News Highlights

Owners. Operators. And Insightful Investors.

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PORTLAND INVESTMENT COUNSEL®

Our views on economic and other events and their expected impact on investments Aug 24th 2015

Energy Sector

Baytex Energy has taken difficult but necessary steps to ensure the long-term sustainability of its business. Last week it has announced a reduced capital program and suspension of the monthly dividend. Through negotiated cost savings with service providers, the company has also materially reduced the amount of exploration and development capital needed maintain its production. Based on the current outlook, Baytex anticipates an approximate 25% reduction in capital spending in 2016. The company expects total exploration and development expenditures for 2015 of approximate $500 million, representing the low-end of its earlier guidance range of $500 to $575 million. Baytex is also tightening its production guidance range for 2015 to 84,000 to 86,000 boe/d (previously 84,000 to 88,000 boe/d). Baytex also believes that current prices do not support further drilling at Peace River or Lloydminster (heavy oil) at this time. As a result, its heavy oil program in Canada has been deferred for the reminder of the year. In the Eagle Ford, Baytex continues to work with its partner, Marathon Oil Corp, on further cost reductions. To-date, about 21% reduction in well costs have been achieved, with a further 8% reduction to approximately US$6.0 million per well expected to be achieved in the second half of 2015. Under this new cost structure and assuming a flat US$50/bbl WTI price, the expected internal rate of return (before tax) of a new well in the Eagle Ford remains a robust 38%. Through these measures, Baytex's sustainability metrics are enhanced, leverage ratios improved and resources are dedicating to the highest rate of return projects. Baytex said it will reinstate the monthly dividend when commodity prices recover to a supportive level. The company anticipates exiting 2015 with senior debt (being the amount drawn on its credit facilities and the principal amount of long-term debt) of approximately $1.8 billion, representing a senior debt to Bank EBITDA ratio of 3.1x, compared to a maximum permitted ratio of 4.5x to the end of 2016. Baytex has unsecured revolving credit facilities consisting of a $1 billion Canadian facility and a US$200 million U.S. facility with a maturity date of June 2019. At the end of December 2015, the company anticipates having approximately $975 million of undrawn capacity on these facilities.

Pacific Exploration and Production – Peru has negotiated a two-year deal with Canada's Pacific Exploration and Production Corp to operate and develop the country's biggest oil block. The Canadian company, which changed its name from Pacific Rubiales Energy Corp, will take over oil block 192 in Peru's Loreto Amazonian region after the contract of the current operator, Pluspetrol, expires. The deal was reached through private talks after the auction of a 30-year concession on the block earlier this month failed to draw any bids, hampered by low oil prices and thorny government talks with nearby indigenous communities. Peru had also negotiated with Perenco Ltd, Omega Energy International S.A. and Pluspetrol for rights to block 192 before the deal with Pacific Exploration was finally reached. Block 192 now produces about 10,000 barrels of oil per day, about a fifth of Peru's relatively small output. Protests by indigenous communities that say block 192 operations have polluted their lands have disrupted output several times in recent years.

Royal Dutch Shell – The Obama administration granted Royal Dutch Shell final clearance to resume drilling for oil and gas in the environmentally fragile Arctic Ocean for the first time since 2012, a move green groups vowed to fight. The U.S. Department of the Interior permit allows Shell to drill in the oil-rich Chukchi Sea off the northwest coast of Alaska. Shell interrupted its drilling program in the region in 2012 after suffering a series of mishaps, including losing control of an enormous rig, from which the Coast Guard had to rescue 18 workers. Harsh conditions in the Chukchi have discouraged other oil companies from drilling there. The go-ahead for Shell comes after repairs were completed to the Fennica, an icebreaker the company leases that carries emergency well-plugging equipment. The ship had suffered a gash in its hull after hitting uncharted shoals off southern Alaska. Shell obtained the leases in the Chukchi during the administration of former President George W. Bush. Since then it has spent about $7 billion on exploration in the Arctic, though oil production is at least a decade away. The Arctic is home to what the U.S. government estimates is 20% of the world's undiscovered oil and gas. Shell is not releasing a timetable for its drilling program.

