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. September 3, 2019

Owner Operated Companies

Facebook, Inc. is tightening its political ad rules in the United States, requiring new disclosures for its site and photo-sharing platform Instagram ahead of the U.S. presidential election in November 2020. The social media giant is introducing a "confirmed organization" label for U.S. political advertisers who show government-issued credentials to demonstrate their legitimacy. All advertisers running ads on politics or social issues will also have to post their contact information, even if they are not seeking the official label. Advertisers must comply by mid-October or risk having their ads cut off. Facebook has continuously revamped its policies around political advertising, which differ by country.

Energy Sector

Crescent Point Energy Corp. – In a significant move, ending several months of uncertainty, Crescent Point Energy announced it would exit Uinta Basin in Utah and sell parts of its assets in southeast Saskatchewan for about $912 million as part of its plan to cut debt under new management. The Uinta Basin asset, expected to produce about 20,000 boed in 2020, was sold to a private operator for about $700 million in cash, the company said without naming the buyer. The oil and gas producer said it would also look to sell more assets, including the remaining portion of its southeast Saskatchewan conventional assets. Including the most recently announced sale, the company said it had divested more than $1.3 billion in assets since the new management took over in 2018. Crescent expects the deal to help reduce its net debt to about $2.75 billion at the end of 2019 from $4.40 billion in 2018. The company said it expects the deal to add about 11% to its debt-adjusted funds flow per share. The company continues to pursue additional asset sales, including the balance of its southeast Saskatchewan conventional assets, and the monetization of its Saskatchewan gas infrastructure assets, the process for which continues to progress.

Whitecap Resources Inc. announced a cut in its capital spending plan by 17% for the second half of 2019 citing global economic uncertainty. The company, which now sees capex of $250 million for the period, said the reduction "is prudent" given the continuing trade wars between the United States and China, and recessionary concerns in 2020. Whitecap now expects full year 2019 capital expenditure at $400 million, $50 million lower than it previous forecast. The company also praised the Alberta government's recent decision to extend crude oil curtailments by one year, along with raising the amount of a producer's output that is exempt from curtailment to 20,000 boed from 10,000 boed. The move would allow the company to allocate capital to its highest rate of return projects without the risk of the associated production being restricted.

Financial Sector

The Bank of Montreal reported Q3 2019 adjusted EPS of $2.38 vs. consensus $2.49. The miss was driven by elevated provisions for credit losses. **Canadian P&C** adjusted earnings up 1% year/year. Provisions for Credit Losses were up 49% year/year, or $67 million, with half the increase coming from stage 1 & 2 additions and the other from specific losses in the consumer book and a lumpy commercial provision. Net Interest Margins were up 4 bps quarter/quarter. Mortgage growth was up 4% year/year, credit card balances rose 6% year/year and commercial loans grew 16%. **U.S. Property & Casualty** reports a 1% year/year earnings decline. Earnings growth was weighed down by a 135% year/year increase in loan losses ($73 million vs. $31 million). Net Interest Margins decreased 15 bps quarter/quarter to 3.46%. Commercial loan growth was 16% year/year, while consumer loans grew 4%. **Wealth Management** adjusted net income was down 14% year/year. Traditional wealth was up 10% year/year. Insurance earnings were down 73% year/year due to elevated reinsurance claims and unfavourable market movements. **Capital Markets** adjusted net income up 5% year/year. Total trading revenues were $419 million and Advisory revenues were $260 million. Provisions for Credit Losses (PCLs) of $306 million were above $221 million consensus, higher losses were reported mainly in Canadian P&C. Of note, analysts believe the introduction of a new collections system in consumer lending may have led to a spike in provisions. CET 1 capital ratio of 11.4% was up from 11.3% last quarter. BMO did not repurchase any common shares during the quarter, its quarterly dividend was unchanged in the quarter, as expected, while adjusted ROE fell to 13.5%.

The Bank of Nova Scotia reported adjusted cash EPS of $1.88 (+7% year/year), slightly above consensus of $1.85. International Banking drove strong results with adjusted net income up 11% year/year, while Canadian Banking earnings increased 3% year/year (both segments delivering positive operating leverage). Capital Markets continues to be weak with adjusted Net Income down 15% year/year. **Canadian Banking**. Adjusted net income was up 3% year/year. Revenue growth of 5% year/year benefitted from loan growth of 4% year/year (e.g. residential mortgages +3%, business loans +10%) and margin expansion (+3 bps quarter/quarter). Deposit growth rose 10% year/year, outpacing asset growth for the fourth straight quarter. Expenses increased 4% year/year implying positive operating leverage of >1%. **International Banking**. Adjusted net income increased 11% year/year (constant currency basis) supported by solid loan growth and recent transactions. Overall loan growth was 28% year/year (similar to last quarter), driven by 41% growth year/year in the Pacific Alliance region (mainly from acquisitions). Net Interest Margin (NIM) declined 13 bps quarter/quarter to 4.45%, primarily from a larger contribution from Chile (e.g. BBVA) and margin compression in Mexico. The bank's international segment drove positive operating leverage of >3%. **Global Banking and Markets**. Adjusted net income declined 15% year/year primarily due to market volatility and deposit margin compression (NIM -21 bps year/year). Expenses increased 9% year/year mainly attributable to higher regulatory costs and unfavourable FX impact. Strong growth in equity trading revenues was mostly offset by a decline in underwriting and advisory sales (compared to higher levels in the previous year). The Corporate loan book across Canada and U.S. grew 12% year/year. Total bank Provisions for Credit Losses were $713 million and came in better than consensus of $744 million. Impaired loans of $776 million (52 bps; +11% quarter/quarter) were affected by strong loan growth and International Banking acquisitions. Provisions on performing loans at -$63 million benefited from favourable macro-economic trends and improving credit (low quality). CET 1 ratio of 11.2% (+10 bps quarter/quarter) was in line with consensus. Internal capital generation (+33 bps) was offset by Risk Weighted Assets (-17 bps), pension re-measurement (-9 bps), and share repurchases (-4 bps or 2.8 million shares in third fiscal quarter). Pro forma, BNS's CET 1 ratio is ~11.7%, benefiting from announced divestitures. BNS announced a quarterly dividend increase to $0.90 (+3c or >3%), slightly higher than consensus of $0.89.

