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. May 6, 2019

Owner Operated Companies

Alphabet Inc. reported its first quarter results, which included an increase in quarterly revenue of 17% from a year ago to $36.3 billion, though falling about $1 billion short of analysts' average estimate, according to IBES (Institutional Brokers' Estimate System) data from Refinitiv US Holdings, Inc. The company saw its slowest revenue growth in three years from increased competition in advertising, weak results in its smartphone business and potentially disruptive changes at YouTube. Alphabet Chief Financial Officer Ruth Porat attributed slower revenue growth to currency fluctuations, competition and unspecified product changes. Google also is working to find the right mix of ad formats to use on mobile devices, voice assistant-enabled home speakers and in emerging markets. About 85% percent of Alphabet's revenue comes from Google's ad business, which sells links, banners and commercials across its own websites and apps and those of partners. Chief Executive Sundar Pichai said revenue slowdowns should be expected as the company focuses on the long term. The company said it would have met expectations, adjusting for currency fluctuations. Alphabet's quarterly costs rose about the same as revenue, up 16.5% from last year to $29.7 billion. In the first quarter, sales of Google's Pixel phones also struggled from intense competition in the premium smartphone market, Porat said. The company is expected to introduce lower-priced Pixel devices next month. Alphabet's expenses included a $1.7 billion fine from the European Commission for having placed anticompetitive advertising restrictions on websites using its searches. Including the European fine, net income was $6.7 billion, or $9.50 per share, compared with analysts' average estimate of $7.3 billion, or $10.48 per share. Earnings excluding the fine were $8.3 billion, or $11.90 per share, beating analysts' estimates $10.61 per share for adjusted earnings. Operating margin excluding the fine was 23%, up from 22% in the year-ago period.

Berkshire Hathaway Inc. reported first quarter results, with gains in its stock investments resulting in a large first-quarter profit, while improved results from its GEICO Corporation auto insurer and BNSF Railway Company units boosted operating results. Berkshire also used $1.7 billion to repurchase its stock in the quarter, a small fraction of the conglomerate's cash hoard, which now totals $114.2 billion. The $21.66 billion overall profit, or $13,209 per Class A share, compared with a year-earlier net loss of $1.14 billion, or $692 per share, and a fourth-quarter net loss of $25.39 billion. These results illustrate what CEO Warren Buffett has called the "wild and capricious" and, in his view, meaningless swings caused by an accounting rule requiring the reporting of unrealized stock gains with earnings, regardless of Berkshire's plans to sell. Berkshire had $15.1 billion of these gains in the first quarter. Operating profit, which Buffett considers a better performance measure, rose 5% to $5.56 billion, or about $3,388 per Class A share, from $5.29 billion, or $3,215 per share, a year earlier.

Results excluded operating earnings tied to Berkshire's 26.7% stake in The Kraft Heinz Company because the food company has not released its own audited quarterly results, Buffett told reporters before the annual meeting. Buffett also maintained that "we paid too much" for Kraft Heinz, which was created in a 2015 merger between Kraft Foods and H.J. Heinz, which Berkshire and Brazil's 3G Capital, Inc. controlled. In last year's fourth quarter, Berkshire took a $3 billion write down on Kraft. GEICO saw pre-tax underwriting profit rise 14% as rising rates and premiums offset higher accident claims. BNSF's profit rose 9% to $1.25 billion as higher demand from the energy and industrial sectors offset lower volumes attributed to severe winter weather and flooding. Among other businesses, the Berkshire Hathaway Energy unit posted a 3% profit increase, while earnings from retailing and services units increased 16%, despite a 19% revenue drop at See's Candies, Inc. because Easter fell late. Berkshire owns more than 90 companies. Last month, Berkshire committed $10 billion to Occidental Petroleum Corporation's cash-and-stock bid for Anadarko Petroleum Corporation, which Chevron Corporation also wants to buy. The Berkshire investment is contingent on Occidental completing its proposed purchase of Anadarko.

