EDISON

Canadian General Investments

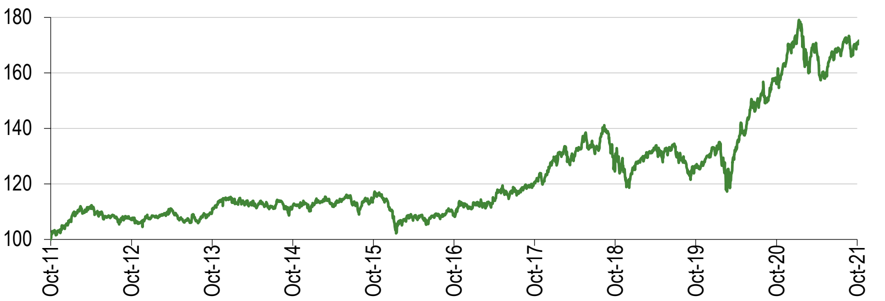
Very long-term record of outperformance

Investment companies
North American equities

15 November 2021

Canadian General Investments (CGI) has been managed by Greg Eckel at Morgan Meighen & Associates (MMA) since 2009. He has an unconstrained investment process, seeking quality companies on a bottom-up basis that can be held for the long term. This approach means that the fund's sector weightings can differ meaningfully from those of the benchmark S&P/TSX Composite Index. The manager invests across the market cap spectrum including niche smaller companies that may not be on everyone's radar screen; hence, CGI may be viewed as a 'one-stop shop' for investment in Canada, although up to 25% of the fund may be held in US equities. The company has an enviable long-term performance track record and pays regular quarterly dividends from both income and capital gains.

Long-term NAV outperformance versus the benchmark



Source: Refinitiv, Edison Investment Research

The analyst's view

MMA provides data which show that over the last 50 years to 31 December 2020, CGI's share price has delivered a total return of 12.0% pa, which is considerably ahead of the benchmark's 9.3% pa total return. Over the last decade to the end of October 2021, the fund's NAV and share price annualised total returns of 14.8% and 14.0% respectively compare with the benchmark's total return of 8.8% pa. While the manager takes account of the macro environment, CGI's successful track record is a result of prudent stock selection. The fund essentially offers a mix of blue-chip businesses and opportunistic investments; as an example, earlier this year, the manager participated in the successful initial public offering (IPO) of Neighbourly Pharmacy. Having the ability to make selected investments in the US, in businesses that are underrepresented in Canada, has proved beneficial such as top 10 holding NVIDIA Corporation, a designer and manufacturer of graphics chips.

Scope for a higher valuation

CGI's shares trade at a wide discount, which may be due to the high level of family ownership, and the fact that the board is unable to repurchase shares as this would invalidate the company's favourable tax status. The current 35.8% discount is wider than the 29.5% to 32.6% average discounts over the last one, three, five and 10 years. Given CGI's very strong performance track record, one may argue that a higher valuation is warranted, having traded close to NAV in 2006.

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Price		**C$41.00**
Market cap		**C$855m**
AUM		**C$1,508m**
NAV*		C$63.89
Discount to NAV		35.8%

*Including income. At 12 November 2021.

Yield		2.1%
Ordinary shares in issue		20.9m
Code/ISIN		CGI/CA1358251074
Primary exchange		TSX
Secondary exchange		LSE
AIC sector		North America
52-week high/low	C$41.43	C$30.00
NAV* high/low	C$63.89	C$44.52

*Including income

Gross gearing*	13.6%
Net gearing*	13.3%

*At 31 October 2021

Fund objective

Canadian General Investments' objective is to provide better-than-average returns to shareholders by investing in a diversified portfolio of primarily Canadian equities. It aims to achieve this through prudent security selection, timely recognition of capital gains/losses and appropriate use of income-generating instruments. CGI's performance is measured against the S&P/TSX Composite index.

Bull points

- Diversified portfolio of North American equities.
- Very long-term record of outperformance versus the benchmark.
- Rising regular quarterly dividends.

Bear points

- Discount remains consistently wide.
- High level of family ownership.
- Gearing will amplify capital losses during a market sell-off.

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Market outlook: Remain vigilant going into 2022

The Canadian stock market, along with many others across the world, has performed very strongly this year. The bellwether S&P/TSX Composite Index delivered a 23.4% total return in the 10 months to the end of October (Exhibit 1, left-hand side). A notable feature is the reversal of some relative sector fortunes compared with 2020. Last year, for example, energy was the weakest sector, declining by 26.6% on a total return basis, compared with a 5.6% index total return, while this year it is the standout performer with a 10-month total return of 53.2% (29.8pp ahead of the index's total return). Other cyclical sectors have performed well including real estate and financials as investors have gravitated towards those areas that are expected to benefit from economies reopening. However, investors should remain vigilant as while corporate earnings have generally exceeded consensus earnings expectations this year, the outlook for 2022 may not be as rosy.

