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. August 26, 2019

Owner Operated Companies

Brookfield Asset Management Inc. – Macer Forest Holdings Inc. has acquired, and Brookfield Asset Management Inc. has disposed of, an aggregate of 7,513,262 common shares in Acadian Timber Corp., pursuant to a private transaction at a price of $17 per share, totalling aggregate consideration of approximately $128 million in cash. The shares represent approximately 45% of the issued and outstanding common shares of Acadian. Brookfield disposed of the shares as part of its investment strategy. Brookfield no longer owns or controls any shares of Acadian and, at this time, Brookfield has no intention to acquire additional securities of Acadian. As a result of this transaction, Benjamin Vaughan has resigned from his position as chairman of Acadian's board of directors, effective immediately. Mr. Cockwell, current director of Acadian and a principal of Macer, has assumed the role of chairman of Acadian's board. Brookfield Timberlands Management LP, a subsidiary of Brookfield, is continuing to act as external manager to Acadian in accordance with the terms of the asset management agreement between Brookfield LP and Acadian.

Walgreen Boots Alliance, Inc. – Building on an exploratory pilot launched in October 2018, The Kroger Co. and Walgreens announced the introduction of a new test area for the retailers, featuring the expansion of Kroger Express and Kroger Pickup at select Walgreens stores as well as the launch of Walgreens' owned-brand health and beauty products in 17 Kroger stores in Knoxville, Tennessee. Starting this fall, 35 Walgreens stores in the area will feature a curated selection of Kroger's popular Our Brands products like Simple Truth®, America's largest natural and organic brand, and national brand products. The assortment will vary by store and can include fresh meat, produce and dairy, frozen foods, shelf-stable products and Home Chef meal solutions to provide customers with a fill-in grocery shopping experience. Most of the Walgreens pilot stores will also provide customers with the convenience of Kroger Pickup, enabling shoppers to place a digital order on kroger.com or through the Kroger app for curbside pickup at a participating location. The Knoxville expansion will also pilot a curated selection of Walgreens' owned-brand health and beauty products in 17 Kroger stores, also debuting in the fall. The destination will feature several categories, including beauty, personal care, over-the-counter medications and wellness. Walgreens Boots Alliance brands No7® and Soap & Glory® will also be a part of the assortment. Launching the original pilot last year in Northern Kentucky allowed Kroger and Walgreens to test-and-learn in a retail setting and source customer feedback and insights, allowing the companies to create a more informed expansion decision. The pilot in Knoxville is a continuation of the test-and-learn approach, and both retailers will continue to assess customer response.

Energy Sector

CES Energy Solutions Corp. announced that it had successfully entered into an amended and restated credit agreement with respect to its syndicated and operating credit facilities. Led by The Bank of Nova Scotia as agent and a syndicate including Wells Fargo Bank, ATB Financial, and The Toronto-Dominion Bank, the credit facility consists of a Canadian syndicated revolving facility of C$150.0 million, a Canadian operating facility of C$20.0 million, a U.S. revolving facility of US$50.0 million, for a total facility size of approximately C$236.0 million. The amended and restated credit agreement extends the maturity date of the credit facility from September 28, 2020 to September 28, 2022; addresses the needs of the corporation's expanding U.S. business and increases availability in the U.S. from US$40.0 million to US$50.0 million through a U.S. revolving facility; provides CES with the ability to use proceeds under the credit facility to repurchase or redeem a portion of the Corporation's outstanding senior unsecured notes, subject to minimum liquidity requirements and adds a lower tier to the pricing grid.

Financial Sector

Barclays PLC - The Financial Times interviewed Group CEO Jes Staley last week on Barclays' plans to remain a force in investment banking. Staley has taken on more oversight this year of the Investment Bank (IB) and believes Barclays is providing a viable alternative in Europe to the dominance of US Investment Banks. Staley believes that Barclays' can capitalize on Deutsche Bank's retreats from key areas of Investment Banking, and also doubts whether their strategy in other areas (e.g. trying to retain a successful Equity Capital Markets franchise without much secondary equities) will succeed. The Investment Banking division is crucial to Staley attaining the important 9% Return On Tangible Equity target for 2019. Recent press articles have also signaled that Staley is prepared to take a tougher line on costs (including compensation - job-cuts elsewhere may help retention levels at Barclays) within the IB to help reach the profitability goal. Staley also reiterates his commitment to the US IB franchise, and indicates that Barclays could even look to return to Asian equities at some stage. The article also comments on how public pressure from activist shareholder Edward Bramson seems to have receded in recent months, although many investors still harbor doubts over Barclays's strategy within investment banking, even if Staley is seen as more focused on its returns within a group context than Tim Throsby did.

