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 25, 2019

The views of the Portfolio Management Team contained in this report are as of February 25, 2019 and this report is not intended to provide legal, accounting, tax or specific investment advice. Views, portfolio holdings and allocations may have changed subsequent to this date. This research and information, including any opinion, is compiled from various sources believed to be reliable but it cannot be guaranteed to be current accurate or complete. It is for information only, and is subject to change without notice. The contents of this Newsletter reflect the different assumptions, views and analytical methods of the analysts who prepared them.

Owner Operated Companies

Berkshire Hathaway Inc. reported a large quarterly net loss even as operating profit soared. The fourth-quarter net loss was $25.39 billion, or $15,467 per Class A share, reflecting more than $27.6 billion of investment losses, including from stocks Berkshire still owns. That compared with a year-earlier profit of $32.55 billion, or $19,790 per Class A share, most of which resulted from a lowering of the U.S. corporate tax rate. Results included a $3.02 billion write-down for intangible assets that Warren Buffett said was "almost entirely" attributable to Kraft Heinz Co., in which Berkshire owns a 26.7% stake. Buffett also released his annual letter to Berkshire shareholders, which did not discuss Kraft Heinz's recent travails or the day-to-day management of the company by his business partner, the Brazilian firm 3G Capital Inc. Net results suffered because many of Berkshire's common stock holdings saw double-digit price declines, including a 30% decline in Apple Inc., its largest holding. Accounting rules require Berkshire to report unrealized stock gains and losses with net income. This causes huge swings in net results, and Buffett has urged investors not to use them as a measure of Berkshire's business performance. In contrast, quarterly operating profit rose 71% to $5.72 billion, or about $3,484 per Class A share, benefiting from improved results in many businesses including the GEICO Corporation auto insurer and BNSF Railway Company. Berkshire ended the year with $111.9 billion of cash and equivalents. For all of 2018, Berkshire's operating profit rose 71% to $24.78 billion, while net income dropped 91% to $4.02 billion.

Danaher Corp. (DHR) – General Electric Co. (GE) announced it is selling its biopharma business to Danaher for $21.4 billion, its first major asset sale under new Chief Executive Officer Larry Culp. The deal will provide GE with a much-needed cash infusion as the maker of power plants and aircraft engines struggles to pay off billions of dollars of debt and insurance liabilities. Culp said the sale to Danaher, where he was CEO for more than a decade and instrumental in revitalizing the company, was a pivotal milestone in efforts to turn around the 126-year old conglomerate. The biopharma business accounted for 15% of GE's healthcare business revenue in 2018. It makes instruments and software that support the research and development of drugs. Danaher develops technology for the dental, life sciences, diagnostics and environmental industries. The GE unit is a great fit with Danaher as it is a leading, recognizable brand with a high mix of consumables/recurring revenue growth exceeding Danaher's, and the deal will be accretive to margins. Danaher said it was considering an initial public offering for its dental business, citing the size of its $21.4 billion purchase of GE's biopharma business. The company had said in July last year that it expected to spin off its dental unit into a publicly traded company to be tax-free to shareholders. Danaher intends to issue about 19.9% of the unit's shares initially, according to the company's Chief Executive Officer, Thomas Joyce.

Kraft Heinz Co. (KHC) has reportedly hired investment bank Credit Suisse Group AG to review options for its Maxwell House coffee business, including a potential sale. The coffee business has about $400 million in earnings before interest, taxes, depreciation and amortization (EBITDA) and could attract a price of at least $3 billion in a sale. Kraft Heinz disclosed a $15 billion write-down on its marquee brands with its 2018 full year results. The company also said it would cut its dividend by 36%, to preserve balance sheet flexibility, and disclosed that the U.S. Securities and Exchange Commission was investigating the company's accounting policies, in particular as it relates to the company's procurement activities. Brazil's buyout fund 3G Capital Inc. and Warren Buffett's Berkshire Hathaway Inc. together own more than 50% percent of Kraft Heinz.

Energy Sector

Crescent Point Energy Corp. announced the appointment of John P. Dielwart to its Board of Directors, effective March 7, 2019. "I'm pleased to welcome John Dielwart as an independent Director on Crescent Point's Board," said Bob Heinemann, Chairman of the Board. "John obviously brings a wealth of valuable business, leadership and governance expertise that he has earned during more than 40 years in the oil and gas industry. We look forward to his contributions as Crescent Point continues to execute its transition plan." Crescent Point remains committed to its deliberate and thoughtful Board renewal process, which it expects to further through planned retirements. Mr. Dielwart will become the Company's eighth independent Director since 2014. Following its 2019 annual general meeting, Crescent Point expects to have completed a full Board renewal since its inception. Mr. Dielwart is one of ARC Resources Ltd.'s founders, held the position of Chief Executive Officer from 2001 to 2013 and serves as a Director on its Board. He is also Vice-Chairman and Director of ARC Financial Corp. and a member of its Investment and Governance Committees. Mr. Dielwart received a Bachelor of Science degree in Civil Engineering with Distinction from the University of Calgary. He is a Professional Engineer, an Institute of Corporate Directors Certified Director and a Past-Chairman of the Board of Governors for the Canadian Association of Petroleum Producers. In 2015, Mr. Dielwart was inducted into the Calgary Business Hall of Fame and received the Oil and Gas Council's Canadian Lifetime Achievement Award in 2018.

