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. June 25, 2018

Owner Operated Companies

Nothing significant to report.

Energy Sector

U.S. land rig count declined 3 week/week to 1,032. The decline in rig count was driven by Horizontal Gas (-3), Directional Gas (-2) and Directional Oil (-1). These declines were partially offset by increases in Horizontal Oil (+2) and Vertical Gas (+1).

Crude Oil prices slipped as OPEC sealed a deal on Saturday which will bring the "real" increase output closer to 1 million barrels a day starting next month to keep prices under control. The agreement goes beyond the initial agreement which suggested output would increase closer to 600,000 to 800,000 barrels per day. Crude futures found support below 68.50 this morning and now testing 69.00. An agreement and cooperation among OPEC and non-OPEC members though should be viewed as a positive overall in our view.

Financial Sector

DNB ASA and SpareBank 1 Gruppen AS has signed a letter of intent to merge their non-life insurance operations, DNB Forsikring AS and Sparbank 1 Skadeforsikring and will thus establish one of Norway's largest insurance companies. At the time of the merger, the new company will have a market share of more than 15% and will thus be Norway's third largest non-life insurance company and the largest non-life insurance company distributing its products through banks. (DNB's non-life insurance operation and Sparebank 1 Skadeforsikring has a market share of approximately 5% and approximately 10% of Norway's non-life market respectively). According to the letter of intent, the exchange ratio will be approximately 80% for Sparebank 1 Gruppen and 20% for DNB. DNB will increase its holding in the new company, whereby Sparebank 1 Gruppen will have a holding of 60% and DNB a holding of 40% at the merger date. The tentative merger date is January 1, 2019, subject to approval of the authorities. We consider the merger positive for DNB as it will increase DNB's exposure into asset light business. It will strengthen DNB's position in the non-life insurance sector. Furthermore, the new company will generate synergies. DNB's non-life insurance company generated a net insurance profit of NOK 683 million, approximately 4.3% of the groups' total net operating income in 2017.

NN Group NV - Announces stock fraction for 2017 final dividend and repurchase of shares to neutralize stock dividend. As NN Group announced on February 15, 2018, its shareholders were given the option to receive the final dividend for 2017 of €1.04 per ordinary share either in cash or in ordinary shares. Shareholders who have elected to receive the final dividend in shares will receive one NN Group NV ordinary share for every 35.03 ordinary shares held. NN Group will neutralize the dilutive effect of the stock dividend through the repurchase of ordinary shares for a total amount of €142 million, equivalent to the value of the stock dividend. These share buybacks will be executed by financial intermediaries under an open market share buyback programme which is expected to end by December 31, 2018.

The Federal Reserve determined the largest U.S. banks were healthy enough to withstand a severe economic downturn and would continue lending during a crisis, as the industry posts record profits and prepares for a wave of regulatory relief. The Fed's "stress test" scenario for the 35 largest bank holding companies, which hold 80% of the assets at banks operating in the US, found the firms were "strongly capitalised" and would retain adequate capital levels in severely adverse conditions, according to the first round of results released overnight by the central bank. (Source: The Australian)

Canadian Banks - The Financial Post reported on Friday that tucked into the recent financial statements of Canada's biggest banks is a hint of tax trouble. Though the banks stress they are in the right, their statements disclose a series of disagreements with the Canada Revenue Agency (CRA). Over the past few years, the CRA has either reassessed or is planning to reassess the Big Six banks for approximately $2.8 billion in taxes and interest that the lenders say is related to the treatment of dividends for the tax years between 2009 and 2013. Some of the banks said the reassessments are tied to alleged dividend rental arrangements; others suggest the issue is merely related to dividends. But all of them have said their tax filings are appropriate, setting up a battle that could reshape the tax playing field for the country's largest lenders. The dispute is shaping up to be a complicated and lengthy one, the roots of which stem from the beneficial tax treatment Canadian companies enjoy on dividends they receive from shares of other Canadian companies. Under the Income Tax Act, the dividends (typically paid out of after-tax earnings) are generally deductible in order to limit multiple levels of taxation. Lindsay Tedds, an economics professor at the University of Calgary, said such transactions "kind of all even out in the wash" if all parties are in the Canadian tax structure, but problems pop up when "tax-indifferent investors" — such as foreign entities or pension funds — get involved. A source close to the dispute said the "nub" is a perceived caveat to the dividend rental rules, which is that they are not intended to apply when deals are primarily done for business purposes.

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Activist Influenced Companies

Nothing significant to report.

Dividend Payers

BHP Billiton PLC - has announced the disposal of the Cerro Colorado copper mine in Chile to Private Equity Manager EMR Capital Pty Ltd for $270 million, before contingent payments of $50 million depending on future copper prices. The mine was approaching the end of its reserve life and was in the 92nd percentile of the cost curve; hence the disposal has business rationale. The valuation compares to estimates of CAD $537 million. While this is a relatively small transaction the disposal provides credence to our thesis that imminent asset disposals will boost FCF generation by BHP, closing the valuation gap with its peers. Furthermore, this should lead to higher return on assets through the removal of low-returning assets from future earnings.