Financial Sector

Barclays/HSBC – HSBC Holdings, Barclays and three other banks agreed to settle U.S. investor lawsuits tied to the currency-rigging scandal, bringing the total so far to more than $2 billion across nine firms. Goldman Sachs Group Inc., BNP Paribas SA and Royal Bank of Scotland Group Plc also agreed to settle class actions claiming the banks conspired to manipulate the $5.3 trillion-a-day foreign-exchange market, said Christopher Burke, whose firm is one of two lead counsels for U.S. investors. The $2 billion includes earlier agreements totaling $808.5 million, with JPMorgan Chase & Co., Bank of America Corp., UBS Group AG and Citigroup Inc.

A federal judge in Manhattan allowed Barclays investor claims to proceed as class action on behalf of all buyers of Barclays American depositary shares from July 10, 2007, to June 27, 2012, who lost money. Investors claim Barclays understated its borrowing costs in Libor submissions from Aug. 2007 to Jan. 2009. Investors claim former Barclays CEO Robert Diamond misled investors in an Oct. 31, 2008, conference call with analysts. Investors claim they lost money after disclosure that the company conspired to manipulate Libor.

Goldman Sachs is buying GE Capital Bank's U.S. online deposits, a move that will give the bank a more stable source of funding to help it better weather future crises. The deal is relatively small, giving Goldman Sachs $16 billion of deposits to help fund its $860 billion of assets. But it represents the latest step in a historic shift for Goldman, a standalone investment bank that has been forced by regulators to look more like a universal bank since the financial crisis.

J.P. Morgan Chase & Co., Goldman Sachs Group and Morgan Stanley are working to create a company that will pull together and clean reams of reference data at a lower cost than what they would spend individually, according to people familiar with the matter. The new entity, which will create a stream of consistent data that banks use to help determine pricing and transaction costs, is the latest example of increasingly cost-conscious banks coming together to save on head count, expenses and time.

Royal Bank Scotland – Selling its Luxembourg-domiciled independent management company and funds-governance business to private-equity firm BlackFin Capital Partners for a "significant premium to book value". RBS (Luxembourg) S.A. had €28.5bn AuM end 2014, sale value not disclosed. Completion subject to approval of Luxembourg regulator.

Activist Influenced Companies

Mondelez – Irene Rosenfeld, the group CEO is reportedly 'willing' to sell if a bid for Mondalez would be made, in the wake of Bill Ackman's taking a material stake in the company. Same source says Rosenfeld is ready to move on and may leave business altogether.

Canadian Dividend Payers

Brookfield Infrastructure Partners said it will buy Australia's rail freight firm Asciano Ltd in a deal valued at about A$12 billion ($8.84 billion). Asciano shareholders will receive A$6.94 in cash and A$2.21 in Brookfield Infrastructure Ltd Partnership units for every share held, which works out to A$9.15. The offer is a 13% premium to Asciano's last traded price of A$8.11. The deal, which would be the seventh largest buyout of an Australian firm by an overseas entity, would underscore the huge international appetite for Australia infrastructure. Record low interest rates have added to the M&A appeal of a sector already struggling with lower valuations because of a downturn in coal exports. Asciano is expected to post a net profit of A$392 million for the year to June 30, according to the average forecast of 16 analysts polled by Thomson Reuters Starmine, its highest since being spun off by Toll Holdings in 2007. Earlier this year, Asciano's former parent company, Toll Holdings, agreed to a A$6.5 billion takeover by Japan Post Holdings Co Ltd.

