growth of 5.5%. For the full year 2017, net earnings were $2.5 billion, or $3.50 per diluted share, which represents a 13.5% year/year increase. Non-GAAP adjusted diluted net earnings per share for 2017 was $4.03 per share, which represents an 11.5% increase over the comparable 2016 amount. Revenues for the full year 2017 increased 8.5% to $18.3 billion, with non-GAAP core revenue growth of 3.5%. For the full year 2018, the Company anticipates that diluted net earnings per share will be in the range of $3.50 to $3.60. The Company continues to expect its 2018 non-GAAP adjusted diluted net earnings per share to be in the range of $4.25 to $4.35. Thomas P. Joyce, Jr., President and Chief Executive Officer, stated, "[…] The team delivered 5.5% core revenue growth, solid margin expansion, and double-digit adjusted earnings per share growth. […] In addition, mid-teens growth in free cash flow helps position us for more significant capital deployment in 2018."

Liberty Global PLC - After press speculation on Friday afternoon, Vodafone Group PLC issued a press release confirming it is in early stage discussions with Liberty Global regarding the potential acquisition of certain overlapping continental European assets owned by Liberty Global, which has yet to comment. The overlapping Continental European assets, Germany, Netherlands, Hungary, Czech Republic and Romania together makes up approximately 47% of Liberty Global's proportionate EBITDA, so while Vodafone would still acquire a material part of Liberty Global, it would be a much smaller deal in Enterprise Value at circa $31 billion vs approximately $74 billion to acquire all of Liberty Global. Based on Friday's closing price, Liberty Global trade on 9.0x estimated 2018 proportionate EV/EBITDA.

Energy Sector

Royal Dutch Shell PLC's adjusted earnings of $4,303 million were in-line with consensus, but 5% lower than our forecast. Adjusted EBIT of $4,682 million was broadly in-line with consensus with a weaker than expected downstream offset by a stronger than expected upstream. Upstream production of 3,756kboed was 1% ahead of forecast, down 4% year/year. It's estimated upstream net income per barrel of $9.6/boe, up $6.9/boe year/year and compares to the $11.3/bl increase in the Brent oil price. On a divisional basis, upstream net income of $1,650 million was $548 million above consensus, helped by some one-off factors, but strong even so in our opinion. Integrated Gas net income of $1,636 million was $116 million above consensus. Reported cash flow from operations of $7.3 billion was down 21% year/year with a build of working capital of $1.1 billion. With cash capex of $6.1 billion and dividends payments of $2.4 billion, there was a negative Free Cash Flow post capex and dividends of $1.4 billion. Net debt of $65.4 billion was down 3% quarter/quarter. Hence, gearing (net debt to capital) of 24.8% was down 0.6pp quarter/quarter. Total proved reserve for 2017 is expected to be 12.2 billion boe with production of 1.4 billion boe. Reported reserve replacement ratio is expected to be 27% for 2017 with organic reserves excluding the impact of acquisitions and divestments expected to be 127%, which is encouraging in our opinion.

Financial Sector

Berkshire Hathaway Inc., Amazon.com, Inc. and **JPMorgan Chase & Co.** will form a healthcare company aimed at cutting costs for their U.S. employees, they said last week. The company will not aim to make a profit and initially focus on technology to provide what they called "simplified, high-quality and transparent healthcare" for their more than 500,000 U.S. employees. The announcement comes as investors in the healthcare sector worry that technology and retailing behemoth Amazon could become a healthcare competitor and eat away at sector profits, just as it has done in retailing. (Source: Reuters)

DNB ASA - Q4 results broadly in line. Net Interest Income in line NOK 8,863 vs 8,836 consensus, Fees 2% below consensus NOK 2,064 vs 2,112 consensus, and Total income in line at NOK 13,278 vs 13,225 consensus. Costs +13% at NOK 6,018 vs 5323 consensus including big goodwill write-offs and restructuring, excluding this they are in line, Pre Provision Profit missed consensus by 8% at NOK 7,260 vs 7,860 on the higher headline costs. Guide for next year is for stable spreads with 3-4% volume growth and 3 billion Loan loss costs (a touch better than consensus). CET 1 16.4% in line, Dividend per share higher at NOK 7.1 on higher earnings versus consensus at NOK 6.77 together with a decision to utilise the remaining part of the share buy-back mandate of 0.5% of outstanding shares. Furthermore, DNB's dividend policy with a payout ratio of more than 50% remains unchanged. Dividend payout for 2017 is 54.6%.

