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IN THIS ISSUE

Mini Portfolio averaging over 10%	1
Panasonic is more than TV sets	2
Glenn Rogers updates Facebook, Barrick Gold, Crown Castle, Hertz Global Holdings	3
The changing dynamics of the car industry	5
Gavin Graham updates Genworth MI Canada	7

BUILDING WEALTH

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MINI PORTFOLIO AVERAGING OVER 10%

By Gordon Pape, Editor and Publisher

This mini-portfolio was launched in November 2012. It is designed for readers with a limited amount of money who want a better return than they could get from a GIC without taking on a lot of risk.

The idea came from two readers who held GICs that were up for renewal. They were unhappy with the rates that were quoted and were looking for other options. This low-risk portfolio was my solution to their dilemma.

However, I stressed at the time, and still do, that while there is not a lot of risk here, the portfolio is nowhere near as safe as GICs. They guarantee both principal and interest (this portfolio does not) and are covered by deposit insurance up to \$100,000. If absolute safety is what you want, stick with the GICs and forget about the extra return this portfolio offers.

Right now, you can find a five-year GIC that pays 3.1% at Oaken Financial. But, as I have explained to several inquiring readers, Home Capital owns Oaken. That company has been going through a major financial crisis and has seen its clients withdraw millions of dollars in a classic run-on-the-bank scenario. Even with deposit insurance in place, many people are obviously uncomfortable with Oaken right now and are voting by pulling out their money.

As always, you need to decide how much risk you are prepared to take on to receive a higher return. If the answer is "none", stick with GICs from the major banks and learn to live with their low rates (1.6% at Royal Bank for five years).

This mini portfolio includes three securities: the common stock of BCE Inc. and Scotiabank, plus the 5.75% convertible debentures from Firm Capital Mortgage Investment Corporation.

The portfolio was last reviewed in November, at which time it was showing an average annual compound rate of return of 10.3%. Here's a look at the components, based on closing prices on May 31.

BCE Inc. (TSX, NYSE: BCE). BCE shares have rallied since our last review, gaining \$3.16 in the six months. We received two dividends totaling \$1.40 per share during the period. The quarterly payout was increased by 5.1% to \$0.7174 (\$2.87 per year) at the start of the year.

Continued on page 2...

Mini portfolio – continued from page 1...

Bank of Nova Scotia (TSX, NYSE: BNS). Scotiabank reported good first-quarter earnings and the shares are up \$3.47 from the time of the last update. The company increased its dividend by \$0.02 per share in March to \$0.76 per quarter (\$3.04 per year). We received two dividends totaling \$1.50 per share for the period.

Firm Capital Mortgage 5.75% Convertible Debentures (TSX: FC.DB.A). The price of these debentures has held reasonably firm despite concerns about mortgage firms in the wake of the problems at Home Capital Group. These

debentures pay interest at the rate of 5.75% semi-annually, on April 30 and Oct. 31. We received a semi-annual interest payment of \$28.75 for each \$1,000 debenture at the end of April. We have 60 shares for the equivalent of six debentures so that amounted to a dividend of \$172.50.

We received interest of \$7.17 from the cash invested in a high-interest savings account with EQ Bank.

Here is how the Canadian Mini-Portfolio stood at the close on May 31.

IWB Canadian Mini Portfolio (a/o May 31/17)

Stock	Shares	Average Price	Book Value	Market Price	Market Value	Retained Income	Gain/Loss %
BCE	140	\$43.44	\$6,081.50	\$61.21	\$8,569.40	\$441.32	48.2
BNS	100	\$55.52	\$5,551.90	\$76.22	\$7,622.00	\$548.60	47.2
FC.DB.A	60	\$101.37	\$6,082.00	\$100.54	\$6,032.40	\$214.89	2.7
Interest			\$30.51		\$37.68		
Totals			\$17,745.91		\$22,261.48	\$1,204.81	32.2
Inception			\$14,984.55				56.6

Comments: The portfolio now has a total value of \$23,466.29 (market value plus retained income). That's up from \$22,172.82 at the time of the November update for gain of \$1,293.47 in the period. That's an advance of 5.8% in six months. Since the portfolio was created, we have gained 56.6%. The average annual compound rate of return is now 10.5%, far in excess of the return on even the most generous GIC.