Global Dividend Payers

Bunzl – British-based Bunzl, which supplies supermarkets, hospital and hotels with products ranging from carrier bags to toilet rolls, posted slower revenue growth for the first half of the year, blaming the loss of two big customers and price declines in the United States. The company also cautioned that it was seeing challenging economic conditions and currency weakness affecting product purchase prices in Brazil and Australia, but said it expected its overall business to improve by the fourth quarter. It reported revenue growth of 5% in the first half of its financial year, at constant exchange rates, to £3.1 billion. That compared with 7% growth a year earlier to £2.9 billion. Chief Executive Michael Roney told Reuters that the loss of two customers in the United States had been significant, and he expected the impact of the lost business and price declines in plastic products to be completed by end of the year. Roney also said the company was suffering from the impact of currency headwinds, particularly in Brazil and Australia where it imports a large percentage of its products.

Deere & Co reported that third-quarter profit tumbled 40% on weak demand for agricultural equipment and a stronger dollar, and gave a bleaker forecast for fourth-quarter equipment sales. Lower commodity prices and falling farm incomes continued to pressure demand for agricultural machinery, with the declines most pronounced in higher-horsepower models. It also cited lower demand for construction equipment. Farm and turf equipment sales, which account for more than two-thirds of total revenue, fell 24% to $5.31 billion in the third quarter ended July 31. Sales in the construction and forestry segment decreased by 13% to $1.53 billion. Net income slid to $511.6 million, or $1.53 per share, from $850.7 million, or $2.33 per share, a year earlier. Total revenue declined 20% to $7.59 billion. The company revised lower its outlook for fiscal 2015 net income to $1.8 billion from $1.9 billion. Its fourth-quarter equipment sales projection was revised down to 24% lower, from 17% lower. In the latest quarter, international sales were softer due to a stronger U.S. dollar. Outside the United States and Canada, net sales fell 23% in the quarter, with 12% of the decline attributable to the effects of a stronger dollar.

Novartis – Swiss drugmaker announced it had agreed to buy all remaining rights to Ofatumumab, which is being developed for relapsing remitting multiple sclerosis and other autoimmune indications, from Britain's GlaxoSmithKline. Basel-based Novartis will make an initial upfront payment of $300 million to GSK for the acquisition of the compound and a further $200 million payable following the start of a phase III study in MS by Novartis. Payments of up to $534 million may be made if pre-agreed milestones are met, Novartis said in a statement. Novartis will also pay royalties of up to 12% to GSK on any future net sales of Ofatumumab in autoimmune conditions. The drug would compete with Roche's experimental medicine ocrelizumab, which succeeded in reducing the relapses and disability progression associated with multiple sclerosis in two late-stage studies announced in June. That treatment may reach the market in 2017, while the Novartis drug would be at least two years behind.

South32 Ltd the mid-sized miner spun off by BHP Billiton in May, said annual underlying profit jumped 41% and flagged big cost cuts over the next three years to help boost returns in a weak commodity market. The company was cast out of BHP with a suite of unloved

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coal, aluminium, manganese, and silver assets mostly in Australia and South Africa but with a strong balance sheet, positioning it to weather tough conditions and snap up assets. "Our business is performing well despite the difficult environment," Chief Executive Graham Kerr told analysts on a conference call. Underlying pro-forma profit for the year to June rose to $575 million. Underlying earnings before interest and tax, which rose 56% to $1 billion, were in line with analysts' estimates. Profit gains were driven by $282 million in cost cuts, mostly in labour and contractor costs. South32 is focused on cutting costs by at least $350 million a year, or around 8% of its controllable cost base, through the 2018 financial year.

Super Retail Group – Reported a decline in its full fiscal year net profit to A$81.1 million from A$108.4 million. The company said the overall result reflects weaker performance and restructuring costs in group's smaller businesses. Revenue from ordinary activities was up 7.1% to A$2.24 billion. The company declared a final dividend for the current period of A$0.215/share.

Wal-Mart Stores – reported weaker quarterly earnings and lowered its annual forecast, as it copes with higher labor costs, a squeeze on pharmacy margins and sliding sales at its British supermarket chain.

The results showed how a move to lift wages and other costs have kept Wal-Mart from taking full advantage of a strengthening U.S. economy, although there was a bright spot in its report: a fourth straight quarter of same-store sales growth. Net profit attributable to Wal-Mart fell to $3.48 billion, or $1.08 per share, in the second quarter ended July 31, from $3.92 billion, or $1.21, a year earlier.

