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. March 5, 2018

Owner Operated Companies

Nothing significant to report.

Energy Sector

Crescent Point Energy Corp. (CPG) posted an 8.4% jump in fourth-quarter production, while higher average realized prices helped the company post a smaller loss from the year-ago period. CPG exceeded production guidance and achieved exit production growth of approximately 10% per share, reaching a 2017 exit production of over 183,000 boed and an average production of 178,975 boed. Fourth quarter 2017 funds flow from operations increases by 17% per share and net debt was reduced by $111.0 million. CPG has organically replaced 152% of 2017 production, with Proved Plus Probable (“2P”) reserves growth of over 4% per share and total 2P reserves of more than 1 billion boe. CPG has been selling non-core assets (transacting over $320 million of non-core dispositions since the beginning of 2017) to fund its capital spending program and pay down debt, while boosting production by focusing on operations in Southwest Saskatchewan and the Williston and Uinta basins in the U.S. CPG’s 2018 guidance remained unchanged with capital expenditures of $1.8 billion, excluding land acquisitions, annual average production guidance of 183,500 boed and exit production of 195,000 boed. The company’s Williston Basin and Southwest Saskatchewan resource plays are expected to generate funds flow from operations in excess of capital expenditures in 2018, supporting continued growth in its Uinta Basin resource play. CPG remains disciplined with its capital spending and expects to direct any excess funds flow from operations realized at higher commodity prices toward debt reduction.

Whitecap Resources, Inc. (WCP) reported another year of significant growth and long-term value creation in 2017. The company concluded the year with the acquisition of the world class Weyburn CO2 enhanced oil recovery project in Southeast Saskatchewan. In 2017, WCP allocated 66% of its funds flow to grow production organically by 15% per share and used 21% of its funds flow to return cash to shareholders through our cash dividend program. This resulted in a total payout ratio of 87% and $64.9 million of free funds flow which was used to reduce bank debt. WCP achieved record annual production of 57,450 boed in 2017 despite significant unexpected third party facility downtime in Q2 2017. Annual production increased 25% or 15% per fully diluted share compared to the prior year. Development capital spending was $338.8 million in 2017 of which $3.0 million was spent on the Weyburn assets. Supported by strong operational execution, stronger crude oil prices and free funds flow, WCP increased its dividend by 5% in 2017 and paid out $104.9 million of cash dividends to shareholders in the year. WCP generated $508.6 million of funds flow in 2017. WCP’s balance sheet remains strong with year-end net debt of $1.3 billion on a total credit facility of $1.7 billion, leaving significant unutilized credit capacity for financial flexibility. Shareholder returns were also enhanced by $10.5 million of share buybacks in 2017 which reduced WCP’s common shares outstanding by 1.2 million shares. WCP is on track to deliver another year of double-digit production per share growth and anticipate funds flow to once again exceed capital expenditures and dividend payments. The company’s robust hedge portfolio provides significant downside protection and, as with previous years, it anticipates a total pay-out ratio of less than 100% in 2018 even with crude oil prices below West Texas Intermediate (WTI) US$45 per barrel.

Financial Sector

The Bank of Nova Scotia reported first-quarter earnings that were ahead of market expectations, helped by a strong performance at its domestic and international businesses. Canada’s third biggest lender reported EPS of C$1.86 for the quarter, up from C$1.57 a year earlier. Analysts had on average forecast earnings of C$1.68 per share, Thomson Reuters I/B/E/S data showed. The bank reported net income of C$1.1 billion, up 12% from a year ago, benefiting from an improved profit margin and a decline in funds set aside to cover bad loans. Net income at the bank’s international business increased by 16% to C$667 million. The bank has focused its international growth strategy on the Pacific Alliance, a Latin American trading bloc comprising Mexico, Peru, Chile and Columbia, where it saw loan growth of 10% or above during the period.

Bank of America Corporation said it plans to open more than 500 new branches across the U.S. over the next four years, as the bank continues to invest in physical and digital enhancements. The lender said the latest push includes a move into three Ohio cities - Cincinnati, Cleveland and Columbus. The growth in the state follows recent expansions in Denver, Minneapolis and Indianapolis and a plan to do so in Pittsburgh, the bank said. With the addition of those four cities and the three Ohio cities, the bank will have branches in 30 top urban markets, which generate 88% of U.S. gross domestic product and have a similar share of U.S. population, Dean Athanasia, co-head of consumer and business banking at the bank, said in an interview. “We are looking at strategically filling in to make sure we have the most optimal network,” Athanasia said. (Source: Reuters)