Changes: Don't mess with success. The portfolio is doing well at present so we'll keep things as they are. We have a total of \$1,242.49 in cash, which we will keep in the EQ account. It is currently paying 2.3%.

I will review the portfolio again in November, on its fifth anniversary.

PANASONIC IS MORE THAN TV SETS

Contributing editor Glenn Rogers looks into the future this week to choose a company on the leading edge of new technology. Glenn is on the boards of Linksoul and Poler Inc. He has worked with private equity and venture groups on a variety of projects leading to successful exits for the investors. Glenn has worked in senior positions in both Canada and the U.S. and is a successful investor himself. He lives with his family in southern California. Here is his report.

Glenn Rogers writes:

Recently, one of our readers asked us about companies that are the leaders in disruptive technology so that he can prepare his portfolio for the next wave of innovation. He was thinking particularly of electric cars and other

related technologies and wanted to know which companies would be driving, no pun intended, development in that area.

There are some obvious choices like Tesla (NDQ: TSLA) and Nvidia (NDQ: NVDA), both of which I previously recommended. Nvidia has had a huge run we recommended it on May 8 when it was trading at US\$103.86. It closed Friday at \$143.64 for a gain of 38% in one month. But I digress.

In response to the reader's question, I started thinking about other companies that are active in future transportation and energy needs like General Electric (NYSE: GE) but in the end, I settled on a less obvious choice. That company is Panasonic (OTC: PCRFY).

Continued on page 3...

Panasonic – continued from page 2...

Most of us know Panasonic from their consumer products, such as televisions, audio equipment, kitchen appliances, air conditioning systems, washers and dryers etc. The company, which is based in Japan, also has a division that manufactures computers, projectors, SD memory cards, in-flight entertainment systems, and other related consumer facing businesses.

What got me thinking about Panasonic as a disruptive company was when I learned about their partnership with Tesla and the huge giga battery factory that has recently been completed outside of Reno, Nevada. This enormous facility will be producing batteries for not only the Model Three Teslas (which is the mass-market vehicle that will start shipping later this year) but also batteries for Tesla's Power Wall systems. These are designed to provide backup and off grid capabilities for homeowners and businesses and are often used as backup when solar energy systems are the primary power source.

Speaking of solar energy, Panasonic also joined forces with Tesla to begin solar panel production in Buffalo, New York. Panasonic is providing the financing while Tesla, through its subsidiary Solar City Corp., will be the chief customer and distributor of the final product.

Even without Tesla, Panasonic is a major producer of batteries and solar panels, which are used in other automotive and consumer applications as well as large storage battery products for industrial and consumer users. In addition to all this, Panasonic has a large division that focuses on semiconductors, advanced industrial sensors, lasers, polymer capacitors, and so on.

Last February, Panasonic appointed Tom Gebhardt as CEO of its North American operations. He had been the head of the company's Automotive Systems subsidiary previously. He's a very forward thinking manager, as this quote from the Tesla newsletter indicates.

"If the scenario says the car drives itself, it's similar to sitting in an airplane seat, because you're no longer actively driving," he said. "We see that as an evolution of the space that has infinite possibilities for us."

In short, the consumer products company that we thought we knew is actually a massive multifaceted industrial business with highly sophisticated product lines that will be at the forefront of many of the disruptive technologies that we will all be using in the years to come.

All that said is Panasonic a good investment? Here the picture is mixed. So far this year shares have gained 14% despite the fact that overall sales for the last four years have been flat to slightly down. The stock, which trades on the over-the-counter market in the U.S., hit a 12-month high of US\$13.40 on Friday. It closed the day at US\$13.35.