ING Greop N.V. says it has agreed to buy a majority stake in payment group Payvision B.V. as the Dutch lender looks to boost its foothold in the payment processing market. The lender's business clients will be able to accept payments through "any channel" including online stores and through retail terminals by using the Payvision platform. Payvision, founded in 2002, allows payments through 150 currencies, 80 payment methods and has offices in the U.S., Europe and Asia. "Payvision's founding team has developed a great business with a proven technology in an area where ING wants to grow," said Ralph Hamers, ING chief executive. The group said it will buy three-quarters of Payvision. Payvision as a whole is valued at €360 million. (Source: Financial Times)

JPMorgan - Jamie Dimon has signed on for another five years as chairman and chief executive of JPMorgan, dampening speculation that the banker was mulling a move into politics. The bank said last Monday it would create a new position of co-president and co-chief operating officer, handing the titles to Gordon Smith head of the consumer banking arm, and Daniel Pinto who runs the investment bank. The appointments raise the possibility that Mr Dimon's successor will come from a younger pool of candidates including Mary Erdoes, head of the asset and wealth management division, Doug Petno, who runs the commercial bank, and Marianne Lake, chief financial officer. (Source: Financial Times)

Wells Fargo & Company detailed new regulatory restrictions imposed by the U.S. Federal Reserve on Friday that sent its shares down sharply in after-hours trading and today, as the third-largest U.S. bank continues to reel from a sales scandal that erupted in 2016. Wells is not allowed to grow beyond the $1.95 trillion in assets it had at the end of last year "until it sufficiently improves its governance and controls," the Fed said in a statement. Wells Fargo estimated that the cap will cut its annual profit by $300 million to $400 million this year, as it reduces some parts of its balance sheet, like corporate deposits and trading assets, in order to continue growing core businesses. That represents 1.5% to 1.9% of the profit Wells generated in 2017. (Source: Reuters)

Activist Influenced Companies

Nothing significant to report.

Dividend Payers

AT&T Inc. reported quarterly profit that beat analysts' estimates, helped by tax cuts and new wireless subscribers, and its chief executive voiced confidence the company will complete its $85.4 billion acquisition of Time Warner, Inc. AT&T reported a net addition of 329,000 phone subscribers who pay a monthly bill in the quarter, helped by lower customer attrition and a "buy one, get one free" promotion for the iPhone 8. The No. 2 U.S. wireless carrier lost 67,000 subscribers a year earlier. AT&T, which owns satellite television service DirecTV, said it lost 207,000 traditional U.S. video subscribers in the quarter as more consumers drop their pay-TV packages. It added 368,000 to its cheaper DirecTV Now streaming service. Net income attributable to AT&T in the fourth quarter was $19.0 billion, or $3.08 per share, in the fourth quarter ended December 31, up from $2.4 billion, or 39 cents a share, in the year-earlier period. Excluding items, the company reported earnings of 78 cents per share, which included a 13-cent impact from tax cuts signed into law by U.S. President Donald Trump late last year. Analysts on average were expecting earnings of 65 cents per share, according to Thomson Reuters. Revenue was $41.7 billion, compared with $41.8 billion in the year-earlier period. Analysts had expected $41.2 billion. For 2018, AT&T said including impacts from tax cuts and a new accounting standard, it expects earnings per share in the $3.50 range, free cash flow of about $21 billion and capital expenditures of $25 billion.

Dufry AG announced the pricing of the Hudson Group's IPO at US$19.0 per share which is at the lower end of the fixed price range of US$19-21 per share. Dufry plans to sell 39.4 million shares in its North America subsidiary with an over-allotment option (30-day) for another 5.9 million shares. This gives a value of approximately US$750 million or US$860 million including the over-allotment option. The shares are expected to begin trading on the NYSE on February 1, 2018 under the ticker symbol "HUD". The closing of the offering is expected to occur on February 5, 2018. The IPO is on track and will provide Dufry with funds to expand its business into Food & Beverage, which is an even bigger market than travel retail in North America. In addition, the cash inflow allows Dufry to reduce its leverage considerably, giving them more financial flexibility for add-on acquisitions.