The Goldman Sachs Group Inc. is exploring the sale and lease back of the £1 billion London headquarters it will move into next year, the building on Plumtree Court. The possible sale and lease back was first reported by Bloomberg. Goldman Sachs, which employs around 6,000 people in London, is due to move from its Fleet Street offices to nearby Plumtree Court in 2019. Plans for the 1.1 million square foot new offices have been on the drawing board since 2012. When completed, it will be about half the size of Goldman's New York headquarters at 200 West Street. (Source: Financial Times)

JPMorgan Chase & Co. raised its key profit goal, and said lower taxes and higher interest rates could help increase its annual pre-tax net income by up to 17.5% in three years. The bank boosted its target for ROTE, to 17% from 15%, according to a presentation on its website ahead of its 10th annual investor day conference. The presentation included earnings simulation that showed annual pre-tax net income would rise to US$44 billion to US$47 billion over the next three years. JPMorgan is the most profitable of the big U.S. banks. Its 13% ROTE in 2017 compared with about 11% at Wells Fargo & Company, Goldman Sachs Group, Bank of America Corporation and Morgan Stanley and 8% at Citigroup Group Inc.

Standard Chartered PLC has swung to a net profit for 2017 and resumed its dividend but, despite a drop in impairment losses, the bank's earnings still fell short of forecasts. The Asia-focused British lender said on Tuesday it had recorded a net profit of US$774 million, compared with a net loss of US$478 million a year earlier and below consensus of US$1.66 billion. Pre-tax profit more than doubled, to US$3.01 billion from US$1.09 billion. Operating income rose 3.5% to US$14.29 billion, while operating expenses edged higher to US$10.12 billion from US$9.98 billion. The bank declared a total dividend of 11 cents a share for last year and said it intended to increase the payout as the company's performance improves. The bank did not declare a dividend for 2016.

The Toronto-Dominion Bank reported Q1 fiscal year 2018 core cash EPS of C$1.56, which was ahead of consensus of C$1.46. Results were better than expected across the bank's operating segments, U.S. Retail and Wholesale Banking in particular. The bank raised its quarterly dividend from C$0.60 to C$0.67 while core ROE improved to 16.8% (up more than 200 bps from last year). The impact of U.S. tax reform on TD's earnings is material, amounting to approximately US$300 million in 2018 based on management's guidance (approximately US$225 million in U.S. Retail and a further US$75 million on the bank's stake in TD Ameritrade). As a result, we expect outsized earnings growth in the segment to be approximately in the 30% range for 2018 (that includes TD Ameritrade), before falling back to approximately 12% in fiscal year 2019. Surprisingly strong trading revenue drove a better result in the Wholesale segment, with earnings up 4% year/year and rebounding by 20% from a tough Q4. Trading strength was evident across product lines sequentially, while on a year/year basis, Equities and FX offset weakness in the Interest Rate and Credit business. The bank's CET 1 ratio, which ended the quarter at 10.6%, now sits at a very comfortable 11.8% on a pro forma basis in our view. That translates into slightly more than C$5 billion of capital in excess of a 10.5% CET 1 ratio. We see a growing likelihood that the bank will deploy some of that excess capital to further enhance its footprint in the U.S., although management reiterated its previous guidance of taking a disciplined approach to any future acquisitions.

U.K. lenders' use of cheap Bank of England funding surged at the end of 2017, just weeks before the tap was due to be turned off. The central bank's £140 billion Term Funding Scheme (TFS) was launched after the Brexit vote to boost the supply of cheap funding to the real economy. It closed on Wednesday this week. Analysts say it has helped keep interest rates low and its closure could apply further upward pressure to rates on products such as mortgages, as banks are forced to seek more costly alternative sources of funding. In total British lenders borrowed £18 billion from the scheme in the final three months of 2017, up 85% on the £9.7 billion drawn down in the prior period. The Royal Bank of Scotland Group PLC (RBS) and Nationwide Building Society were among those to draw billions of pounds from TFS in the fourth quarter, according to Bank of England data released today. Taxpayer-controlled RBS borrowed the most, at £5 billion, taking its total drawings under TFS to £19 billion. Nationwide took £2.9 billion, bumping its total up to £12.4 billion. (Source: The Telegraph)

Activist Influenced Companies

Pershing Square Holdings, Ltd. announced it plans to buy back $300 million worth of its own shares, after Dutch regulators threw up roadblocks that prevented billionaire investor William Ackman from making a tender offer himself. In January, Ackman, who runs hedge fund Pershing Square Capital Management, announced plans for a $300 million infusion into the publicly traded company, which is listed in Amsterdam and London. The move was aimed at reducing the discount to the net asset value at which Pershing Square's public shares are currently trading. Now the company itself not Ackman will be buying the shares. After the tender is completed, Ackman and senior associates at his New York-based Pershing Square Capital Management would be able to buy shares in the open market. Should he and others spend the $300 million they had initially earmarked in January, the total $600 million would represent more than 20% of the market capitalization of Pershing Square Holdings that is currently not owned by affiliates of the hedge fund. Ackman listed the fund in Amsterdam four years ago as a way to create permanent capital for his hedge fund - investors can sell only if there is another buyer. This has helped stabilize capital at the $9 billion firm in the last years.

