

U p d a t e E d i t i o n

THE INCOME INVESTOR

Volume 16, Number 15

Issue #1815

August 16, 2018

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Next issue: August 30

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BROOKFIELD BUYS ENERCARE

By Gordon Pape, Editor and Publisher

One of our stock recommendations is being taken over and the net result is a big profit for Income Investor readers.

Enercare Inc. (TSX: ECI, OTC: CSUWF) is being bought out by Brookfield Infrastructure Limited Partnership (TSX: BIP.UN, NYSE: BIP) in a friendly deal valued at \$4.3 billion, including debt assumption. Brookfield is also one of our picks.

The price values Enercare at \$29 a share. That's a 53% premium over the stock's closing price on the day before the deal was made public.

Enercare was originally recommended in this newsletter in March 2016 at \$15.70, so readers who bought at that time will walk away with a capital gain of 85%.

Brookfield investors were less enthusiastic; the shares bounced up after the news was announced but then slipped back. Sam Pollock, CEO of Brookfield Infrastructure, said the partnership is acquiring "a high-quality business that has established a leadership position in North America".

He went on: "It benefits from stable, long-term cash flows through equipment rentals to a well-established customer base, and we see attractive opportunities to grow the business and continue to create value, leveraging Brookfield's significant presence in the utility, home building, and multi-residential sectors across Canada and the U.S."

Enercare provides water heaters, water treatment, furnaces, air conditioners, and other rental products to about 1.6 million customers in Canada and the U.S. It also offers plumbing services, protection plans, and related services.

Under the terms of the deal, investors can choose to receive all cash for their shares. However, Canadian residents also have the option to receive 0.5509 of an "exchangeable unit" for each Enercare share. These will be exchangeable on a one-for-one basis for a unit of Brookfield. This exchange option is capped at 15 million units. If more are requested, they will be allocated on a pro rata basis.

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The exchange option should be carefully considered by anyone who holds Enercare in a non-registered account. If you take cash, you will have to report your profit as a capital gain and be taxed accordingly. Accepting the exchange option instead will result in a tax-deferred rollover, which means no tax will be assessed until you sell your BIP units.

If your shares are in an RRSP, RRIF, or TFSA, taxation is not a concern. However, if you don't have a position in Brookfield Infrastructure you might want to consider an exchange. It's a top-class security and has been a recommendation of The Income Investor since September 2010.

The deal is subject to approval by a two-thirds vote of Enercare shareholders. That is not expected to be a

problem, giving the large premium being paid and the strong approval of the company's board. If all goes according to plan, the transaction should close in the fourth quarter.

Action now: Enercare shares are trading at close to the offer price, with fairly large volumes. I don't advise selling into the market and paying a sales commission. It is highly unlikely the deal will fall through, especially given the fact Enercare would have to pay a break fee of \$111 million if it should pull out. So, hold on to your shares and redeem them without paying a commission when the deal closes. Whether you choose cash or BIP shares will depend on your personal goals. Either way, you win.

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GORDON PAPE'S UPDATES

(Note: All prices are as of the close of trading on Aug. 10.)

The North West Company Inc. **(TSX: NWC, OTC: NWTUF)**

Type: Common stock

Trading symbols: NWC, NNWWF

Exchanges: TSX, Grey Market

Current price: C\$28.60, US\$22.94

Originally recommended: April 25/07 at C\$18.83, US\$16.65

Annual payout: \$1.28

Yield: 4.5%

Risk Rating: Moderate risk

Website: www.northwest.ca

Comments: This stock has been on a bit of a roller-coaster ride, dipping as low as \$26.50 in mid-March. However, the net result of all this movement is that the current price is virtually unchanged from the time of my last review in February. For an interest-sensitive stock, that's acceptable.

First-quarter results for fiscal 2019 (to April 30) saw sales drop by 4.1% (1.4% excluding the impact of foreign exchange) to \$465.7 million. That compared to \$485.8 million in the first quarter last year. The company said that store closures related to hurricanes in the Caribbean in the third quarter last year negatively impacted sales by approximately \$23.9 million.