Management has done a good job of increasing operating profit despite the lack of top line growth. In fiscal 2017 (Panasonic has a year-end of March 31) the company generated an operating profit of ¥276.8 billion, up 3% over 2016. Sales were just over ¥\$7.3 trillion for a net profit of ¥\$172.4 million (¥100 = C\$1.22).

This coming year the company expects sales to increase by 6%, with a jump of 21% in operating profits as the forward-looking businesses they are investing in begin to make significant contributions to profits and revenue.

The stock pays semi-annual dividends, which totaled US\$0.22 per share in the past 12 months. Panasonic has a history of gradually increasing the payout over time. Recently, the research firm Nomura upgraded the stock and a predicted a 21% increase in the share price over the next year.

I like Japan these days and with Panasonic you get global exposure and broad participation in the technology and industrial systems that should do well over the next few years.

Action now: Buy with a target of US\$16.

GLENN ROGERS'S UPDATES

Facebook (NYSE: FB)

Originally recommended on Sept. 30/13 (#21335) at \$51.24. Closed Friday at \$153.61. (All figures in U.S. dollars.)

Background: This social media giant, which was founded in 2004, had over 1.28 billion daily active users as of March. The company also owns such popular websites and services as Instagram, Messenger, Oculus, and WhatsApp. The stock has a market cap of over \$440 billion.

Performance: We recommended the stock in September 2013 when it was trading at \$51.24. The last update was in August, at which time the shares were reiterated as a Buy at \$124.96. The stock has now almost tripled since the first recommendation.

Recent developments: Facebook reported a year-over-year increase of 49% in total revenue, to just over \$8

Continued on page 4...

Glenn Rogers's updates – continued from page 3...

billion in the first quarter. Of that, \$7.9 billion came from advertising, with mobile revenue accounting for 85% of that.

The operating margin improved from 37% to 41% and the company reported net earnings of \$3.1 billion (\$1.04 per share) compared to \$1.7 billion (\$0.60 per share) in the previous year. On a per share basis, that represented an improvement of 73%.

Founder and CEO Mark Zuckerberg was laconic in his comments, saying simply: "We had a good start to 2017."

Dividend: None. This is strictly a capital gains play.

Action now: Hold. This stock has been a home run and I see no reason to sell it now. Since the original recommendation, the company has acquired What's App, Instagram, and Oculus, and I'm sure they aren't done on the M&A front. Facebook has continued to grow its user base, although at slower pace given their enormous global footprint. I think this is a good core holding for any portfolio and I would use any pullbacks to add to your position.

Barrick Gold Corp. (TSX, NYSE: ABX)

Originally recommended on May 16/11 (#21119) at C\$43.62, US\$45.15. Closed Friday at C\$21.87, US\$16.20.

Background: Toronto-based Barrick is one of the world's largest gold miners. In 2016, the company produced 5.52 million ounces of gold at a cost of sales of \$798 per ounce, and all-in sustaining costs of \$730 per ounce. More than 75% of its gold production comes from the Americas region, including Argentina, Canada, Dominican Republic, Peru and the United States. The company also has mining operations and projects in Australia, Chile, Papua New Guinea, Saudi Arabia, and Zambia. At the end of 2016, Barrick had proven and probable gold reserves of 85.9 million ounces (two billion tonnes, grading 1.33 grams per tonne).

Performance: I last updated this stock in August 2013 when it was trading at C\$21.11, US\$20.07. Since then it has mostly traded sideways, not counting the lurch downward in 2015 when it traded as low as US\$8. The shares have since recovered somewhat.

Recent developments: The company reported first-quarter results on April 24 with net earnings of \$678 million and first quarter revenues of \$1.99 billion (note that Barrick reports in U.S. dollars, as do most major gold producers). That compared to a net loss of \$83 million in

the prior year. Some of this improvement can be attributed to impairment reversals and lower currency losses.

Adjusted net earnings were \$162 million versus \$127 million in the prior year. Not surprisingly, these net earnings reflect the higher prices of gold and copper, Barrick's other mainstay mineral. The company is also improving its balance sheet, reducing debt in the first quarter by \$170 million.

Barrick completed the sale of 50% of its mine in Argentina for \$960 million, the majority of which they will use for debt reduction.

