News Highlights

Owners. Operators. And Insightful Investors.

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Established in 2007

PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments. March 26, 2018

Owner Operated Companies

Carnival Corporation, the world's largest cruise operator, reported better-than-expected first-quarter results as customers bought tickets at higher prices and spent more on board, prompting it to raise its full-year profit forecast. Net revenue yields, a keenly watched metric that measures spending per available berth, climbed 3.9% on a constant currency basis, well above the company's estimate of 1.5% to 2.5%. Carnival has benefited from a recent spurt in interest in cruising, as customers prefer to spend more on experiences such as travel, instead of buying clothes and accessories. The company said it now expects adjusted earnings of $4.20 to $4.40 per shares for 2018, compared with $4.00 to $4.30 per share estimated previously. Net income attributable to Carnival shareholders rose to $391 million, or 54 cents per share, in the quarter ended Feb. 28, 2018 from $352 million, or 48 cents per share, a year earlier. Carnival's net revenue jumped 11.6% to $4.23 billion, above analysts' estimate of $4.11 billion. Excluding items, it earned 52 cents per share, topping 43 cents per share estimated by analysts, according to Thomson Reuters.

Oracle Corporation – Business software maker Oracle reported is third quarter results, which included cloud business revenue of $1.57 billion, up 31.7%, though falling short of the average analysts' estimate of $1.59 billion, according to Thomson Reuters. A late entrant into the rapidly growing cloud-based software business, Oracle has aggressively stepped up efforts to play catch up with rivals such as Amazon.com, Inc., Microsoft Corporation and Salesforce.com Inc. Last year Oracle launched its autonomous database cloud to compete with Amazon Web Services (AWS). Revenue from Oracle's traditional software licensing business, its largest, rose nearly 4% to $6.42 billion. Oracle forecast current-quarter adjusted profit between 92 cents and 95 cents per share above estimates of 90 cents. The company reported a net loss of $4.02 billion, or 98 cents per share, in the third quarter ended Feb. 28, 2018 compared to a profit of $2.24 billion, or 53 cents per share, a year earlier. Oracle recorded a charge of $6.9 billion in the reported quarter, due to the recently enacted U.S tax law. Excluding items, the company earned 83 cents per share. Total revenue rose 6.1% to $9.77 billion. Analysts were expecting a profit of 72 cents per share on revenue of $9.78 billion.

Energy Sector

Cardinal Energy Ltd. announced its operating and financial results for the quarter and year ended December 31, 2017 as well as its 2017 year-end reserves. Cardinal achieved an all in total pay-out ratio of 98% in Q4 2017 despite accelerating planned Q1 2018 development activity into 2017. Fourth quarter 2017 operating costs per boe decreased 12% to average $20.34 per boe as compared to the same period in 2016. Operating netbacks improved 52% in the fourth quarter and 70% for 2017, respectively over the same periods in 2016, to average $22.64/boe and $18.36/boe. Cardinal achieved a 151% increase in cash flow from operating activities and a 75% increase in adjusted funds flow during the fourth quarter compared to the same period in 2016. For 2017, cash flow from operating activities and adjusted funds flow increased 26% and 39%, respectively, compared to 2016. The company increased its annual production by 28% and fourth quarter production by 43%, which included a 39% increase in crude oil production compared to 2016. Cardinal's 2017 production reserve replacement was 4.7x Proved Developed Producing (PDP) and the company increased its PDP Reserve Life Index (RLI) to 9.3 years from 8.5 years. The focus for Cardinal in 2017 was on two transformational light oil acquisitions, the Grande Prairie acquisition in late Q1, 2017 and the Midale and House Mountain light oil acquisition on July 1, 2017. Both acquisitions have helped to transform Cardinal from a medium quality (WCS) weighted asset base to a light oil weighted asset base. Along with each of the acquisitions came a large light oil-drilling inventory, stable declines and high netback production. In the fourth quarter of 2017, light oil made up 53% of the company's gross revenues. Cardinal has built a high quality sustainable asset base with an approximate 10% annual decline rate.