Trans Mountain Expansion (TMX) – Canada's National Energy Board (NEB) regulator recommended on Friday that Ottawa approve expansion of the government-owned Trans Mountain oil pipeline, but made new recommendations to mitigate harm to Pacific Ocean killer whales and the environment. The Canadian government in September directed the NEB to conduct a new review of its application to nearly triple the capacity of Trans Mountain, which it bought last year from Kinder Morgan Canada Ltd., to ensure it gets built.

Financial Sector

Barclays PLC produced a reasonable set of Q4 2018 numbers. Profit Before Tax Q4 2018 was £374 million compared with consensus £465 million (adjusted for litigation). Excluding £140 million one-off underlying Profit Before Tax Q4 2018 was £514 million or +11% (+£49 million) ahead. However, included £150 million Brexit uncertainty provision. Pre-provision £1,120 million was +14% (+£140 million) ahead with Year/Year income -1% and costs -4%. That said, cost performance included a Bank levy £81 million below consensus. Barclays U.K. misses, international consumer a big miss but underlying quality looked fine in our view, Corporate & Investment Bank better than expected at £55 million versus £30 million profit but tiny figures. Tangible Net Asset Value per share of £2.62 was +6 pence or +2% better than expected. Published Core Equity Tier 1 ratio 13.2% ahead of consensus 12.9%. Risk Weighted Assets of £312 billion look in line with expectations. And helpfully management highlight progressive dividend and surplus to be returned to shareholders

Royal Bank of Canada reported adjusted cash EPS of $2.19 (+7% Year/Year), in line with consensus of $2.19. Total revenue came in higher (due to Insurance), and core Net Interest Income trends were strong in both Canada and U.S. Expenses were in line, but higher than consensus estimates. Credit provisions increased from Capital Markets and Personal & Commercial Banking. Provisions came in well above expectations. Total bank Provision for Credit Losses (PCL) were $514 million (34 basis points; 11 basis points Quarter/Quarter) vs. consensus of $363 million mainly due to higher provisions in Capital Markets and Personal & Commercial Banking. The Provision for Credit Losses ratio of 34 basis points impacted EPS by $0.06, while the lower tax rate of 19% benefited EPS by $0.08. Challenging market conditions negatively impacted Wealth Management, Capital Markets and Investor & Treasury Services. Canadian banking Net Income rose 4% Year/Year mainly impacted by higher costs. Core Equity Tier 1 ratio of 11.4% (-10 basis points Quarter/Quarter) was modestly below consensus of 11.5%. Strong internal capital generation (+34 basis points) was more than offset by organic Risk Weighted Asset growth (-18 basis points), share buybacks (-7 basis points; repurchased 3.7 million shares in Fiscal Quarter 1 vs. 15.3 million last year), regulatory reforms (-9 basis points) and FX / Other (-10 basis points). RBC increased its quarterly dividend to $1.02/share (or 4%), higher than consensus of $1.00/share (or 2%). The new dividend implied a current yield of 4.0%.

Standard Chartered PLC has set aside $900 million to cover potential fines from the U.S. and the U.K., the bank said last week. The $900 million provision, which will be included in the company's fourth-quarter results slated for release on Tuesday, will cover potential penalties related to "historical violations of U.S. sanctions laws" and "previously disclosed investigations relating to [foreign exchange] trading issues", the bank said in a stock exchange filing. The company said that some of the funds would be deployed to pay a £102.2 million fine by the U.K.'s Financial Conduct Authority, related to historical financial crime controls. The bank earlier in February agreed to pay $40 million in fines to settle claims from U.S. authorities related to the manipulation of emerging markets currency pricing. (Source: Financial Times)

Activist Influenced Companies

Barclays PLC – Financial Times reports activist Ed Bramson loses support of key ally in Barclays campaign. Aviva Investors has told the Financial Times it would side with Barclay's board ahead of May Annual General Meeting vote. Article cites David Cumming, Chief Investment Officer for equities at Aviva Investors, saying "As significant shareholders in Barclays and Sherborne Investors Guernsey B Ltd., we do not see merit in Edward Bramson's proposal to join Barclays' board as a non-executive director. We expect the incoming Chairman of Barclays to provide appropriate oversight of the group's strategy and lead the required changes to the board".