The company will release its second-quarter results on July 26 and with gold prices continuing to strengthen we should see some upward momentum in the share price.

Dividend: The stock pays a small quarterly dividend of \$0.03 per share.

Action now: Hold.

Crown Castle International (NYSE: CCI)

Originally recommended on Oct. 26/15 (#21538) at \$85.32. Closed Friday at \$104.59. (All figures in U.S. dollars.)

Background: This company owns and operates cell towers and fiber optic systems throughout the United States and Puerto Rico.

Performance: I recommended this stock in October 2015 when it was trading at \$85.32. It was updated in October 2016 as a Buy at \$94.21. It closed Friday at \$104.59 for a gain of 22% from our original recommendation.

Recent developments: First-quarter results exceeded the high range of the company's guidance. Site rental revenue was up 7% to \$857 million and net income increased 148% to \$119 million.

"Given the expected substantial increase in mobile data demand over the coming years, we are excited about the opportunities for growth we see as a result of our position as a leading provider of wireless infrastructure in the U.S.," said CEO Jay Brown. "Our tower business continues to see steady levels of activity in the short term. Over the longer term, we believe there is an extended runway of growth driven by positive industry developments."

The company raised guidance for the remainder of this year, forecasting a profit of between \$427 million and \$477 million for the 12 months.

Continued on page 5...

Glenn Rogers's updates – continued from page 4...

The company also closed the acquisition of Fibernet and announced agreement to acquire Wilcon Holdings for \$600 million. Wilcon is a fiber services provider that owns approximately 1,900 route miles of fiber cable, primarily in Los Angeles and San Diego. The deal is expected to close in the third quarter of this year.

Dividend: The stock pays \$0.95 a quarter (\$3.80 a year), thanks to a 7% hike in the payout in December. The yield at the current price is 3.7%.

Action now: Hold. This is a good core holding that gives you exposure to the growing demand for wireless data.

Hertz Global Holdings (NYSE: HTZ)

Originally recommended on May 13/13 (#21319) at \$93.20 (split-adjusted). Closed Friday at \$10.08. (All figures in U.S. dollars.)

Background: This was originally recommended as a single company, but it is now two separate entities. Hertz Global Holdings is the car rental business (now called New Hertz) while Herc Holdings (NYSE: HRI) is the equipment rental operation.

Performance: This has been a nightmare stock. We last updated it as a Hold in August when it was trading at

\$50.58 and since then it has been straight down. The shares closed Friday at \$10.08 for a loss of 89% based on the split-adjusted original price.

Recent developments: The company's recent quarter showed a loss of \$67 million on sales of \$1.92 billion. On top of that, a spike in used car inventories has hurt resale prices, which means the company earns less from the sale of older models. Additionally, ride sharing services have stolen business faster than many people expected. All and all, Hertz is facing problems on every front.

Competitor Avis has had a similar fate. It wasn't supposed to be this way since mergers in the industry created an effective duopoly. Both companies were supposed to have better pricing power and reduced competition.

Some analysts think the stock could fall to zero while others still rank it a hold. Ironically Avis still has a buy rating.

Both companies have new senior management who are attempting to turn things around but it may be that secular changes in the economy are too large to overcome.

Action now: Sell. This is one of the companies that has become a victim of disruptive technology, sooner than anyone might have expected.

THE CHANGING DYNAMICS OF THE CAR INDUSTRY

By Vitaliy Katsenelson, CFA

Sprint, T-Mobile and Verizon are all fighting to best one another's iPhone offers. What is really amazing about the situation is that no matter how this war among wireless carriers plays out, there will be one clear winner — Apple. And in the end, the carriers will be collective losers — they'll be killing their margins to out-subsidize one another. They will be spending millions of dollars on advertising to get customers to come to their stores to buy — yes, Apple iPhones. If consumers choose Apple's iPhone Upgrade Program instead of the carriers', then Apple will win even bigger.