Financial Sector

Barclays PLC – activist Edward Bramson via Sherborne Investors Management LP has bought voting rights for over 5.16% of capital in Barclays to become effectively among Barclay's top 5 shareholders – behind U.S. asset manager Capital Group, BlackRock Capital Investment Corporation, Qatar's sovereign wealth fund and Tiger Global Management Corp. – the hedge-fund firm run by Chase Coleman. Sherborne's most recent high profile U.K. investment Electra Private Equity delivered a total return of approximately 50% since their involvement at the end of 2015. They were also highly successful at F&C Asset Management PLC where over a period of time he took control and ultimately sold the company. We are not familiar with Sherborne but understand their core philosophy is to (i) develop a turnaround thesis; (ii) acquire a significant equity position and (iii) obtain a mandate for board change.

Activist Influenced Companies

Nomad Foods Limited reported fourth quarter and full year 2017 financial results, which included full year 2017 organic revenue growth of 3.9%, adjusted EBITDA of €328 million and adjusted EPS of €1.00. Nomad initiated 2018 Guidance of Adjusted EBITDA of €350 to €360 million and adjusted EPS of €1.08 to €1.13. Stéfan Descheemaeker, Nomad Foods' Chief Executive Officer, stated, "2017 was an outstanding year for our Company. We reported full year organic revenue growth of 3.9% and expanded gross margins by 100 bps. These results, which exceeded the expectations we set at the start of the year, are a testament to the power of our iconic brands, a proven strategy and relentless execution. We enter 2018 in a position of strength. Goodfella's Pizza, once closed, will provide a complementary source of growth to our base business and illustrate the power of our value creation model." For the fourth quarter, revenue increased 4.7% to €508 million. Organic revenue growth of 5.6% was driven by 3.0% growth in volume/mix and 2.6% growth in price. Gross profit increased 18% to €160 million. Gross margin expanded 350 basis points to 31.5% due to positive mix, improved pricing and promotional efficiency and manufacturing improvements. Foreign exchange currency translation positively impacted gross margin by 10 basis points. Adjusted EBITDA for the quarter increased 31% to €82 million. Adjusted profit after tax increased 93% to €46 million reflecting interest rate savings from debt repricing amendments and lower depreciation and amortization. Adjusted EPS increased 108% to €0.27, reflecting Adjusted EBITDA growth and a lower share count resulting from share repurchases.

Dividend Payers

Dufry AG - With an organic growth of +7.4%, Q4 showed as expected (more difficult comparisons) a slightly lower growth (+5.9%, 9 million +7.9%), which was better than expected. The highest growth was in Latin America (+10.8%), whereas the other ones showed mid-single-digit growth (Southern EU +6.8%, U.K./ Central EU +6.3%, Asia +5.4%, North America +6.5%). Gross margin improvement had a little bit of a slowdown compared to 9 months 2017 (+100 bps) but with +80 bps to 59.4% it was in line with expectation and the same is true for EBITDA with +10 bps to 12.0%. Management advise Dufry's new business operating model launched in 19 countries, should be implemented by end of 2018 – and is expected to drive efficiency by +50 bps in 2018. The EBITDA margin target of 13% was confirmed. Synergies from World Duty Free SpA reached CHF 125 million, above the original target of CHF 105 million. FCF excluding one-time items +18% to CHF 571 million. With the Initial Public Offering of Hudson Ltd., net debt/EBITDA is down to 2.9x, which will allow to pay out for the first time a dividend, but details are not communicated yet.

GEA Group AG announced that the current CEO will not renew his term of office beyond December 31, 2019 and also that he will leave the Executive board at the April 2019 annual general meeting. The Chairman also commented that the supervisory board's goal is to appoint a successor by the end of 2018. In our view it would be logical and the likely outcome that, once a suitable candidate is selected, that the hand over process commences rather than waiting until the end of 2019. We view the commitment to management change as a positive step: Since Q3 2016, GEA has issued multiple profit warnings with there being a seeming lack of control within the organization. In part, this relates to soft end markets (which are improving) and IT under-investment (which is being addressed). However, we do also believe that there has been a lack of pro-activity on the part of management. Most disappointing though was the last weeks' Capital Markets Day where GEA had the opportunity to enact more shareholder friendly actions (buybacks, details on underperforming revenues) but gave no commitments on either of these fronts placing the share price under further pressure. Over the last two years, the greatest problem at GEA has been that cost savings have not been dropping through to the bottom line. Ongoing continuous improvement acts as an annual offset of cost inflation and would in our view go a long way to mitigating the €40 million wage inflation GEA sees each year and GEA could look to simplify its organization and, as well as focusing on underperforming assets, a business review could be extended to the more volatile business areas such as Dairy Farming that have limited synergies with the rest of the group. We believe a new CEO should commit to stabilizing underlying earnings before pursuing further Mergers and Acquisitions. We also believe that enacting a share buyback would improve the attractions of the GEA investment case and makes sense in the context of the relatively cheap cost of the equity (taking a mid-term view) and that the business is currently ungeared.