Dividend Payers

Mondelez International Inc. (MDLZ) updating conference call - As expected, Mondelez reaffirmed its 2019 guidance and long-term outlook. Specific to 2019, the company continues to look for organic sales growth of +2-3% Year/Year and constant currency EPS growth of +3-5% Year/Year. With regard to its long-term algorithm, Mondelez continues to target organic sales growth of +3% plus Year/Year, $3 billion+ free cash flow, and dividend growth that outpaces EPS growth. Notably, Mondelez expressed confidence in ongoing momentum in global category growth (+2.8% Year/Year in 2018) and indicated key factors that would bridge from its 2019 organic sales guidance (+2-3% Year/Year) to its long-term algorithm include whitespace expansion, extending brands into adjacent categories, and market share gains. With regard to investment, Mondelez continues to qualify 2019 as a year of stepped-up investment spend, as we believe it expects to reinvest the bulk of its cost savings (embedded in guidance). Interestingly, going forward, the company expects to invest at least half of its ongoing cost savings into the business. Further to the topic of cost savings, Mondelez indicated that following a period of transformational cost savings work, the company is shifting to continuous incremental improvement. That is, in our view, as opposed to transformational cost savings, which can be disruptive to the business, Mondelez sees an opportunity to generate savings in areas such as procurement, logistics, supply chain, and other G&A buckets -- without creating an obstacle for top-line growth. With regard to its joint ventures, we do not believe the company has indicated a change in its posture. That is, Mondelez noted that it views its existing stakes as financial investments (as opposed to strategic, in our view), and that a potential monetization depends on the value creation opportunity it sees ahead and potential uses of funds. In our view, Mondelez still sees these investments as driving continued value creation and thus we would not necessarily anticipate a change in ownership structure. Lastly, with regard to free cash flow, Mondelez provided some clarity around the drivers of its $3 billion+ long-term target. Specifically, Mondelez expects cash earnings to grow +mid-single digits Year/Year, helped by capital expenditure in the range of 3.5% (vs. 4.5% historically), lower restructuring spend, and further working capital improvement. While we recognize the company is still in the early stages of its pivot towards more of a balance between top and bottom line growth, it appears to us that Mondelez is starting to see improving top line trends materialize in response to its investments and remains confident around its shift from a focus on margin percent to margin dollars.

Economic Conditions

Canada – Retail sales in Canada retreated 0.1% in the month of December, albeit marginally better than the expected 0.3% pull-back. The core sales figure, which strips out the sales of vehicles and parts was also negative, down 0.5% in December, which was worse than expected. Much of the weakness is explained by the lower prices at the gas pump, while in volume terms sales rose by 0.2%. Growth was driven by strong sales in the building materials category.

U.S. Business activity remains robust in the U.S., with durable goods orders advancing by 1.2% in December, just shy of the expectations for a 1.5% improvement. Much of the growth in the month was driven by the notoriously bulky transportation orders, though the core reading was also positive, up 0.1%. Sales of capital goods were strong during the month, whereas sales of computers and communication equipment saw a significant pullback.

U.S. existing home sales unexpectedly fell in January, down 1.2% to 4.94 million units, the third decline in a row and the lowest since November 2015. The January drop was all in singles (2nd time in a row) while lower-priced condos drew more interest. More homeowners put a FOR SALE sign up, but the months' supply is still super-tight at 3.9. On a regional basis, the Northeast was the only area to register more sales, while the rest of the country was down. First-timers' share of sales fell to a one-year low of 29% and another step away from the norm of about 40%. Investors sensed some opportunity and stepped up, accounting for 16% of overall sales. The share of sales to repeat homebuyers was steady at 55%. This data helps to suggest in our view that the U.S. economy stumbled around the turn of the year, keeping the central bank cautious.

Japan's exports started the year on a weak footing as it contracted for a second straight month by -8.4% Year/Year (from -3.9% Year/Year in December), worse than Bloomberg's modest median forecast of -5.7%. This is the first back-to-back export decline recorded in more than 2 years. Imports also declined -0.6% Year/Year in January (from +1.9% Year/Year in December), although the pace of contraction was less severe than Bloomberg's median forecast of -3.5%. The weak exports coupled with more benign import contraction resulted in wider than expected trade deficit at JPY 1,412.2 billion in January (from a modest JPY 56.7 billion deficit in December 2018 and above Bloomberg's median expectations for a deficit of JPY 1,029.1 billion). On a seasonally-adjusted basis, the trade deficit was JPY 370 billion, from a deficit of JPY 221.5 billion in December 2018. A weak export outlook may be a drag on economic growth this year.

Financial Conditions

The U.S. 2 year/10 year treasury spread is now 0.17% and the U.K.'s 2 year/10 year treasury spread is 0.40% - 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. Also, the narrowing gap between yields on the two-year and 10-year Treasuries is of concern given its historical track record that when shorter term rates exceed longer dated ones, such inversion is usually an early warning of an economic slowdown.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 4.35% (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 13.66 (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 bodes 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 & Scollard Development Trust
- ITM AG Investment 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 www.portlandic.com/prices

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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