News Highlights

Owners. Operators. And Insightful Investors.

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PORTLAND INVESTMENT COUNSEL®

Established in 2007

Our views on economic and other events and their expected impact on investments. December 17, 2018

Owner Operated Companies

Alphabet Inc. – Alphabet's Google is investing more than $1 billion on a new campus in New York, becoming the second major technology company after Amazon.com, Inc. to pick America's financial capital to expand and create thousands of jobs. The 1.7 million square-foot campus, called Google Hudson Square, will include leased properties at Hudson Street and Washington Street. Google hopes to start moving into the building by 2022 and plans to double its New York headcount to 14,000 in the next 10 years. With a plethora of white-collar workers and good infrastructure, the city provides a better option to other places that would require more investment.

Carnival Corporation, the world's largest leisure travel company, announced it will launch four new cruise ships in 2019 across three of its leading global brands – Carnival Cruise Line, America's Cruise Line; Costa Cruises, the largest European cruise operator; and Princess Cruises, the world's largest international premium cruise line. The world will get a preview of one of these spectacular new vessels when Carnival Cruise Line debuts a floral replica of its new Carnival Panorama sailing down Colorado Boulevard in the Rose Parade on New Year's Day. The new vessels also include Sky Princess, Princess Cruises' fourth Royal-class ship; and Costa Smeralda, the second of Carnival Corporation's total of 11 new ships joining the fleet between 2018 and 2025 that can be powered by liquefied natural gas (LNG) both in port and at sea; as well as Costa Venezia, Costa Cruises' first ship designed and built specifically for the China market. The four ships are part of Carnival Corporation's ongoing fleet enhancement strategy with 20 new ships scheduled for delivery between 2019 and 2025. These new ships build on the success of Carnival Corporation's four ships launched in 2018, which include Carnival Horizon from Carnival Cruise Line, Seabourn Ovation from Seabourn, MS Nieuw Statendam from Holland America Line Inc. and most recently, AIDAnova – the world's first cruise ship that can be powered by LNG both in port and at sea – from AIDA Cruises Ltd.

Energy Sector

Baytex Energy Corp. announced a 2019 capital budget of $550 to $650 million, which is designed to generate average annual production of 93,000 to 97,000 boed. Commenting on the announcement, Ed LaFehr, President and Chief Executive Officer, said: "As we enter 2019, our top priority is disciplined capital allocation across our strong portfolio of assets. We will focus activity on our high return, high netback light oil assets in the Viking and Eagle Ford and we will continue to prudently advance the East Duvernay Shale. Importantly, we have the operational flexibility to adjust our spending plans based on changes in the commodity price environment." Approximately 80% of the company's capital development program will be directed to its high netback light oil assets in the Eagle Ford and Viking. Approximately 10% of the capital will be directed to the East Duvernay Shale as Baytex builds on its success in this light oil resource play. Over 90% of the company's operating netback is expected to come from its light oil assets in the Eagle Ford and Viking. Baytex's light oil and condensate production in the Eagle Ford commands premium Louisiana Light Sweet (LLS) based pricing. Adjusted funds flow in excess of capital expenditures, lease payments and asset retirement obligations will be allocated to debt repayment. A USD $1.00/ barrel (bbl) change in the price of West Texas Intermediate (WTI) impacts Baytex's annual adjusted funds flow by approximately $30 million on an unhedged basis ($24 million on a hedged basis). The company's production mix is forecast to be 83% liquids (46% light oil and condensate, 27% heavy oil and 10% natural gas liquids) and 17% natural gas. The company's 2019 guidance assumes the curtailment of approximately 1,000 bbl per day of heavy oil for the first six months of the year. Baytex's Eagle Ford asset in South Texas is one of the premier oil resource plays in North America. The asset generates a strong operating netback and FCF and contains a significant inventory of development prospects.