Roche Holding AG will acquire the outstanding shares of Foundation Medicine, Inc.'s (FMI) stock not already owned by Roche for a value of $2.4 billion ($137/share). This represents a 47% premium to FMI's 30-day price. Roche already owned approximately 55% of FMI following the acquisition of a majority equity interest in January 2015. This merger agreement is in line with Roche's strategy of providing personalized medicines. The deal is expected to close in the second half of 2018. The complete takeover by Roche was unanimously endorsed by the deciding bodies of both companies. The purpose and goal of this merger is summarized as: (i) Accelerate broad availability of comprehensive genomic profiling in oncology; (ii) Together, the companies will leverage expertise in genomics and molecular information to enhance the development of personalized medicines and care for patients with cancer; (iii) Focus on driving ubiquity of FMI's high quality comprehensive genomic profiling (CGP) testing and innovative data services to realize Roche's vision of personalized healthcare and; (iv) FMI to continue its operations as a separate and autonomous legal entity. Notably, FMI is continuing its operations as a separate and autonomous legal entity, which is why it will stay an independent profit center, likely within Roche's Diagnostics Division. On the other hand, we expect also Roche's Pharma Division to indirectly benefit from this acquisition, as the genomic profiling of the patients' tumor tissues will indicate which combination of targeted cancer therapeutics will be the most appropriate for the patient's cancer disease, some of such medicines would be offered by Roche. At a further level of data integration, e.g. by combining these molecular cancer data with the imaging data to come from Roche's JV with General Electric Company (GE), doctors will be helped outline what the most appropriate therapeutic regimen would be overall. The consideration of GE's imaging data will help to properly stage a cancer disease and refine the therapeutic regimen proposed by FMI's genomic profiling of the tumor tissue.

Roche reported positive results from the Phase 3 IMpower133 study of Tecentriq plus chemo (carboplatin, etoposide) in first line extensive stage small cell lung cancer (SCLC). The study met both overall survival (OS) and progression free survival (PFS) co-primary endpoints at the first interim analysis. Final data was previously expected in 2019. SCLC represents approximately 15% of all lung cancer diagnoses with extensive-stage disease accounting for approximately two thirds of these patients at diagnosis. This is the first I-O chemo combination to show P3 efficacy in first-line SCLC. To date, Tecentriq has reported positive studies in chemo combo but they have often come in the face of similar or arguably superior data from Keytruda. If Tecentriq is able to establish a significant timing lead in this setting with competitive efficacy data versus peers, SCLC could contribute a significant portion of PharmaValues expectations.

Economic Conditions

Canadian Economy Falters on Stalled Inflation, Retail Sales Drop – Canada (Bloomberg): Last Friday, Bloomberg highlighted that with the domestic economy showing unexpected weakness in the second quarter, recording sluggish readings for both inflation and retail sales, expectations for the Bank of Canada to increase interest rates appears to have waned somewhat. On Friday, Statistics Canada released that the consumer price index recorded an annual pace of 2.2% in May, unchanged from April and well below economist expectations for a 2.6% gain. In a separate report, Statistics Canada outlined that retailers recorded a 1.2% sales drop in April, also unexpected.

U.S. housing starts rebounded 5% in May to an 11-year high of 1.35 million units annualized, well above the consensus call for a 1.9% increase. And, the increase was supported by a 2nd gain in a row for singles, while multi-unit starts retraced much (not all) of the prior month's slump. The Midwest accounts for the bounce back in starts, as it was the only region to show an increase (62%). The South, which accounts for about half of overall starts, slipped 0.9%, while the Northeast took a 15% hit and the West fell 4%. (There was likely little impact from Subtropical Storm Alberto, which hit very late in May).

Greece - received a 10-year extension on maturities to the tune of €96.6 billion as part of its debt relief deal. The governing bodies are expected to approve the disbursement of the 5th and last tranche of the support programme amounting to €15 billion to Greece which will then be leaving the programme with a sizeable cash buffer of €24.1 billion covering the sovereign financial needs for around 22 months. The International Monetary Fund will not participate in the Greek programme with financing but its engagement will include post-programme monitoring.

Turkey - President Erdogan won the election and so avoided a second round of voting. Erdogan won 53% of the votes while his next closest competitor came in at 31%. Expectations are now whether Erdogan puts pressure on the central bank to reflate the economy as he campaigned.

Financial Conditions

The Bank of England (BoE) as widely expected left the policy rate at 0.5% and the asset purchase program at £435 billion. What was slightly surprising was that three of the nine monetary policy committee (MPC) members voted for a 25bps hike. For the first time since joining the MPC four years ago, Bank of England Chief Economist Andy Haldane joined Ian McCafferty and Michael Saunders in that call. In a further surprise move, policymakers also voted to change the guidance on when they will consider reducing the stock of debt purchased in the bank's quantitative easing program. Having previously said they would not consider selling the bonds until the key rate reached 2%, they have now cut that to 1.5%.

The U.S. 2 year/10 year treasury spread is now .35% and the U.K.'s 2 year/10 year treasury spread is .56% - 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 4.57% (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 4.0 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 14.99 (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:

- Bay & Scollard Development Trust
- 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 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) of our investment funds are published on our Portland website at http://www.portlandic.com/prices/default.aspx

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

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