Another observation about Apple: Its brand extends far beyond technology and coolness. Over the years, the company has accumulated incredible goodwill with consumers. There is only one other company that comes to mind that has generated a similar amount of affection: Amazon.com. Amazon made shopping online

easy, its customer service is impeccable, and it is transparent with consumers about pricing. After all, it allows other merchants to sell their merchandise through its website. Amazon will even ship it for them. Consumers' trust in Amazon's pricing is so great that most people don't even bother with comparison shopping anymore; they skip Google (which is not good news for Google, by the way) and go directly to Amazon.

I recently found myself willing to pay a few dollars more on Amazon than on a competitor's website because I knew that if I needed to return the product, the process would be seamless. That goodwill turns Apple and Amazon into "platforms" (a very trendy word on Wall Street now), allowing them to launch a wide variety of new products.

Continued on page 6...

Car industry – continued from page 5...

When Apple comes out with the Apple car, it will be able to grab a disproportionately large market share from the General Motors of the world because of that deep well of goodwill. By the time my youngest child, Mia Sarah, who is almost two, learns to drive, internal combustion engines will likely be a relic consigned to museums (just like Ford's Model T).

I had an "aha!" moment when I recently visited a Tesla store and saw its cars' power train. It looks just like a skateboard — it basically consists of a flat slab of metal (which houses the battery), four wheels and an electric engine the size of a large watermelon. That's it — the Tesla has only 18 moving parts. I don't know how many moving parts an internal combustion engine (ICE) car has, but it must be hundreds if not thousands. Interestingly, ICE cars also have more electronics than a Tesla.

Wall Street is going gaga over the stocks of dealerships (especially after Warren Buffett's Berkshire Hathaway bought Van Tuyl Group) and carmakers. I am in the minority, but I think that party will come to an end. Just like Tesla, Apple is not going to be using a dealership model to sell its cars. It would not want the Apple car buying experience to be tainted by a sleazy car salesman. Just as with the iPhone, the company will want to have complete control of the buying experience.

If both Tesla and Apple bypass the dealership model, the GMs of the world will be at an even larger competitive disadvantage. They will have to abandon the dealership model too. Yes, I know, selling cars directly to consumers is not legal in many states, but if the U.S. Constitution could be amended 27 times, the law on car sales (which is an artifact of the Great Depression) can be amended as well. The traditional dealership model is unlikely to survive anyway, as its economics dramatically degrade in the electric-car world. A car that has very few moving parts and minimal electronics has few things to break. Consequently, electric cars will need less servicing, throttling the dealerships' most important profit center.

The baby boomer generation romanticizes cars. Most boomers can recite the horsepower and other engine specs of every car they have ever owned. For the tail end of Gen X (my generation) and Millennials, a car is an interruption between Facebook and Twitter. We know the brand of speakers in our car but if asked we would have to Google for its horsepower. We feel little

romanticism for our cars and have much higher brand loyalty to Apple and Google than to GM or Ford.

What is also amazing about electric cars is that they aren't that much different from smartphones. Smartphone prices have declined significantly over the years because their components became ubiquitous and commoditized. With the exception of spark plugs and tires, most components of a GM car will be different from the ones you'll find in a Ford. The opportunity for scaled manufacturing and so commoditization is very limited in the auto industry.

The simplicity of electric cars and the declining ambition of Tesla, Apple, and whoever else enters that space to be known as a "car" company will likely lead to commoditization of components and thus lower prices. Tesla today is more a software and battery company than a car company.

Think back to the day when Apple introduced the iPhone. No one suspected that it (and the smartphones that followed) would enable a service like Uber, which is busy putting cabdrivers worldwide out of business.

The unforeseen consequences of the advent of electric cars will reverberate much farther than the demise of dealerships and significant shifts in market share in the auto industry. Gasoline can only be made from oil. (Yes, there is ethanol, but the economics of ethanol in the U.S. are problematic.) Sources of electricity are diverse — natural gas, coal, nuclear, solar, wind, hydro, oil (and I'm sure I'm forgetting something). Seventy percent of oil goes into cars and trucks. Just imagine for a second the shifts in global political alliances if oil lost its luster. The U.S. might forget how to spell "Saudi Arabia," and the Middle East might start looking very different.