Linamar Corporation reported first quarter results which included increased revenues, by 4.3%, to reach $2.0 billion, while the normalized EBITDA was flat compared to last year, at $297 million. Continued business wins maintained the strong launch book, at over $4.3 billion. The industrial segment (which includes SkyJack Inc. and MacDon Industries Ltd.) saw revenues up 17.0% and normalized operating earnings up 24.2%. The transportation segment sales were up on strong launch activity despite key customer production cuts in Europe and Asia. The company's operating earnings for the quarter were $187.7 million, which compares to $214.9 million in Q1 2018, a decrease of $27.2 million. Q1 2019 operating earnings for Transportation were lower by $25.6 million, or 18.3% compared to Q1 2018. "We are happy with our first quarter results in a tough market environment," said Linamar CEO Linda Hasenfratz. "Sales and market share are up despite market slowdowns in a few areas and EBITDA consistent to last year, not an easy accomplishment. We are laser focused on continuing to grow top and bottom line this year and expect to see significant free cash flow as evidenced already by our first quarter results."

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Energy Sector

Baytex Energy Corp. reported its operating and financial results for the first quarter of 2019, which included adjusted funds flow of $221 million ($0.40 per basic share), a 100% increase compared to $111 million ($0.20 per basic share) in Q4 2018. The company generated production of 101,115 boed (84% oil and natural gas liquids), exceeding the high end of its annual guidance and a 2% increase over Q4 2018. Baytex realized an operating netback of $26.56/boe ($28.63/boe including financial derivatives). Eagle Ford production increased 7% to 41,097 boed, representing the highest quarterly production rate achieved in the field and reflects continued strong well performance and an active first quarter completion program. During the quarter, Baytex reduced its net debt by $90 million during the quarter as adjusted funds flow exceeded capital expenditures and extended the maturity of its revolving credit facilities to April 2021. The company maintains strong financial liquidity with its credit facilities approximately 50% undrawn. Based on the forward contracts prices for 2019, Baytex is forecasting adjusted funds flow for 2019 of approximately $950 million. Further deleveraging remains a top priority. The company is now expecting 2019 production of 95,000 to 97,000 boed (previously 93,000 to 97,000 boed) with budgeted exploration and development capital expenditures of $575 to $625 million (previously $550 to $650 million). We met with the Baytex management a couple of weeks back and believe that the company is on track to being transformed into a more robust, lower leverage operator, with meaningful upside from its prolific Eagle Ford field and the prospective East Shale Duvernay field. We expect the markets to start taking note as well and which should address the company's depressed valuation metrics.

Royal Dutch Shell PLC - Adjusted earnings of $5.3 billion were 17% ahead of consensus. Adjusted EBIT of $6.1 billion was 20% ahead of consensus, driven mainly by a stronger than expected Integrated Gas but all the operated businesses performed strongly relative to the consensus. Upstream production of 3,752,000 boed was 1% below forecast, and down 2% year/year. It is estimated upstream net income per barrel of $12.5/boe, up $1.1/boe year/year and compares to the $3.3/barrel (bl) fall in the Brent oil price. Shell are to increase the next tranche of share buyback to a max of $2.75 billion, $250 million higher than last tranche. Reported cash flow from operations of $8.6 billion was down 8% year/year with a build of working capital of $3.5 billion. Excluding working capital movements, it is estimated underlying cash flow of $10.5 billion and up 12% year/year. With cash capital expenditures (capex) of $5.6 billion and dividends payments of $3.9 billion, there was a positive FCF post capex and dividends of $1 billion. Adjusting for scrip, it is estimated organic cash breakeven of $63/bl, down $4/bl year/year and down 3% quarter/quarter. Excluding IFRS16, net debt of $56.1 billion was up 9% quarter/quarter. Hence, gearing (net debt to capital) of 21.9% was up 2% quarter/quarter. Including IFRS16, net debt was $72.3 billion with gearing of 26.5%. Management Outlook: Integrated Gas production expected to decrease by 10,000-50,000 boed year/year in Q2 with liquefied natural gas volumes to be similar year/year; Upstream production expected to be up 150,000-200,000 boed year/year due to ramp ups and lower maintenance and; Refinery availability expected to increase year/year due to lower maintenance.