Toronto Dominion (TD) Bank reported Q3 2019 cash EPS of $1.79 in line with consensus. **Canadian Personal & Commercial** posted 2% year/year adjusted earnings growth which was a bit lower than expected. Growth was 5% on a pre-tax pre-provision basis. Provisions for credit losses (PCLs) rose 28% year/year, mainly attributable to a 25% increase in Stage 3 (i.e. specific) provisions. NIM decreased by 3 bps quarter/quarter to 2.84%. Mortgage/Amortizing HELOC balances grew by 6% year/year. Card balances were up 4% year/year. Commercial loan growth was 8% year/year. **U.S. P&C** net income increased 6% year/year. Pre-tax pre-provision profit growth was 6%. The efficiency ratio improved by 60 bps. However, Net Interest Margin was down 11 bps quarter/quarter. Mortgage growth was 8% year/year while credit card balances increased by 7% year/year. Meanwhile, commercial lending was up 7% year/year. **Capital Markets** net income was up 9% year/year. Total trading revenues were $500 million and Advisory revenues were $116 million. Total bank PCLs were $664 million vs. consensus of $692 million. CET 1 capital ratio of 12.0% was unchanged sequentially and TD repurchased 11.25 million shares during the quarter.

Activist Influenced Companies

Nothing significant to report.

Dividend Payers

Bunzl plc - First half revenue: £4,528 million, operating profit: £303 million vs. company consensus £298 million. Operating profit margin: 6.7%. EPS: 60.4p. Net debt: £1,927 million with leverage of 2.1x. Organic revenue growth of 0.8% in the half is slightly weaker than 1.1% estimates whereas Group margin of 6.7% is around 10 bps ahead of estimates. Better than expected EBITA is due to North America, where EBITA was around 5% ahead of estimate. Gross margins were higher than expected, while cost savings and synergies also contributed. All should continue in the second half. Overall forecasts are likely to see slightly lower organic sales growth (Barclays H2 organic growth of 0.7%) but better margins. FX would add £5 million to EBITA if we mark to market today. No significant acquisitions completed in the first half of the year but management says it is in active discussions with a number of targets. On outlook, revenue growth is expected to slow due to North America (lower sales to a large grocery customer and price deflation) and the UK (continued challenging trading environment) but margins are expected to compensate as a result of better U.S. gross margin, synergies and cost savings. Trading in the rest of the world and Continental Europe is expected to be similar for the remainder of the year.

Economic Conditions

U.S. business activity, as measured by the Institute for Supply Management (ISM) Purchasing Managers Index (PMI), is showing signs of stagnation, with the index reading of 49.1 falling short of the expected 51.1 level. New hiring, orders and productions retreated in the month.

The consumer sentiment saw mixed readings for August, with the consumer confidence, as measured by the Conference Board, showing as still elevated 135.1 index points level, ahead of the expectations, while the consumer sentiment, as measured by the University of Michigan, at 89.8 index points, fell short of expectations. Personal income, meanwhile, failed to impress in July, up only 0.1%, short of the expected 0.3%. Part of the same report, the core personal consumption expenditure (PCE) price index, the U.S. Fed's favourite inflation gauge, fell in line with expectations, at a tame 1.6% year/year rate of change.

Canada – Canadian economy expanded ahead of the expectations, at an annualized rate of 3.7% in the second quarter, thanks to a jump in goods exports. Exports of goods jumped 3.7% in the second quarter, on higher exports of energy, farm and fishing products, and non-metallic minerals. Exports of services rose 1.1%, maintaining the pace seen in the first quarter. Business investment declined 1.6%, while consumer spending slowed to 0.1%.

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Financial Conditions

The Reserve Bank of Australia (RBA) kept its official cash rate (OCR) on hold at 1.00%, as expected, stating the same as in August that "It is reasonable to expect that an extended period of low interest rates will be required in Australia to make progress in reducing unemployment and achieve more assured progress towards the inflation target. The Board will continue to monitor developments in the labour market closely and ease monetary policy further if needed to support sustainable growth in the economy and the achievement of the inflation target over time".

The U.S. 2 year/10 year treasury spread is now -0.014% and the U.K.'s 2 year/10 year treasury spread is 0.064%, 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, U.K's 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 3.58% (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 housing inventory is at the low end of a more normal range of 4-7 months.

The VIX (volatility index) is 20.49 (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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