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. April 9, 2018

Owner Operated Companies

Oracle Corporation as reported by Bloomberg, Oracle Corp. chief executive Safra Catz criticized the bidding process for a huge Pentagon cloud computing contract in a private dinner with President Donald Trump, complaining that it seemed designed for Amazon.com, Inc., to win. Trump heard her out and said he wants the contract competition to be fair, but made no indication he would interfere in the bidding, the people said. Oracle, where Catz shares the CEO title with Mark Hurd, is competing with Amazon for the contract. The Pentagon intends to award a single contract for multi-year cloud services. The contract could go to one team made up of multiple companies. That plan has drawn criticism from lawmakers as well as Amazon competitors including Microsoft Corporation, International Business Machines Corporation and industry groups that include Oracle. They're worried the plan will favour Amazon, which is dominant in the cloud services market. The Defense Department has said it wants to shift to the cloud for a tactical edge on the battlefield and to modernize its technology infrastructure. A final request for proposals, which outlines a contract as long as 10 years, is scheduled to be released in May with an award by the end of September. Amazon Web Services (AWS) is Amazon's fastest-growing and most profitable business, subsidizing its international e-commerce expansion and investments in video streaming and devices. Its profits help satisfy investors while Bezos pumps money into long-term initiatives that aren't profitable. Amazon had operating income of $4.1 billion on sales of $178 billion in 2017, and it would have lost money without AWS.

Energy Sector

Crescent Point Energy Corp. as reported by Reuters, Cation Capital, a private investment firm led by the former deputy head of global oil and gas at Macquarie Group, said it intends to nominate four candidates to Crescent Point Energy's board at a shareholders meeting next month. Cation said it was "compelled to take this action given the significant destruction of shareholder value and the abject failure of the Canadian oil producer's current leadership across all aspects". The firm said it has been talking to a special committee of Crescent's board, but that discussions have failed to result in "meaningful progress." Crescent Point, in return, said Cation's last-minute demand was unreasonable and reckless, adding that the firm "appears to have been created for the sole purpose of creating conflict and havoc." "We, therefore, believe Cation lacks credibility and is engaged in an ill-conceived and self-serving exercise," Crescent Point said in a statement. On Monday, Cation said its director nominees hold, or exercise control of 1,478,772 common shares, representing 0.3% of the company's total common shares. "Notwithstanding poor corporate performance over recent years, remarkably executive compensation has ballooned, with an increase of 17% in total compensation since 2016," Cation's President Sandy Edmonstone, who oversaw global energy platform operations at Macquarie, said in a letter addressed to Crescent Point's board last week.

Financial Sector

Barclays PLC's - £1 billion transformation is complete, as the bank became the first in the U.K. to switch on its "ring-fence" – splitting up its investment bank from its retail bank. It used the extra bank holidays over the Easter weekend to make the move, meaning it could switch off its online banking service overnight and have extra time to fix any unexpected problems before the start of the business week. Around 1,500 Barclays' staff were working overnight on Saturday into the early hours of yesterday. The bank's biggest-ever restructuring means Barclays U.K. will be run as a stand-alone retail bank. The new Barclays U.K. business will be run by chief executive Ashok Vaswani and a board led by Sir Ian Cheshire, the former boss of B&Q PLC owners Kingfisher PLC. Its project has -involved ring-fencing 24 million customers, £250 billion of assets and changing a million sort codes (Source: The Telegraph). Barclays is also believed to be planning a "multimillion-pound" share buyback after it agreed to pay $2 billion in civil penalties to settle an investigation by the U.S. Department of Justice into its marketing of residential mortgage-backed securities, Sunday Times reports. Barclays - will split its euro rates trading team because of Brexit and proposes to move part of the unit that trades Eurozone government bonds and interest rate swaps away from London, the Financial Times reported. Also starting the process of replacing Chairman John McFarlane, saying he's expected to step down at the annual meeting next year, Sky News reported.