Nestlé S.A. - The shareholder agreement between Nestlé and the Bettencourt family expired last Wednesday. The relationship has lasted since 1974. The last agreement was signed on Feb. 10, 2014. The date corresponds to the time-period of six months after the death of Liliane Bettencourt on Sept. 21, 2017. Nestlé holds a 23.2% stake in L'Oréal S.A., corresponding to a market value of CHF 28 billion or 10.9% of market cap as at Dec. 31, 2017. The Bettencourt family holds a 33.1% stake. With its fiscal year 2017 results last month, Nestlé stated that: 1) L'Oréal continues to be an important investment; 2) it remains committed to L'Oréal that has given "very good returns" over the years (12% since 1974 or 14% per annum in the past ten years, corresponding to 9% of EPS); 3) it will not renew the agreement in order to maintain all "available options"; 4) it does not intend to increase its stake; 5) it is committed to maintaining a constructive relationship with the Bettencourt family. We do not expect any changes in the mid-term. Longer term, we believe Nestlé could use the firepower to finance a larger acquisition. We don't see Nestlé divesting, even partly, its stake to launch a buyback.

Roche Holding AG has reported positive headline data from the IMpower131 study in first line (1L) squamous cell lung cancer. The study compares Tecentriq (atezolizumab, PD-L1) plus chemotherapy (carboplatin + nab-paclitaxel) versus chemo alone. Data released last week are from an interim analysis of Progression Free Survival (PFS), one of the co-primary endpoints for the study. Overall survival data is not yet mature. Squamous cell non-small lung

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cancer (NSCLC) is a large, poorly treated market today. It represents approximately 30% of all 1L lung cancer patients diagnosed. Roche is first to market with phase 3 data in this patient setting … potentially providing differentiation for Tecentriq for the first time but the commercial position is unclear until we know the efficacy by PD-L1 status. Roche's lead is likely to be short-lived with Merck & Company, Inc., a fast follower in squamous 1L lung with the near-identical Keynote-407 study due to report in 2018.

Economic Conditions

U.S. existing home sales bounced back 3.0% in February, beating expectations for about a 0.5% rise and the first increase in three months. The 5.54 million level (annualized) is only a 2-month high but the upward trend remains intact. Sales of **single-family homes** were snapped up (+4.2%), which make up the lion's share of sales; the smaller component, condominiums, fell 6.5%. Two consecutive monthly increases in the **supply of homes for sale** helped but, at 3.4 months' supply, it is still a seller's market.

U.S., the consumer price index rose a consensus matching 0.2% month/month in February. The price of energy rose 0.1% in the month. Meanwhile, food prices were flat. On a three-month annualized basis, core prices were up 3.1%, two ticks more than in the prior month. Year/year, headline inflation increased one tick to 2.2% while the core measure stayed put at 1.8%. More generally, inflation seems to be picking up gradually, in line with the Fed's scenario. That should encourage the central bank in its normalization process.

U.S. industrial production jumped a much stronger-than-expected 1.1% in February (expectations were pegged at +0.3%). While there was a modest downward revision to January (now -0.3% from -0.1%), and some big moves below the surface, overall this is a solid report in our view.

U.S. durable goods orders jumped 3.1% in February, doubling the consensus call and nearly erasing the prior months 3.5% drop. It was also the largest monthly increase since last June. However, the headline is always heavily influenced by aircraft orders and they surged 25.5% in the month. Excluding transportation, orders grew a solid 1.2%, the largest move in four months. +1.2%, both 2x expectations. Other major areas saw solid gains, including general machinery, electrical equipment, and metals. Computer and electronic products slipped 0.2% but are still up 6.5% year/year.