Canadian Imperial Bank of Commerce (CIBC) - reported Q3 2019 core cash EPS of $3.10 and consensus of $3.06. Better than expected trading revenues offset higher Provisions for Credit Losses

(PCL). Canadian P&C profits up 2% year/year. Pre-tax pre-provision earnings were up 4% while operating leverage was 0.3%. On average, mortgages were down 1% year/year, while credit cards increased 1% and commercial loans rose 12%. PCLs were up 13% year/year. Net Interest Margin was up 6 bps quarter/quarter, which we believe largely reflects new volume mix (e.g. commercial loan growth, negative mortgage growth, 9% deposit growth). U.S. Commercial Banking and Wealth Management adjusted earnings up 6% year/year (USD basis). Pre-tax pre-provision earnings were up 11% while operating leverage was negative 0.5%. PCLs were up 107% year/year. Loan growth was 15% year/year and deposit growth was 20% year/year. **Capital Markets** earnings down 13% year/year. Pre-tax profits were down 3% year/year, with negative 2% operating leverage. The earnings drop was primarily attributable to elevated provisions in the oil & gas sector, leading to PCLs of $42 million versus $1 million of reversals last year. Trading revenues were $375 million and Advisory revenues of $112 million compared. Group Provisions for Credit Losses of $291 million compared to $280 million consensus. CIBC's Core Equity Tier 1 ratio of 11.4% was up 20bps quarter/quarter and the bank announced a 3% dividend increase.

ING Group -The Financial Times writes on ING's growth in Australia in recent years, as foreign banks begin to (very slowly) chip away at the dominance of the big 4 Aussie banks. It will be interesting to see how this dynamic unfolds from here, given the reputational and financial impact on the 'big 4' from their major misconduct scandal over the last ~18 months. The article looks at how ING has sharply increased its customer numbers in Australia since 2015, while net profits in the country grew +15% year/year in FY 2018. With 2.4 million customers, it is now ranked as the fifth largest Australian bank in terms of mortgages and customer savings. It's seen as some validation for how ING's online only / digitalized business model in Australia has become increasingly relevant, as the market moves more towards this and away from branches etc. It's allowed ING to attract customers, and then cross-sell, but still from a low-base, with only about 3% market share in Australian mortgages and deposits. At a group level though, ING Australia is still a minor contributor, comprising about 5% of net profit, but is part of the Challengers & Growth markets, a division where ING expects to extract F&C growth (5-10% compound annual growth rate target at group level)

Royal Bank of Canada reported Q3 2019 core cash EPS of $2.26 vs. consensus estimate of $2.29. The miss was on the revenue line, particularly in Capital Markets (e.g., trading & advisory revenue miss = $0.05 EPS impact) and in Investor & Treasury Services (negative Net Interest Income (NIM)). **Canadian P&C reports** 8% year/year earnings growth. Pre-provision, pre-tax earnings growth up 8%. Operating leverage was 1.7%. Mortgage growth was 6% year/year, credit cards increased 5%, while commercial loans were up 10% year/year. NIM increased 6 bps year/year (flat quarter/quarter). Total Provisions for Credit Losses (PCLs) rose 4% year/year. **Wealth Management** earnings were up 11% year/year. Within this figure, City National loan growth was 15% year/year and NIM was down 5 bps quarter/quarter. City National margins were down due to higher deposit costs. **Capital Markets** earnings down 6% year/year. Pre-tax, pre-provision profits were down 9% year/year and PCLs increased $53 million from last year mainly due to a single account in Industrial Products sector. Total trading revenues of $713 million (down 12% year/year). Advisory revenues were $488 million, were down 10% year/year. Insurance earnings up 29% year/year. Higher favorable investment-related experience and impact of new longevity reinsurance contracts were the drivers. **Investor & Treasury services** earnings down 24% year/year. Primarily a reflection of lower Funding & Liquidity revenue due to lower client deposit margins and lower Asset Services revenues due to lower client activity. Net Interest Income was negative $16 million this quarter (third negative figure in a row). PCLs of $425 million compared with consensus of $448 million. Although there was a single-name loss in Capital Markets, total commercial/wholesale credit losses were subdued relative to recent quarters. Royal Bank of Canada's Common Equity Tier 1 (CET1) capital ratio of 11.9% was in line with forecast and was up 10 bps quarter/quarter and it increased its quarterly dividend 3% to $1.05 per share.