Financial Sector

BNP Paribas SA said last week it had received a licence to be the lead underwriter for yuan-denominated bonds from foreign non-financial corporate issuers in China, known as Panda bonds. BNP Paribas China Ltd. received a Panda Corporate Bond Lead Underwriting Licence Type B licence from China's National Association of Financial Market Institutional Investors (NAFMII) on December 7, the bank said in a statement. It follows HSBC Holdings PLC and Standard Chartered PLC as the third bank to receive lead underwriting licences for non-financial corporate Panda bonds. "This senior underwriting licence will help us to attract more foreign issuer participation in China's bond market. This will help widen the issuer pool beyond Chinese issuers, as well as increase inbound foreign investment," George Sun, head of Global Markets for Greater China, said in the statement. (Source: Reuters)

NN Group NV has confirmed that it has received regulatory approval to merge the respective Dutch non-life and life legal entities of former NN Group and Delta Lloyd NV. This is as anticipated. It will result in a goodwill charge of €352 million in Q4 2018 below the operating line and will have no impact on Solvency 2 metrics. It is good that NN Group has achieved this step but hardly a surprise. Analysts (and they think the market) typically exclude goodwill from their valuation appraisal already so apart from some technical comment their first thought is that this should just be accounting noise.

Activist Influenced Companies

Activism in Canada – Billionaire hedge fund manager John Paulson's success in ousting the bulk of Detour Gold Corporation's board could serve as a "template" for an expected increase in shareholder activism in the gold sector. The Canadian mining company's shareholders voted for five board nominees backed by Paulson & Co. Inc. at a special meeting, and Detour's interim Chief Executive Officer and the chairman were not re-elected to the nine-member board. Paulson, which has a 5.7% stake in Detour, had pushed for a complete change of the board and the resignation of interim CEO Michael Kenyon, saying that under his leadership the company had "unsuccessfully tried to boost short-term performance" and run up accounts payable to exaggerate cash flows. Kenyon stepped down. Newly-elected Chairman James Gowans said he looked forward to working with the board to recruit a new CEO. Detour shareholders voted to keep the size of the board at nine, while Paulson was backing an eight member board consisting of its candidates.

Dividend Payers

BHP Group PLC has successfully completed its off-market tender buy-back of BHP Group Limited shares. The final transaction size of AUD $7.3 billion has enabled BHP Group Limited to buy back approximately 265.8 million BHP Group Limited shares, which represents 8.3% of the issued share capital of BHP Group Limited and 5.0% of the total issued capital of BHP Group Limited and BHP Group PLC. The final price for the Off-Market Buy-Back has been set at AUD $27.64 per share (Buy-Back Price). This is a discount of 14% to the Market Price of AUD $32.1387 per share. In addition, the Board of BHP has determined to pay a special dividend (Special Dividend) of USD $1.02 per share, which will be paid to all BHP shareholders with an entitled registered holding as of Friday January 11, 2019. The Special Dividend represents the residual USD $5.2 billion of net proceeds from the sale of its Onshore U.S. assets not returned via the Off-Market Buy-Back, based on the reduced number of shares on issue of approximately 5,058 million following completion of the Off-Market Buy-Back. BHP Chief Financial Officer, Peter Beaven, said: "We are pleased to have completed the Off-Market Buy-Back which, together with the Special Dividend, will deliver on our commitment to return the net proceeds from the sale of our Onshore U.S. assets to our shareholders. Completion of this program will bring total cash returned to shareholders to USD $21 billion over the last two years."

Bunzl PLC trading statement: Full year constant currency revenue growth is expected to be approximately 8-9%. Organic growth of "more than 4%"; implies approx. 2.5% in Q4 and 4% in Q3. Acquisition contribution expected to be approx. 4%. One new acquisition announced last week. The group has purchased CM Supply, a Danish company engaged in the supply of own brand and customized foodservice disposals which is expected to deliver DKK 37 million of revenue in 2018 (£4 million). Management says the pipeline for further acquisitions remains active. Management says trading is in line with its expectations, an implicit reiteration of full year consensus. The shares are trading on approx. 17x 2019 estimated Price to Earnings and approx.14x Enterprise Value/EBITA, with a 2.3% dividend yield and an approx. 6% FCF yield.

