

News Highlights

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PORTLAND
INVESTMENT COUNSEL®

Established in 2007

Our views on economic and other events and their expected impact on investments.

January 8, 2018

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Owner Operated Companies

Walgreens Boots Alliance, Inc. – Drugstore chain Walgreens reported better-than-expected profit and sales for the first quarter, helped by a jump in prescription volumes due to new contracts signed last year. Pharmacy sales, which accounted for 72.4% of its U.S. business in the quarter, rose 14.1%, with same-store sales rising 4.7%. Comparable-store sales at its retail division, however, fell 0.9%. The company also reported a 22.1% fall in profit, hurt by an impairment charge related to its investment in Chinese wholesale partner Guangzhou Pharmaceuticals. Net income attributable to Walgreens fell to \$821 million, or 81 cents per share, in the first quarter ended Nov. 30, from \$1.05 billion, or 97 cents per share, a year earlier. On an adjusted basis, the drugstore chain earned \$1.28 per share, beating the analysts' average estimate of \$1.26 per share. Net sales rose 7.9% to \$30.74 billion. Analysts on average were expecting a revenue of \$30.35 billion, according to Thomson Reuters. The drugstore chain also lifted the lower end of its full-year adjusted profit forecast by 5 cents to \$5.45 per share.

Energy Sector

Royal Dutch Shell PLC announced the acquisition of First Utility, one of U.K.'s largest independent suppliers of electricity and gas. The acquisition underpins the ongoing consolidation trend in the U.K. energy retail. First Utility has c.825,000 customers in the U.K.: 3% market share in both electricity and gas. Owing to increasing competition, the company incurred a pre-tax loss of £12.7 million in 2016. A deteriorating financial position and balance sheet forced the company to shelve its IPO plans last year. The market capitalization was quoted at c.£500 million. Shell also held warrants in First Utility whereby Shell could get equity stake in First Utility in the event of the latter's liquidity issues. First Utility already have an electricity and gas sourcing agreement with Shell whereby Shell acts as an intermediary for First Utility to source energy from the wholesale market whilst First Utility sells it to its customers under the Shell brand. First Utility currently provides services in gas, electricity, broadband and homes services but has been aiming to widen the service portfolio to telephony, mobile, insurance and connected home. First Utility has also highlighted that it is possible that it could become a vehicle for further consolidation in the U.K.

Financial Sector

Dufry AG - Elliott International Corporation has built a 5.6% stake in Dufry. Elliott is an American hedge fund, which was founded and run by Paul Singer and has now more than US\$34 billion in assets

under management. Singer is best known for battling Argentina for 15 years over its debt default, but the company has also taken stakes in companies like BHP Billiton PLC (pushing for spin off) and Energen Corporation (pushing for a sale) in 2017. It is not clear, who is the seller of the 5.6% stake, but it is probably connected to the collar structure of the holding of the largest shareholder HNA Group with JPMorgan as the provider. With Elliott as a new shareholder it will be interesting to see what kind of strategies they will propose. We consider the stock to have a strong underlying business with mid-single-digit organic growth and a strong margin improvement in 2018.

Activist Influenced Companies

Brookfield Business Partners LP together with institutional partners has entered into an agreement to acquire 100% of Westinghouse Electric Company LLC, a leading global provider of infrastructure services to the power generation industry, which is currently owned by Toshiba Corporation. The transaction provides for a purchase price of approximately \$4.6 billion, expected to be funded with long-term debt financing and the balance by the assumption of certain pension, environmental and other operating obligations. "Westinghouse is a high-quality business that has established itself as a leader in its field, with a long-term customer base and a reputation for innovation," said Cyrus Madon, CEO of Brookfield Business Partners. "We look forward to bringing our significant expertise and reputation as a long-term owner and operator of critical infrastructure in the U.S. and globally, as well as our deep facilities management capabilities, to enhance the Company's position as a leading global infrastructure services provider to the power generation industry." Westinghouse is among the world's leading suppliers of infrastructure services to nuclear power generating facilities. The company provides sophisticated engineering, maintenance, facilities management and repair services to its global customer base. Westinghouse is a leader in its field, as the largest service provider to the world's nuclear power facilities. Westinghouse has a well-established installed base of long-term customers globally. The majority of the Company's profitability is delivered through regularly scheduled services which are provided under long-term contracts. Westinghouse's core business has generated stable margins and consistent free cash flow. Brookfield Business Partners will commit to fund approximately 50% of the equity on closing using existing liquidity. Prior to or following closing, a portion of Brookfield Business Partners' investment may be syndicated to other institutional investors. Westinghouse filed for

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bankruptcy in March after two nuclear power plants it had designed and was constructing in the U.S. Southeast had gone billions of dollars over their fixed-cost contracts. Brookfield's acquisition of Westinghouse is expected to close in the third quarter of 2018.