Wal-Mart lowered its forecast for the year ending in January to a range of $4.40 to $4.70 from its outlook of $4.70 to $5.05 in February. In February Wal-Mart had flagged it would spend $1 billion on higher pay and for training, which will weigh on earnings this year. It also warned of higher spending to boost its e-commerce infrastructure as it seeks to close the online gap with Amazon.com. The retailer lowered its forecast for opening smaller-format stores, and now plans to open 160 to 170 Neighborhood Markets locations for the full year, down from 180 to 200. It said it was still on track to open 60 to 70 Supercenters this year.

Economic Conditions

US – US inflation reading for the month of July did not help tip the balance towards either a September Fed raise in the interest rates nor towards a postponement of the same. The headline reading was a 0.2% year on year increase in consumer prices, with most price series seeing subdued growth in the month. The core reading, which excludes the effects of fuel and food prices, was 1.8% year on year, in line with expectations.

On the housing front, a number of upbeats news provided some support for the otherwise battered equity markets. The US existing home sales for July, advanced against expectations for a flattish reading, to a 5.59 million units annualized level in July, while housing starts were also better, to a 1.21 million units annualized level reading for the same month. The National Association of Home Builders housing market index reading, a key reading of the US home-builders sentiment, advanced to 61.00 index points, well into the 'optimistic' territory, as expected. The 'fly in the ointment' was the July reading for US housing building permits, which came in at 1.12 million units, significantly lower than expected and than June's 1.34 million units annualized reading.

Canada – Inflation readings in Canada were a bit more menacing than South of the border, with a headline rate of 1.3%, mildly lower than the expectations, and a core reading, which excludes the eight most volatile series, including food and gasoline, in line with expectations, at 2.4%, above Bank of Canada's stated target. The higher core inflation rates are undoubtedly helped by the falling Canadian dollar.

Canadian retail sales for June surprised on the upside, at 0.6% versus expectations for a 0.2% advance, driven by sales of electronics and sporting goods, but also a recovery at gasoline stations, likely to be reversed in subsequent months. Pricing advances in certain retail categories also played a role. The core sales figure, which strips off the sales of vehicles and parts, were also strong, at 0.8% versus the expected 0.5% improvement.

Financial Conditions

US Federal Reserve policymakers remain determined to signal that although Quantitative Easing has stopped, the stimulus remains via keeping rates at present low until earliest September 2015. The US 2 year/10 year treasury spread is now 1.46% and the UK's 2 year/10 year treasury spread is 1.30% - 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 their costs of capital. It seems the top tier 6-9 investment banks will continue to command their market and possibly increase their share – as barriers to entry for newcomers have in our view been raised.

Influenced by the withdrawal of quantitative easing, the US 30 year mortgage market rate has increased to 3.93% (was 3.31% end of November 2012, the lowest rate since the Federal Reserve began tracking rates in 1971), as the Federal Reserve effectively continues to give priority to incentivising home ownership. Existing US housing inventory is at 5.0 months supply of existing houses. So the combined effects of low mortgage rates, near record high affordability, a more promising economic recovery, job creation, and low prices are finally supporting the housing market with housing inventory well off its peak of 9.4 months and we believe now in a more normal range of 4-7 months.

The VIX (volatility index) is 13.49 (compares to a post-recession low of 10.7 achieved in early June) 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 7 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

Private/Alternative Products

Portland also currently offers private/alternative products:

- Portland Focused Plus Fund LP
- Portland Private Income Fund
- Portland Global Energy Efficiency & Renewable Energy Fund LP
- Portland Advantage Plus Funds
- Portland Private Growth Fund

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

Sources: Thomson Reuters, Bloomberg, KBW,BMO, Credit Suisse, Macquarie, Barclays, TD, Scotiabank

Source: Thomson Reuters, Bloomberg, KBW,BMO, Credit Suisse, Macquarie, Barclays, TD, NBFinancial