Financial Sector

Ares Capital Corporation: Q1 2019 core net investment income per share of $0.48 was above the consensus of $0.43/share. Most items came in better than expected, but the beat was mainly from structuring fees as Ares had a solid origination quarter with gross commitments of approximately $2.0 billion. Book value per share was $0.09/share higher quarter/quarter at $17.21. Overall, this was another strong quarter for Ares as it continues to outperform expectations. Ares had $2.0 billion of new commitments during Q1 of which approx. 42% were in first lien, 39% were in second lien securities, 8% in subordinate certificates, with the remainder in other equity and preferred securities. Against that, Ares had approx. $1.4 billion of exits. The portfolio mix at quarter end was 44% first lien (vs. 47% previously), 30% second lien (vs. 29%), and 6% in subordinate certificates. Overall yield on debt and income producing securities at amortized cost increased 20 basis points (bps) to 10.4%. Balance Sheet Leverage was approx. 0.84x debt to equity, up from 0.71x the prior quarter.

DNB ASA - Q1 2019 Results. Net Interest Income NOK9,289 million misses consensus by 2% affected by fewer interest days and increased resolution fund levy of NOK 94 million. Fees also 1% light at 2,219 million. Total Revenues of 13,062 million brought back in line with a 25% beat in Trading 751 million vs. 599 million and 6% Other Operating Income beat of 3,772 million. Costs 3% worse at 5,465 million vs. 5,327 million consensus. Lower Loan Loss Costs means Pre Tax Profits misses by just 1% whereas Net Profit is inline at 7,582 million. CET 1 20bps ahead of consensus and flat quarter/quarter at 16.4% vs. 16.2%. Loans slightly stronger by about 1%. Overall results slightly on the weaker side but nothing major in our view.

HSBC Holdings PLC - Profit Before Tax (PBT) was $6,213 million, including -$137 million of adjustments. Underlying PBT Q1 2019 was $6,350 million or +12% (+$664 million) ahead. Beat was primarily driven by a very strong Non interest income number (+$787 million ahead). Net interest income (NII) looked disappointing (Net Interest Margin 1.59% vs. Q4 1.66%). However, revenue includes $414 million of "non-recurring" items. Excluding that Revenue was +1% (+$88 million) ahead and underlying PBT was +4% (+$250 million) ahead. Pre-provision $6,343 million was +11% (+$642 million) ahead or +4% (+$228 million) excluding non-recurring items. We would expect modest changes to consensus with NII forecasts likely to come down. Management guiding to "modest progression" for the year against flat in Q1 and consensus +4%. Annualizing Q1 gives approx. $30.0 billion plus better Hong Kong Inter Bank Offered Rate potentially adds +$0.5 billion to give approx. $30.5-$31.0 billion for the year against

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consensus $31.6 billion. Shortfall likely to offset by Non interest income Q1 non-recurring items and approx. $370 million underlying beat. There is much to like about HSBC in our view, particularly in the context of a demanding U.K. outlook. Overall decent numbers with good cost control, good revenues and good capital.

Standard Chartered PLC - Good Q1 2019 numbers in our view - Q1 costs the standout performance. Profit of $1,242 million beats consensus of $867 million by 42%. Underlying PBT was $1,384 million, +23% (+$260 million) ahead consensus. Beat was primarily driven by costs and impairments (Private Banking $48 million write-back). Pre-provision $1,398 million was +10% ahead. No obvious one-offs although we understand that investment spend is expected to be weighted more to Q2-Q4. Revenues in line with consensus (but quality disappointing as retail and wealth management missed), -2% year/year. Capital was disappointing at 13.9% CET 1 against 14.3% expectations. $1 billion buyback announcement not included in figures (i.e. proforma 13.5%).