Pershing Square Holdings, Ltd. – Bill Ackman, whose hedge fund Pershing Square Capital Management is Howard Hughes' biggest shareholder, announced it is trimming the firm's holdings for tax reasons and in order to invest some \$300 million of his own money into Pershing Square Holdings, his publicly listed portfolio that trades like a closed-end fund. Pershing Square Capital Management will still own a 17.6% in Howard Hughes, down from 23.4%. After months of buying back more than \$40 million worth of Pershing Square Holdings shares, the shares were still trading roughly 20% below their net asset value. Sluggish returns - the Pershing Square Holdings portfolio lost 4% in 2017 while Pershing Square International lost roughly 1.5% - are prompting new moves, including the planned \$300 million cash infusion from Ackman and senior associates. The cash infusion from Ackman, whose net worth is estimated at \$1.4 billion by Forbes, is aimed to "assist in reducing the discount to net asset value at which Pershing Square's public shares currently trade".

Dividend Payers

George Weston Limited / Loblaw Companies Limited announced on December 18 that both companies have been involved in a price-fixing arrangement involving certain packaged bread products over a 14-year time frame – in March 2015, Loblaw's uncovered items that raised internal flags and self-reported its concerns to the Competition Bureau (CB), leading to a CB investigation of regular coordinated price increases on certain products by retailers and wholesalers -- Loblaw's/Weston worked with the CB confidentially under an immunity agreement -- companies under investigation include Loblaw and Weston Bakeries -- other retailers including Overwaitea Foods, Metro Inc., Empire Co. Ltd. and Walmart Canada have been cooperating with the investigation, as has Canada Bread -- Empire and Metro indicated they have found no evidence at this time that either company or their employees participated in price-fixing activities. Loblaw's/Weston expressed regret over these activities and noted they have taken action since uncovering these actions – the individuals involved are no longer involved with either company -- management is confident that no other product or category is at risk -- they have taken further steps including (1) establishing an independent compliance office led by a Chief Compliance Officer reporting directly to the Board (2) re-training sales and marketing personnel at Weston Bakeries, merchant and store managers at Loblaw, and senior leaders, and (3) beginning to implement ISO 19600 certification which will provide independent third-party validation of standards. Loblaw's also announced it will be offer clients who purchased bread during the period a \$25 Loblaw gift card -- some could see this as turning the unfortunate event into

a marketing opportunity, as Loblaw's will be collecting customer data -- Loblaw's will take a provision of \$75-\$150 million based on a take-up of 3-6 million customers – the provision will be adjusted in time to reflect the actual take-up. Class action lawsuits have been filed against Loblaw's /Weston and are likely to result in negotiated settlements, not atypical in such cases -- management did note it would be open to any reasonable settlement offer and expects that Loblaw's will be subject to the larger settlement -- management also believes gift card take-up may offset/reduce any negotiated settlement amount and will also be tax deductible.

Economic Conditions

Canada – Employment in Canada surprisingly expanded by 78,600 positions in December, as the expectations were only factoring in about 1,000 jobs added in the month. The unemployment rate dropped to 5.7% from 5.9% in November and compared to expectations for a worsening, to a 6.0% level. There were 23,700 full-time and 54,900 part-time positions added in the month. By sector, financial services and education were the key contributors to job gains, whereas manufacturing and healthcare subtracted from growth in the month.

U.S. – The U.S. economy added 148,000 non-farm payrolls in December, falling short of the expectations for 190,000 job gains and compared to November's revised higher 252,000 figure. The unemployment rate held steady, at 4.1%, while average earnings accelerated, up 0.3% month on month, from 0.2% in the month prior. The manufacturing sector added an impressive 25,000 jobs, ahead of the expectations for a 15,000 positions gain, with most of the weakness exhibited by the retail sector.

Consumer credit in the U.S. expanded by \$19 billion in the month of November, marginally lower than the \$20.5 billion recorded for the month prior.

U.S. housing starts defied expectations with a 3.3% jump in November to 1,297k units annualized, the 2nd increase in a row, 12.9% above a year ago, and the 2nd highest level since August 2007. October's hurricane-related bounceback was revised down. All of the gains were in single-family homes, which accounted for nearly 3/4s of total starts, while multis slipped a bit. The North East and the Mid West cooled a little while the South and the West jumped at a double-digit pace. Although building permits dipped 1.4%, the decline was not as large as expected and, at 1,298k, is in line with total starts, suggesting some levelling off in coming months but with supplies of existing homes still tight, we could see further gains in starts in the months ahead.

Portugal has reached a turning point in its economic rehabilitation after Fitch Ratings became the second rating agency to upgrade the country to investment grade. Portugal's bonds which soared above

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16% during the Great Recession dropped to 1.76% last week in anticipation of the Fitch upgrade. (Source: Financial Times)



Financial Conditions

The U.S. 2 year/10 year treasury spread is now .51% and the U.K.'s 2 year/10 year treasury spread is .72% - 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.

Influenced by the withdrawal of quantitative easing, the U.S. 30 year mortgage market rate has increased to 3.95% (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 9.68 (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 augurs 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:

- [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 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 <http://www.portlandic.com/prices/default.aspx>

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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, 'ROE' return on equity, 'ROTE' return on common equity.

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