Activist Influenced Companies

Brookfield Business Partners L.P. – Graphite electrode maker GrafTech International Holdings Inc., said it could raise up to $907 million (C$1.16 billion) in what could be the largest initial public offering (IPO) in the steel sector in a decade. The offering of 37.8 million shares is expected to be priced between $21 and $24 per share, the company said. The shares are being offered by GrafTech's sole shareholder - an affiliate of Brookfield Business Partners, a unit of Brookfield Asset Management Inc. The asset manager bought Ohio-based GrafTech in 2015, when the steel industry was struggling with a slump in prices due to record exports by China. GrafTech makes graphite electrode products used in electric arc furnaces to make steel and other ferrous and non-ferrous metals. The company reported net sales of $550.8 million for 2017, up from $438 million a year earlier. The company swung to a profit of $8 million in 2017, compared with a loss of $235.8 million in 2016. As reported by Bloomberg, Brookfield acquired GrafTech in 2015 with an equity investment of about $855 million. If the IPO were to price at the top end of the range, that would ascribe a valuation to the company that is 8.5 times what Brookfield paid for it three years ago. GrafTech intends to list on the New York Stock Exchange under the symbol "EAF", the company said. JPMorgan Chase & Co. and Credit Suisse Group AG are among lead underwriters of the offering.

Dividend Payers

Dufry AG - As already announced at the 2017 results presentation, Dufry's board of directors proposes to the AGM a dividend of CHF 3.75/share; this gives a cash outflow of CHF 202 million and is a 55% payout ratio compared to its cash EPS. In the future, it is planned to pay at least CHF 200 million per annum - cash flow from operating activities in 2017 was at CHF 724 million and after capex (CHF 284 million) the FCF reached CHF 458 million. In addition, the CHF 400 million buyback will be done over a period of up to 12 months. At the current share price this gives 3.05 million shares which represents 5.6% of the outstanding shares. After the Hudson IPO in February, 2018 the pro forma net debt/EBITDA was at 2.9x and it is the target to stay in a range of 2-3x.

GEA Group AG announced last week that investor Albert Frere had lifted its stake in the company to 5.13% of voting rights from 4.33% held previously. GEA stated that Frere crossed the 5% holding threshold on March 23, triggering a mandatory report. Fonterra in its Global Dairy Update today reported that milk production in EU increased 4% year/year in January driven by strong dairy prices, with most of the growth coming from Germany and Italy, which reported a combined growth of 7% in January, partially offset by decreases in both Hungary and Sweden. New Zealand milk production in February decreased 2% year/year due to difficult weather conditions, while Australia milk production (+2% year/year) continues to be steady on improved seasonal conditions and cost efficiencies. U.S. milk production was up 2% in January driven by larger herd numbers and improved production per cow. Continued strong import demand was seen in China (+44% in January) with substantial growth seen in fluid and fresh dairy and whey powder. Imports from Asia (ex-China) decreased 4% while Latin America decreased 8%.

Northland Power Inc. has expanded its board of directors from six to seven members and has appointed chief executive officer John Brace to the additional board position, effective today. Along with Northland's other board members, John will stand for re-election at Northland's AGM on May 23rd, 2018. John has been with Northland since 1988 and has served as Northland's Chief Executive Officer since 2005. John has guided Northland's strategy from being an Ontario-focused generator of clean energy to becoming an international leader in clean and green energy, developing, financing, constructing, owning and operating facilities that provide stable and sustainable dividends to its shareholders. "It is a pleasure to welcome John to Northland's Board," said James Temerty, Chairman of Northland Power's Board of Directors. "John brings considerable insight and expertise, having led Northland through a remarkable growth trajectory, and I am confident that he will bring additional value for Northland's shareholders in stewarding their interests from the Board." "I would like to thank the Board for the trust they are placing in me to continue to execute against Northland's vision of being one of the world's top clean and green power producers," added John Brace.

Novartis AG announced that it plans to acquire American AveXis, Inc. for US$8.7 billion, equaling US$218 per AveXis share. The deal is expected to close mid - 2018. AveXis has several gene therapy trials ongoing in Spinal muscular atrophy (SMA), an inherited neurodegenerative disease caused by a defect in a single gene. SMA is a rare neuromuscular disorder characterized by loss of motor neurons and progressive muscle wasting, often leading to early death. The disorder is caused by a genetic defect in the SMN1 gene, which encodes SMN, a protein widely expressed in all eukaryotic cells (that is, cells with nuclei, including human cells) and necessary for survival of motor neurons. The lead gene therapy candidate is AVXS-101, is a one-time intravenous treatment for SMA type 1, designed to prevent further muscle degeneration caused by SMA by delivering of a fully functional SMN gene into target cells and production of SMN protein levels. AVXS-101 is currently undergoing pivotal studies. The U.S. Food & Drug Administration (FDA) has granted AVXS-101 Orphan Drug designation (SMA) as well as Breakthrough Therapy designation (SMA Type 1). A Biologics License Applications (BLA) filing with the FDA for AVXS-101 is expected in 2nd Half 1208 with approval expected in 2019. PRIME and Sakigake designations have been secured in Europe and Japan, respectively. We believe this acquisition makes strategic sense, as Novartis will need to compensate for generic erosion of Gilenya and Afinitor. With an estimated 2019 launch of AVXS-101, revenue contribution would come in time. Moreover, this acquisition would bolster the company's Neuroscience franchise that otherwise could lose critical mass due to generic erosion of Gilenya. Nonetheless, the offered premium of 88% over Friday's closing price mandated flawless execution.