Despite the decline in revenue, net earnings attributable to shareholders were \$17.8 million (\$0.36 per share, fully diluted) compared to \$0.17 per share last year.

One reason for the bottom line improvement was a decrease in the company's tax rate, which dropped income tax expense by \$1.8 million. The consolidated effective tax rate was 17% compared to 38% last year. The reduction in the U.S. federal corporate income tax rate from 35% to 21% effective Jan. 1 was also a factor in this as the company has operations in Alaska.

There was no change in the dividend, which has been stuck at \$0.32 per quarter since March of 2017.

Action now: Hold for yield.

Brookfield Infrastructure Limited Partnership (TSX: BIP.UN, NYSE: BIP)

Type: Limited partnership

Trading symbols: BIP.UN, BIP

Exchanges: TSX, NYSE

Current price: C\$53.39, US\$40.70

Originally recommended: Sept. 15/10 at C\$12.60, US\$12.25 (split-adjusted)

Annual payout: US\$1.88

Yield: 4.6%

Risk rating: Moderate

Website: www.brookfieldinfrastructure.com

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Comments: All the attention was focused on the Enercare takeover, but Brookfield also released its second-quarter results this month and they were quite good.

The partnership reported net income for the quarter of \$125 million (\$0.21 per unit) compared to loss of \$0.06 per unit in the prior year (Brookfield reports in U.S. dollars). Management said net income improved primarily due to organic growth and contributions from new investments made in the past 12 months.

Funds from operations (FFO) came in at \$294 million (\$0.75 per unit), down slightly from last year. Management said the results were impacted by the loss of income associated with the sale of assets and the time required to redeploy the proceeds into new investments.

The bottom line is that Brookfield is performing about as expected. The yield is attractive however I do not expect much in the way of capital gains for a while as this is an interest-sensitive security.

Action now: Hold.

Norbord Inc. (TSX, NYSE: OSB)

Type: Common stock

Trading symbol: OSB

Exchange: TSX, NYSE

Current price: C\$51.55, US\$39.27

Originally recommended: May 30/13 at C\$33.70, US\$31.94

Annual payout: \$2.40 (variable)

Yield: 4.7%

Risk Rating: Higher risk

Website: www.norbord.com

Comments: Norbord shareholder received a pleasant surprise earlier this month when the board approved a special stock dividend of \$4.50 for shareholders of record as of Sept. 1. Not surprisingly, the share price jumped on the news.

The announcement came after the company posted the best second-quarter results in its history with adjusted earnings of \$167 million (\$1.92 per share, fully diluted) compared to \$95 million (\$1.10 per share) in the same quarter last year. The company reports in U.S. currency.

Norbord manufactures oriented strand board (OSB), which is used in home construction. It is a cyclical company that is currently benefitting from high prices and strong demand for its products. CEO Peter Wijnbergen says that is expected to continue.

"Given the positive outlook for OSB demand in North America and Europe driven by continued growth in the construction and renovation of homes, as well as meaningful growth in industrial end-uses and export markets, Norbord is well positioned to continue to return excess capital to shareholders, including through share repurchases," he said.

But a word of warning. This is a boom or bust company. Right now, it is going through a boom phase. But as recently as March 2017 the quarterly dividend was only \$0.10 per share and the stock was trading at around the \$30 level. So, enjoy the ride for now but be prepared to sell at the first sign of a slowdown in home construction.

Action now: The stock is a Buy for aggressive investors. If you act before Sept. 1 you will receive the special dividend, but the share price will probably drop after that date to reflect the big payout.

Pembina Pipeline Corp. (TSX: PPL, NYSE: PBA)

Type: Common stock

Trading symbols: PPL, PBA

Exchanges: TSX, NYSE

Current price: C\$46.06, US\$35.12

Originally recommended: June 24/09 at C\$14.77

Annual payout: \$2.28

Yield: 4.95%

Risk rating: Moderate

Website: www.pembina.com

Comments: When I updated this stock in June, I rated it as a Buy with the comment that it looks to be the best choice in the pipeline sector at this time.