When the day comes that Apple makes its entrance into the auto industry, it will likely be successful and very disruptive. After all, it has the much-needed software know-how to design a car (it is already working with car companies on CarPlay, the iPhone-centered car infotainment system), it boasts a global network of stores, it has a deep well of goodwill with a billion fans globally, it possesses unlimited resources (\$150 billion of net cash and it generates \$50 billion of free cash flows a year), and its imagination has not been damaged by decades of producing cars with internal combustion engines.

Let me stress that last point. There is a very good

Continued on page 7...

Car industry – continued from page 6...

reason why Nokia, which at one time was the dominant cellphone manufacturer, failed to compete with Apple's iPhone. It had too much institutional knowledge. It had hundreds of engineers who tried to add IQ to a dumb phone. They were attempting to convert Symbian, a dumb phone operating system, into a smart phone operating system. Despite Apple showing Nokia how the smartphone should look, they couldn't see their product as a smartphone but rather just as the next iteration of a dumb phone.

General Motors' answer to Tesla was not any different from Nokia's response to the iPhone. GM came out with the Chevy Volt, which was really one of its internal combustion engine cars with an electric engine dumped

in. Unless an ICE car company creates a silo unit isolated from the rest of the operation, it will be very difficult if not impossible to get engineers who have designed ICE vehicles all their lives to suddenly change the paradigm of their thinking and turn into electric-car engineers.

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GAVIN GRAHAM'S UPDATES

Genworth MI Canada Inc. (TSX: MIC, OTC: GMICF)

Originally recommended by Irwin Michael on Aug. 9/10 (#20128) at C\$25.54, US\$24.85. Closed Friday at C\$31.49, US\$23.87.

Background: Genworth is the second-largest mortgage insurer in Canada for those borrowers who cannot make a 20% deposit when buying a home. Its policies guarantee 90% of the mortgage for the lender.

As house prices have risen, the government has tightened the conditions for mortgage insurance. In October 2016, Finance Minister Bill Morneau strengthened the rules so that borrowers who need mortgage insurance must use the posted Bank of Canada mortgage rate (4.64% at the time) rather than the actual rates available, many of which were at 2% or lower. Genworth estimated that one third of existing insured borrowers "would struggle to meet the new standards," and its share price fell 11% on the announcement.

Performance: Despite the contagion effect from Home Capital and the changes to mortgage insurance implemented last year, share price is off only 2% year to date.

Recent developments: At the beginning of May, Genworth announced that it expected the tighter rules would cause transactional mortgage insurance volumes, its core product, to fall between 15% and 25% this year. It also expected a significant decline in the value of new portfolio insurance.

However, Genworth said these declines would be offset by premium increases it introduced in March to offset the higher capital requirements. The high volumes of insurance it wrote between 2014 and 2016 would ensure that "its premiums earned in 2017 should be modestly higher." This is because Genworth books its premiums over a three-year period to smooth out its earnings and reflect credit losses, making its earnings fairly predictable. In fact, its loss ratio in the first quarter ended March 31 fell to 0.15 from 0.24 the previous year. It also announced that Home Capital mortgages represented only 1% of its total mortgages insured, and their delinquency rate was below that of Genworth's total portfolio of 0.21 at the end of December 2016.

For the first quarter of 2017, Genworth earned a net profit of \$106 million, up 21% from \$88 million the previous year. Earnings per share of \$1.17 were up 17%. Premiums written were \$167 million, up 9%, and its claims losses fell to \$26 million from \$37 million last year. Book value was \$39 a share, and the company remained rated BBB+ by S&P and A (stable) by Dominion Bond Ratings. As Genworth's CEO Stuart Levings always points out, the most important determinant of losses is the unemployment rate, which is declining, even in Alberta, which represents only 20% of Genworth's insurance portfolio.

Action now: Genworth remains a Buy for its cheap rating, strong balance sheet, and conservative financing.