Activist Influenced Companies

Nothing significant to report.

Dividend Payers

South32 – FY 2019 EBITDA was +1% in-line with Bloomberg consensus. The key divisional beats came from Illawarra Coal, Brazil Aluminium, Cerro Matoso and Cannington, which offset misses in SA energy coal and a slightly higher than expected negative statutory adjustment (+6%). Earnings came in -7% vs. consensus. FY 2019 Free Cash Flow including associate dividends (12% yield) was solid at $1,113 million net of a $129 million working capital build. Capex & exploration in FY 2019 was $710 million. Following dividends of $344 million and buybacks of $281 million, this left S32's net cash position at $504 million vs. $726 million at March 2019. The board approved a final dividend of $2.8/share (40% payout ratio), taking the FY 2019 dividend including special dividends to $9.6/share (5.1% yield) which is below consensus (-22%, which we think likely assumed a special dividend). In addition to the dividend, the company announced a $250 million increase in shareholder return programme which will likely be in the form of a buyback ($264 million to be returned by Sep 2020). The FY 2019 dividend would be $14.6/share if we include this amount (7.7% yield). As such the majority of the net cash position will be returned to shareholders apart from the $150 million which is being allocated to the Trilogy JV investment by Jan 2020. That brings total shareholder returns paid in FY 2019 to $938 million (9.9% yield) and declared in FY 2019 to $731 million (7.7% yield). FY 2020/FY 2021 production guidance in the key divisions (Worsley, Illawarra and Aus Mn) was either in-line or slightly ahead of expectations whereas FY 2020 unit cost on an EBITDA weighted average basis is about 3% higher than expectations.

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Economic Conditions

In Canada, retail sales were flat in June, surprising consensus which was expecting a 0.3% decrease. While auto sales fell 2.5%, sales excluding autos rose 0.9%, also surprising consensus on the upside which was looking for that measure to stay flat. Ex-auto sales were hit by just 3 subsectors, namely gasoline stations, health/personal care and furniture, which were more than offset by increases for sellers of building materials, general merchandise, clothing/accessories and sporting goods/hobbies/music. In real terms, Canadian retail sales rose 0.4% in June. Inclement weather in May could be one of two temporary factors which likely helped retail sales in June. The other was the Toronto Raptors winning the NBA finals in June, recall that clothing/accessories (+4.2%) and sporting goods/hobbies/books/music (+3.7%) bounced in the month. Real retail sales likely contributed to June GDP. Looking at the quarterly perspective, real retail sales were stable in Q2 after two consecutive quarters of declines.

U.S. existing home sales met expectations last month, rising 2.5% in July to a 5-month high of 5.42 million units annualized, and following an upward revision to the prior month. Despite this pickup, sales are still just 0.6% above year-ago levels, but that is the first positive reading in 18 months. **First-timers** made up 32% of the share of home sales last month, down from a 7-year high of 35% in June, but within the average so far this year. Those who have went through this before (aka **repeat homebuyers**) accounted for 49%. **Distressed buyers** (which describe the type of sale, not the buyers themselves) were just 2%, down from 3% a year ago and from as high as 40% back in 2011. Single-family homes rose 2.8% in July, while condos and apartments remained unchanged. Supplies remain tight, as the number of homes available for sale fell for the first time in 2019, taking the months' supply down to 4.2, still well below norms. **Prices** are still rising, up 4.5% year/year, but lower mortgage rates should help take the sting out.

U.S. new home sales plunged 12.8% in July to 635,000 units, annualized, a 2-month low. But note that **June was revised up big time**, and are now up 20.9% to 728,000 units (was 646,000 units), the highest since July 2007. There were small downward revisions to April and May but that is neither here nor there....this is a volatile arguably unreliable report in the short term in our opinion. Note that U.S. homebuilders have been increasingly optimistic of late (NAHB index edged up to a 3-month high in August), with prospective homebuyer traffic picking up over the last couple of months, likely prompted by lower borrowing costs and lower rates will drive the big decision (to buy or not to buy?), assuming that job gains and wage gains continue to head in a northerly direction. But if "recession" talk amps up, that could frighten buyers enough to push them back to the sidelines in our view.

Financial Conditions

The U.S. 2 year/10 year treasury spread is now 0.006% and the U.K.'s 2 year/10 year treasury spread is 0.027% - 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 3.55% (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 6.4 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 19.72 (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 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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PIC19-049-E(08/19)