EnTrustPermal Ltd. conference – We attended the EnTrustPermal's 10th Annual Investment Summit last week. We were pleased to hear most of the investment themes we have been espousing for years at Portland being reinforced as top of mind for some of the world's most renowned (mostly activist) investors. There was a clear sense that the investment environment going forward is likely to be substantially different compared to the past ten years or so. Although the chance of a repeat of the great financial crisis was given a low value, most investors are concerned with the effect of emerging inflation, steadily increasing interest rates and reduced quantitative easing (including by the European and Japanese central banks). The view is that investing in the equity markets is likely to become a significantly more discerning affair, an environment far more benefiting active management and value-focused investors. The Conference surmised that of the active managers, "activist" or "engagement investors" afford the benefit of taking charge and driving operational (and to a lower extent, financial) change in order to navigate the more challenging environment. High levels of alignment are achieved through similar levels of investment stakes (i.e. 'skin in the game') and co-investing with similarly concerned shareholders, including large institutions and even large passive investors (i.e. Vanguard, BlackRock) adds more leverage to the engagement angle. As we've said in the past, we, at Portland, view activism as a key value creating strategy, within our founder/owner/operator-led approach to businesses.

Activist investor's chief avenue for value creation is addressing corporate governance shortcomings and re-instating the owner/operator focus at the companies they target. One point, made repeatedly during the conference, emphasizes the need for a long-term perspective (i.e. staying power, patient capital) when it comes to activist/engagement actions, and, we would add, is a key mark of investing versus speculating. In the words of Barry Rosenstein, "market overwhelms catalysts every time", so patience and co-investing with capable teams (activists or owner-operators) is key.

On the economy (with a focus on the U.S.), some speakers were bullish and appreciated the pro-business stance of the current administration. They see the tax reform and the repatriation of capital as key catalysts of mergers and acquisitions activity. On the other side, speakers voiced concern with the relatively high levels of valuation for both public and private assets, fuelled by the exceptionally long period of exceptionally low cost of debt. Investors present at the conference see the normalization of the interest rate environment (and the demise of a nearly four decades-long fixed income bull market) as a driver of increased volatility in the markets (be it equity or credit), which would create dislocation and so many present commensurate investment opportunities.

Our investment framework pivots around co-investing alongside founder or owner-operators in businesses domiciled in long-term growth industries. The best reflection of this investment stance can be found in our Portland 15 of 15 Fund, Portland Value Fund and Portland Value Plus Fund (where we also allocate to activist ideas) and, more recently, Portland Special Opportunities Fund.

Dividend Payers

Nothing significant to report.

Economic Conditions

The U.S. plans to impose 25% tariffs on steel imports and 10% on aluminum, about the most aggressive option available under Section 232 (based on a provision that allows protection for national security). The U.S. President's response to harsh criticism to the move is: "trade wars are good, and easy to win", suggesting that retaliatory moves - and there likely will be - will be met with even more U.S. actions.

U.S. manufacturing sector expanded at a 13½-year high (of course, this is before the threats of tariffs on steel and aluminum were made). And the broader nonmanufacturing sector also continued to expand, although at a slightly slower pace. The U.S. nonmanufacturing Institute for Supply Management (ISM) slipped 0.5 pts to 59.5 in February, the third decline in the past four months but still the third highest reading since August 2005. There was encouraging news for future activity as new orders climbed for the second month in a row, up 2.1 pts to 64.8, the highest since August 2005, while current business activity rose again, up 3.0 pts to a one-year high of 62.8. Supplier delivery delays were steady at 55.5, which in itself means slower delivery times …. don't be surprised to see this gauge increase in coming months (not enough trucks, not enough drivers).

Italy - 5-Star and Northern League have garnered 50.1% of the votes in Italy towards electing the next government and adding Brothers of Italy would total 54.4% votes for the 3 largest populist parties (>55% including all populist parties). Initial reactions include the possibility of a 5-Star / PD coalition (leftist populist) or 5-Star / Northern League (euro skeptic) and an extended wait time should be expected (51 days average to form a government since 1992). Needless to say, any movement towards a 5-Star / Northern League coalition in coming weeks is expected to be taken negatively by the markets.

Financial Conditions

The U.S. 2 year/10 year treasury spread is now .61% and the U.K.'s 2 year/10 year treasury spread is .68% - 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 4.43% (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 3.4 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 21.00 (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 Global Sustainable Evergreen Fund
- Portland Global Sustainable Evergreen 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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