Activist Influenced Companies

Brookfield Business Partners (BBU) reported results for its first quarter, which included funds from operations(FFO) of $205 million, or $1.59 per unit, compared to $138 million, or $1.07 per unit in 2018. “We have had a strong start to the year and each of our business segments performed well resulting in robust quarterly Company FFO,” said Cyrus Madon, CEO. “We advanced several capital recycling initiatives, announced the acquisition of Healthscope and closed the acquisition of Clarios, the leading global supplier of automotive batteries.” BBU’s industrials segment generated FFO of $81 million during the quarter, compared to $114 million in the first quarter of 2018. Following the partial divestiture last year, BBU’s ownership of GrafTech International Ltd. is 27% compared to 34% in the first quarter of 2018 and, as a result, its proportionate share of GrafTech’s FFO is lower this year. North American Palladium reported strong performance as a result of higher sales volumes and continued strong palladium pricing during the quarter. BBU progressed a number of initiatives so far in 2019, some of which are detailed next. On April 30, 2019, together with institutional partners, they closed their acquisition of Clarios for a purchase price of approximately $13.2 billion. Clarios is the global market leader in automotive batteries. In January 2019, together with institutional partners, BBU reached a definitive agreement to acquire up to a 100% controlling interest in Healthscope Ltd., a leading Australian primary care provider, for a purchase price of approximately $4.1 billion. In April 2019, together with institutional partners, BBU recapitalized Cardone for $195 million, which is being used to support near term liquidity requirements in the business. Cardone is a leading remanufacturer of automotive parts in North America. In March 2019, BBU signed an agreement to sell BGIS, a global provider of facilities management services, for approximately $1 billion.

Dividend Payers

Dufry AG - partnership with Holland America Line Inc. - adding 1,500m^2: Dufry already had a partnership with Holland America Line on 9 ships with 2,000m^2 retail space and gets now a contract for additional 1,500m^2 with 6 new ships, giving them 3,500m^2 on all 15 ships. Cruise liners/seaports accounted for only 3% of Dufry sales, but has high growth potential especially now with the number of ships doubled to 33 ships in 2018. The new signed retail space of 1,500m^2 just adds 0.3% to Dufry’s global retail space, but the additional contract with Holland America strengthens Dufry’s position in analysts’ view.

Fortis Inc. reported first quarter 2019 net earnings of $0.72 per common share and adjusted net earnings of $0.74 per common share, up from $0.70 in the same period last year. The annual capital expenditure plan is on track with $0.7 billion (of the $3.7 billion budgeted for the year) invested during the quarter. Fortis completed sale of interest in Waneta Expansion Hydroelectric Project for approximately $1 billion and repurchased US $400 million of corporate debt. In March 2019 Tucson Electric Power Company (“TEP”) finalized its plans for the construction of the US $370 million Oso Grande Wind Project (also referred to as the New Mexico Wind Project). Once complete, this 247-megawatt wind farm will become TEP’s largest renewable energy resource, enough to power nearly 100,000 homes annually. The company’s $17.3 billion five-year capital plan is expected to increase rate base from $26.1 billion in 2018 to $32 billion in 2021 and $35.5 billion in 2023, translating into three- and five-year compound average growth rates of 7.1% and 6.3%, respectively. Fortis expects long-term sustainable growth in rate base to support continuing growth in earnings and dividends. Fortis is targeting average annual dividend growth of approximately 6% through 2023.