Roche Holding AG posted good fiscal year 2017 numbers with sales being slightly ahead of consensus (+0.5%), core operating profit slightly lower (-0.9%) and core EPS also slightly lower (-0.6%). Both divisions beat estimates while only Pharma posts a core operating profit margin in-line with estimates, Diagnostics margin came in 129 basis points below estimates. Biosimilar erosion of Mabthera (Rituxan) in Europe is in-line with expectations. The board proposed a dividend of CHF 8.30 a bit below expectations of CHF 8.50. Roche expects sales to grow in the stable to low-single digit range. Core EPS is targeted to grow at high-single digit. Excluding the U.S. tax reform impact core earnings per share are targeted to grow broadly in line with sales. The U.S. tax reform is significantly positive in our view and will drive Roche's corporate core tax rate to the low twenties range vs. mid to high twenties previously. Moreover, the sales and profit guidance excl. U.S. tax reform impact implies that Roche aims to grow top as well as bottom line through the period of significant biosimilar impact, and that the company is able to translate the sales increase onto the company's profitability (core EPS growth).

Economic Conditions

U.S. – The indicators for U.S. business activity painted a mixed picture for the month of January. The Institute for Supply Management's (ISM) Purchasing Managers Index (PMI, i.e. the manufacturing index) resulted in a lower reading, of 59.1, in January, compared to December's 59.7 level, albeit slightly ahead of the expectations of a 58.5 level. Its non-manufacturing (services) counterpart, the non-manufacturing index (NMI), advanced strongly in the same month, to 59.9 points from 55.9 points in December, easily beating expectations, which were calling for a more modest improvement, to a 56.5 reading.

U.S. consumer sentiment continued to improve in January, reaching a 95.7 points level, from 94.4 in December and ahead of the consensus expectations. Both the "expectations" and the "current conditions" components of the composite index improved in the month.

U.S. Nonfarm payrolls rose 200,000 in January, above market expectations and up from last year's average pace of 181,000. Downward revisions totalling 24,000 in the previous two months still left the average (188,000) above the full-year pace. Almost all industries continued bulking up their staff. Manufacturers have been on a six-month hiring streak, reflecting strength in capex, consumer durables and exports. Despite a hefty increase in household survey jobs (409,000), the unemployment rate stayed at 4.1% for a fourth straight month, as the labour force ballooned by more than half a million. Both the participation rate and employment rates held steady. Wage gains played some role in an outsized 0.3% increase in average hourly earnings that drove the yearly rate to an eight-year high of 2.9%. Other wage measures have also picked up moderately, with hourly compensation in the nonfarm business sector rising 2.4% last year.

The U.K. economy expanded by a better-than-expected 0.5% in the last three months of 2017, official figures say. However, the Office for National Statistics (ONS) said the broader picture was "slower and more uneven" growth. In 2017 as a whole, growth was 1.8% compared with 1.9% in 2016 - the slowest since 2012, the ONS said. The services sector, which accounts for the bulk of the economy, expanded by 0.6% in the fourth quarter - stronger than the 0.4% rise in the three months to September. "The boost to the economy at the end of the year came from a range of services including recruitment agencies, letting agents and office management," said Darren Morgan, head of GDP at the ONS. (Source: BBC)

The Eurozone's economy grew at its fastest pace for a decade in 2017, according to official figures. The economy of the 19-nation bloc grew by 2.5% last year, according to Eurostat, the strongest growth since the 3% rate seen in 2007. Eurostat also said that the Eurozone grew by 0.6% in the final three months of 2017. The European Central Bank has been carrying out a huge stimulus programme in an attempt to drive eurozone growth. That programme has seen the bank slash its main interest rate to zero, and spend billions of euros a month on buying financial assets. Growth in the eurozone has been picking up and it is now regarded as one of the strongest parts of the global economy. (Source: BBC)

Financial Conditions

The U.S. 2 year/10 year treasury spread is now 0.71% and the U.K.'s 2 year/10 year treasury spread is 0.91% - 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 4.22% (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 3.9 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 19.05 (compares to a post-recession low of 9.52 achieved in early November) 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 Advantage Plus - Everest and McKinley Funds
- Portland Focused Plus Fund LP
- Portland Focused Plus Fund
- Portland Global Aristocrats Plus Fund
- Portland Global Energy Efficiency and Renewable Energy Fund LP
- Portland Private Growth Fund
- Portland Private Income Fund
- Portland Special Opportunities Fund
- Portland Value 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.

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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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