The company came through with strong second-quarter results that drove the price higher despite the headwind of higher interest rates.

All the numbers were impressive. Revenue came in at \$1.9 billion, up from \$1.2 billion in the same period of 2017. For the first six months of the fiscal year revenue was \$3.8 billion compared to \$2.6 billion the year before. The acquisition of Veresen last year was a major contributor to the revenue growth.

Earnings were \$246 million (\$0.43 per share), up from \$117 million (\$0.24 a share) on the second quarter of 2017. For the first six months, Pembina earned \$576 million (\$1.02 per share) compared to \$327 million (\$0.72 a share) the year before.

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"We are seeing strong customer demand for our services, leading to higher volumes and increased utilization in the Pipelines and Facilities Divisions, combined with rising commodity prices which drive solid performance in our Marketing business," said CEO Mick Dilger.

The monthly dividend was increased by a penny in May to \$0.19 per share (\$2.28 per year).

Action now: Pembina remains a Buy and is still the best choice in the pipeline sector.

YOUR QUESTIONS

Cash dilemma

Q – In your last issue of *Income Investor* you urged one to be cautious of the global mess being created by Trump and the impending stock market crash. My question/conundrum is this: is it worth incurring the capital gains to move to a cash/defensive position to avoid this coming market fall? – Barry D.

A – This is an excellent and timely question. I wish I could provide a definitive answer. But that would require clairvoyance, which I do not claim to have.

Here is what we know. This nine-year bull market is the second longest in history and won't run forever. Stock prices are high, and the risks of an all-out global trade war are rising, which will not be good for anyone's economic prospects. Many respected market analysts are warning that there is trouble ahead.

You have to make your own decisions in that context. Review your portfolio and determine how vulnerable it would be if we had a repeat of 2008. Would the potential loss be worse than the capital gain you would take on your profits?

I would never suggest selling everything, since we can't know how events will evolve, especially given the unpredictability of President Trump. But I do think that increasing cash reserves is not a bad idea at this point, especially for older people with a relatively short time horizon. – G.P.

High-yield bond funds

Q – I would like your current view on high yield bond funds/ETFs. Should I keep the ones I have or sell them? Should I buy more? I value your opinion. – Larry M.

A – High-yield bond funds invest in lower-rated securities that offer a higher coupon rate. They have been weak performers this year, which is not surprising in a period of rising interest rates. As of July 31, the average six-month return for all the funds/ETFs in this category was -0.34%. I don't expect it to improve any time soon.

That said, there are exceptions. The PHN High Yield Bond Fund is in the black so far this year and shows a one-year gain of 4.1% (D units) compared to an average of 1.3% for the category. The Purpose Strategic Yield Fund, which invests in international bonds, was up 6.8% over the year to July 31 (A units). And there are other good performers.

So, your buy/sell decision should not be based on how the category is doing but rather on how your own funds are performing as well as those you may be considering.

However, keep in mind that high-yield bonds are vulnerable in a recession because of their weak credit rating. If the economy looks like it is heading in that direction, it would be a signal to reduce your exposure. – G.P.

TORONTO MONEY SHOW

I will be speaking at the Toronto Money Show again this year, and I hope to meet some *Income Investor* readers while there. The date for my presentations is Friday, Sept. 14. Here is the schedule:

10.10 a.m. – Opening ceremonies. Topic: The Crystal Ball: Where Now for the Markets?

4.15 p.m. – Workshop. Topic: Picking Winners in Turbulent Times

6.15 p.m. – Panel discussion. Topic: Everything You Need to Know About the Markets.

Admission is free, but I strongly recommend that you register well in advance.

Go to <http://gordonpape.torontomoneyshow.com/> and click in the Attend Free button. – G.P.