WPP PLC issued a press release ahead of their investor day last week "fundamentally repositioning WPP as a creative transformation company with a simpler offer that allows WPP to meet the present and future needs of clients". For 2018, the release states "we anticipate reporting full-year results in line with consensus expectations, with full-year like-for-like revenue less pass-through costs growth now expected to be closer to -0.5%." We currently forecast -0.6% organic for Fiscal Year 2018 estimates with headline EPS of 107.6 pence and company-compiled consensus was at -0.9% with headline EPS of 106.0 pence. For 2019, the release states "2019 will be a year of investment in the business with the execution of our cost-savings programme and further actions taken to return the company to long-term sustainable growth. Previously announced account losses will create the anticipated headwind, particularly in the first half of the year." We currently forecast -1.0% organic and company-compiled consensus is at -1.6%. WPP has announced their new medium-term financial targets to be achieved by the end of 2021 estimates: Organic growth (defined as like-for-like revenue less pass-through costs growth) in line with peers; Headline operating profit margin (excluding associates) of at least 15%; FCF conversion of 80%-90% including earn outs. "The company will incur cash costs for restructuring of £300 million over the next three years, reflecting actions to position the company for growth, address under-performing units and streamline our operations." "The annual savings from the actions are anticipated to be £275 million by the end of 2021. WPP will reinvest approximately half of these savings in 2019 to 2021." "As previously announced, the Board of WPP has decided to develop Kantar Group with a potential strategic or financial partner, with WPP retaining a significant minority interest and strategic links with Kantar. Proposals will be evaluated on their financial and strategic benefits and if a transaction is agreed it is likely to be announced in the second quarter of 2019. Preparations are well underway and we have received numerous unsolicited expressions of interest." WPP states: "The company has made good progress on its divestment of non-core assets, raising £704 million from 16 disposals to date. We continue to target a reduction in average net debt to EBITDA ratio to within our revised target range of 1.50-1.75x by 2021. Over the next three years we will prioritise the dividend over share buy-backs and will balance targeted mergers & acquisitions with divestments. The Board anticipates declaring a final dividend of 37.3 pence at the Preliminary Results to deliver a full-year dividend for the current financial year of 60 pence which it intends to maintain."

Economic Conditions

U.S. industrial production jumped 0.6% in November, tripling expectations and the biggest gain in three months but it was led by utilities (rebound from the hurricanes; output ex utilities was up 0.3%) and mining (record oil production). The key component, manufacturing, which accounts for about just under three-quarters of total production, was flat, held back by output of non-durables. (Note also that there were downward revisions to the prior two months.) The setback in business equipment is also disappointing. The manufacturing capacity utilization rate fell for the 2nd straight month, with the latest 76.3% reading the lowest since July.

U.S. Retail sales edged up 0.2% in November, which was a little above expected and the second increase in a row. The albeit-modest headline was held back by lower gasoline prices, which was expected. But core sales, which strip out autos, gas and building materials, jumped 0.9%, the most in one year! That in itself was solid but then, there was the big upward revision to the prior month (was 0.3%, now 0.7%). That is the best back-to-back reading in two years and suggests that consumer spending was stronger than expected in Q4.

U.S. inflation, as measured by the changes in consumer prices, moved lower to a 2.2% year/year rate of change in November, compared to October's 2.5% rate, mostly driven lower by lower energy prices. The core reading, which excludes the most volatile price series, including energy and food, also came in at 2.2%, as expected, though a tenth higher than October's 2.1% print.

Financial Conditions

The European Central Bank (ECB) started buying government bonds in March 2015, since then the monthly amounts have fluctuated but now, all of that is coming to an end. The ECB announced last week that, as of December 2018, its asset purchase program is coming to an end, the buying itself has concluded; the program is still in play. The ECB announced its interest rates were unchanged, staying at levels that they've been at since March 2016: Refi rate at 0.00%; Marginal lending facility at 0.25% and; Deposit facility at -0.40%. The ECB also maintained the rates guidance ….key rates will "remain at their present levels at least through the summer of 2019", or until inflation is sustained at close to 2%.

The U.S. 2-year/10-year treasury spread is now 0.16% and the U.K.'s 2-year/10-year treasury spread is 0.52% - 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 4.63% (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 23.01 (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.

And finally ....this will be our last newsletter this year .... and while clouds are gathering over a decade long equity bull run and young analysts need history books to learn about the Great Recession of 2007 to 2009.... we take comfort in knowing we live in a great country with a great diversity of talent and opportunity and **wish you all the very best** for the **coming festivities** and the **New Year**.

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

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