Canada's consumer price index rose 0.6% (not seasonally adjusted) in February, allowing the year/year inflation rate to climb to 2.2%, the highest since October 2014. In seasonally adjusted terms, CPI rose 0.2%, thanks to increases in six of the eight broad categories €only food prices (flat) and clothing (small drop) defied the trend. Excluding food and energy, the CPI rose 0.7% (not seasonally adjusted), allowing the year/year print to move up to 1.8%, the highest in a year. On an annual basis, the CPI-trim and CPI-median both stand at 2.1%, while CPI-common moved up to 1.9%. The hot inflation data is consistent with an economy with no remaining slack in our view (after last year's GDP surge). Assuming seasonal patterns hold in March, headline CPI is on track to grow in Q1 by 2.1% year/year, i.e. above the 1.7% estimated by the Bank of Canada in January's Monetary Policy Report. In addition, the average of the three annual core measures now stands at 2.0%, the highest in six years. However, given ongoing uncertainties with regards to trade (NAFTA negotiations) and housing, the central bank may stick to its loose stance for another few months.

Canadian retail sales rose just 0.3% in January. Sales were up in 7 of the 11 subsectors, but the 1.2% decline for autos/parts dealers was a major drag on overall sales. Excluding autos, sales rose 0.9%. There were gains for sellers of gasoline, furniture, general merchandise, health/personal care products, electronics, clothing, and food/beverages, which dwarfed decreases for sellers of sporting goods, building materials, and miscellaneous items. In real terms overall retail sales rose 0.1%.

Financial Conditions

U.S. Rates: Marking the inaugural meeting with Jerome Powell as head, the FOMC (Federal Reserve Open Markets Committee) raised policy rates by 25 bps, resulting in a 1.50% to 1.75% target range for fed funds. This marks the sixth rate hike since policy normalization commenced in December 2015, it's also the first time in exactly a decade that the Fed's key policy rate is above core personal consumption expenditures (PCE) inflation. Real policy rates are finally turning positive. The policy statement toned down the current economic assessment, with economic activity rising at a "moderate" pace instead of a "solid" one before, but mentioned that "the economic outlook has strengthened in recent months." In other words, the "moderation" is deemed to be temporary. There are now expected to be three full (i.e. 25 bps) rate hikes in 2019, up from two to three and two full moves in 2020, up from 1.5 previously. The longer-run median also went up bit to 2.875% from 2.75%. Real GDP growth was raised by 3/10s this year and next (to 2.7% and 2.4%, respectively). In addition, the jobless rate was lowered by as much as 4/10s by 2020 (to 3.6%).

U.K. Rates: The Bank of England has left the door open to raise U.K. interest rates in May after making no change this month, holding them steady at 0.5%. Two members of the Bank's nine-member Monetary Policy Committee - Ian McCafferty and Michael Saunders - backed an increase in rates to 0.75%. That was a departure from the unanimous vote at the last Monetary Policy Committee (MPC) meeting in February. In November, the Bank raised rates to 0.5%, the first increase for a decade. The MPC said "ongoing tightening" was likely to be needed to return inflation back to the Bank's 2% target. Last Tuesday, the Office for National Statistics said consumer price inflation was 2.7% in February, down from 3% the previous month and the lowest figure since July 2017. (Source: BBC)

The U.S. 2 year/10 year treasury spread is now .56% and the U.K.'s 2 year/10 year treasury spread is .56% - 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 4.45% (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 22.29 (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.

AND FINALLY... bitcoin

51-year-old billionaire, Bruce Flatt, who runs Canada's global asset manager Brookfield Asset Management currently speaks for US$285 billion ($370 billion) of "real" assets. Flatt is trying to explain why bitcoin will never join his "wealth of things". "What it is? I don't know," Flatt assessed. "As far as we can tell, it has no intrinsic value. There isn't anything in it. There is nothing it will do to create wealth. Therefore, it is not an asset for us. Whether some others think it is an asset, I don't know. It is just not, not for us. And I would say good luck to all the people that do invest in it. We wouldn't." In Flatt's February newsletter to Brookfield shareholders, the contrarian investor listed "bitcoin mania" and the recent $US500 million sale of an Italian renaissance painting as two topical triggers for a new investment prudence.

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

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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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