Economic Conditions

U.S. nonfarm payrolls growth slowed to 103,000 in March, well below market expectations (185,000) and the weakest in six months. However, February's hefty increase was revised up to 326,000. While January's advance was marked down by 63,000 to

176,000, the three-month average gain remained solid at 202,000, only modestly below the six-month trend of 211,000. Declines in retail and construction jobs weighed on the March figure, though most other sectors slowed as well. The dip in construction may have reflected the Northeast snowstorms, though the number of nonfarm workers (159,000) unable to work due to bad weather was not much more than the norm for the month. A partial retracement in the participation rate cut the labour force, keeping the unemployment rate steady at 4.1% for a sixth straight month. However, the more comprehensive U6 measure returned to its cycle low of 8.0% due to fewer involuntary part-time workers, implying less slack in labour markets.

The U.S. nonmanufacturing Institute for Supply Management (ISM) fell for the second month in a row in March, and although it landed at its lowest level since December, it is still far above the expansionary 50 level. The headline slipped 0.7 pts to 58.8, weighed down by production (-2.2 pts to a 2-month low of 60.6) and new orders (-5.3 pts to a 3-month low of 59.5).

Canadian employment rose 32,000 in March according to the Labour Force survey, above consensus expectations calling for a 20,000 increase. With the participation rate unchanged at 65.5%, the unemployment rate remained unchanged at 5.8%. There were job increases in both public (+20,000) and self-employed (+20,000), which dwarfed the 7,000 decline in the ranks of the private sector. Employment in the goods sector jumped 22,000 with rises in construction, agriculture, utilities and resources more than offsetting the decline in manufacturing. Services-producing industries increased employment by 11,000 courtesy of gains in Public administration, educational services, healthcare and professional services among others which offset losses in trade, business services and other services. Full time employment was up 68,000, offsetting losses of 36,000 for part-timers. Hourly earnings were up 3.1% year/year (unchanged from the prior month).

Canada - The Financial Post reported last week that RBC president and CEO Dave McKay is urging the federal government to stem the flow of investment capital from this country to the United States — because, he warns, it's already leaving in "real time." McKay discussed some of his biggest concerns about Canadian competitiveness, particularly those related to recent U.S. tax reforms, during a recent interview. Ottawa has come under pressure from corporate Canada to respond to a U.S. tax overhaul that's expected to lure business investments south of the border. McKay told The Canadian Press that a "significant" investment exodus to the U.S. is already underway, especially in the energy and clean-technology sectors. The flight of capital, McKay added, will likely be followed by a loss of talent, which means the next generation of engineers, problem solvers and intellectual property could be created not north of the border, but south of it instead. "We would certainly encourage the federal government to look at these issues because, in real time, we're seeing capital flow out of the country," McKay said. "We see our government going around the world saying what a great place Canada is to invest — yes, it is a great country, it's an inclusive country, it's a diverse country, it's got great people assets. "But if we don't keep the capital here, we can't keep the people here — and these changes are important to bring human capital and financial capital together in one place."

Financial Conditions

The Reserve Bank of Australia (RBA) left its official cash rate (OCR) unchanged at a record low of 1.5%. Last week's decision marks the 18th-consecutive meeting with the same outcome. The last rate change was on August 8, 2016 – the final meeting before Philip Lowe took over as governor from Glenn Stevens. No other RBA governor had spent this long in the job without moving rates.

The U.S. 2 year/10 year treasury spread is now .51% and the U.K.'s 2 year/10 year treasury spread is .53% - 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 4.40% (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 21.28 (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:

- Bay and Scollard Development Trust
- 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.

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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