Economic Conditions

U.S. Payroll Jobs - The pace of hiring picked up in the spring, likely reflecting stronger domestic demand, while wages remained on low simmer despite a lower jobless rate. We believe there’s no need for the Fed to do anything rash here. Nonfarm payrolls rose 263,000 in April, beating market expectations of 190,000. Two-month revisions tallied +16,000. While the three-month average has slowed (to 169,000) from the past year trend (218,000), that’s still a healthy pace of hiring after a record 103 consecutive monthly increases. Private payrolls expanded 236,000 on broad-based gains apart from retail and information. Federal government payrolls rose 11,000, the most since December 2016, likely due to early hiring for the 2020 census. **The unemployment rate fell to a new 49-year low of 3.6%**, though the “all in” rate stayed at 7.3%, so there might still be a margin of slack left in labour markets. Household employment (always volatile) fell for a second straight month, but so did the participation rate, resulting in

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a near half-million slide in the labour force. Average hourly wages rose just 0.2%, holding the yearly rate at 3.2%. Given rising productivity, that's nowhere near fast enough to spark inflation. Aggregate work hours fell slightly, retracing the prior month's big gain, and consistent with our Q2 GDP call of 1.5%.

Trade talks - Stock Markets fell on Monday on the U.S. President Donald Trump's trade tweets over the weekend. Trump threatened to raise tariffs from 10% to 25% on $200 billion of China's exports to the U.S. The U.S. is still unhappy that China demands a very broad and immediate rollback of Special 301 tariffs without offering more concessions on enforcement, or China's own tariffs. Tough talk from Trump on China might mean a softer response to auto tariffs (due by May 18). They are simply not in a position to impose 25% tariffs on Japanese and EU cars. Realizing that an exemption is necessary for both, Trump has to show "toughness" in Chinese talks, even if they are clearly in their final stages. There are signs of a framework for resolving steel and aluminum tariffs on Mexico and Canada. Mexico is engaged in talks with the U.S. to replace tariffs with trade-rate quotas. This is basically a tiered tariff schedule based on quantity. One would expect something similar for Canada.

Financial Conditions

The U.S. Federal Reserve's Federal Open Markets Committee (FOMC), as widely expected, kept its policy Fed Funds Target Rate (FFTR) unchanged at the 2.25%-2.50% range in a unanimous decision (10-0). The surprise was the Fed decision to lower interest on excess reserves rate (IOER) by 5bps to 2.35% (from 2.40% previously) and the move was intended to keep Fed funds rate closer to the mid-point of the target range. The key market-moving takeaway was FOMC Powell's assessment during his press conference that while core inflation has fallen short in early 2019, he attributed it to transitory factors at work, dashing hopes that the Fed will cut interest rates imminently. The Fed, as scheduled, will also slow its reduction in holdings of U.S. Treasuries from the current level of US $30 billion per month to US $15 billion with effect from May 2, 2019. There is no change to the reinvestment of Mortgage Backed Securities that exceeds the monthly cap of US $20 billion.

The Bank of England last week voted unanimously to keep rates unchanged. The Bank upgraded its growth forecasts to 1.5% in 2019, up from 1.2% from February's forecasts. The Bank saw growth accelerate to 0.5% in Q1 with companies stockpiling ahead of Brexit but expects the momentum to fade and sees growth slowing to 0.2% in Q2. The vote was unanimous. Money markets are now pricing in a 20% chance of a hike by year-end. However, the biggest uncertainty on policy remains Brexit. On that front, the latest headlines say Theresa May and Jeremy Corbyn are getting close to a Brexit deal after a month of talks. May seems to be capitulating on one of her red lines and is considering some kind of permanent customs union with the E.U. The Conservatives and Labour teams will hold a final round on May 7 or 8 to decide whether a consensus is possible.

The U.S. 2 year/10 year treasury spread is now 0.19% and the U.K.'s 2 year/10 year treasury spread is 0.42% - 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 2 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 4.14% (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 17.43 (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.

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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 Fund
- 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) per unit 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.

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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, 'GDP' gross domestic product, 'netback' is a measure of oil and gas sales revenues net of royalties, production and transportation expenses and is used to compare performance in the oil and gas industry, 'ROE' return on equity, 'ROTE' return on common equity, 'ROTCE' return on tangible common equity.

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