Supply chain disruptions are leading to inflationary pressures which, if they persist, will likely lead to central banks in developed markets having to raise interest rates; base rates in some emerging economies are already increasing. Higher interest rates could particularly affect the valuations of highly valued growth stocks as it would reduce the present value of their future income streams.

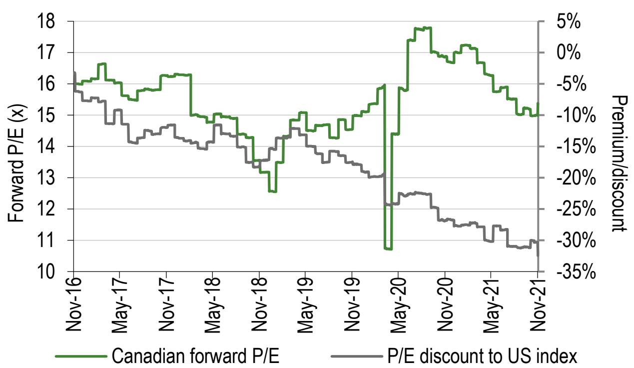
Looking at the graph below, in aggregate, Canadian equities remain relatively attractively valued, with the Datastream Canada Index trading on a 15.4x forward P/E multiple, which is a 32.4% discount to the Datastream US Index and wider than the 27.7% discount around six months ago (the five-year average discount is 18.2%). While investors may associate Canada with financial, energy and materials stocks, as shown in the table below, there are plenty of other opportunities available in the country, with the remaining eight sectors making up around 45% of the S&P/TSX Composite Index.

Exhibit 1: S&P/TSX Composite Index data and valuation

S&P/TSX Composite Index data (at 31 October 2021)

	Number of companies	Weight (%)	10M21 total return (%)	2020 total return (%)
Financials	28	31.8	31.2	1.7
Energy	23	13.5	53.2	(26.6)
Industrials	30	11.9	20.8	17.0
IT	15	11.4	25.1	80.7
Materials	55	11.3	(0.5)	21.2
Comm'n services	7	4.7	19.0	(3.7)
Utilities	16	4.4	6.5	15.3
Consumer staples	13	3.5	11.9	4.3
Cons. discretionary	13	3.4	9.8	17.1
Real estate	24	3.1	33.8	(8.7)
Healthcare	9	0.9	(7.6)	(23.0)
Index	**233**	**100.0**	**23.4**	**5.6**

Valuation of DS Canada index versus DS US index (last five years)



Source: Refinitiv, Bloomberg, Edison Investment Research. Note: Performance in Canadian dollar terms. Numbers subject to rounding.

The fund manager: Greg Eckel

The manager's view: Higher inflationary pressures

Eckel reports that while Canadian GDP growth remains in positive territory, there has been a reset of expectations as enthusiasm has waned following the reopening of the economy. While consensus 2021 GDP forecasts have been maintained, expectations for 2022 have, so far, been revised down from 4.0% to 3.8%. Global growth estimates are also coming down, in part due to a slowing Chinese economy, tight energy supplies in Europe and a worldwide shortage of semiconductors. Inflation in Canada is rising – the 4.4% rate reported for September 2021 was the highest since February 2003. It is above the Bank of Canada's upper target limit of 2.0%; however, inflationary pressures are expected to ease, hence the manager suggests that the Canadian authorities will let the economy run hotter until this materialises.

The Bank of Canada has already started to taper its bond purchases, so is 'ahead of the curve' compared with other developed nations, as it acknowledges that liquidity needs to be reined in. Both US and Canadian 10-year treasury yields have risen, and yield curves are flattening, indicating that expectations for higher short-term interest rates are rising. Eckel comments that interest rates need to normalise to ensure that asset bubbles do not continue to grow. He provides an interesting analogy: 'when you teach an infant to walk you hold its hands up to assist its mobility; however, support has to be removed otherwise the child will never walk on its own'.

The manager explains that in Canada, many of the COVID-related government programmes are expiring and there are questions about whether they will be renewed. He comments that the Canadian government employed a 'shotgun approach' during the pandemic, by very quickly rolling out support measures that were being adopted across the world. Despite this, Canada's finances remain in 'relatively good shape' as its net debt is the lowest within the G7 and one of the lowest in the G20. Prime Minister Trudeau was re-elected in the latest Federal election, but he is in a minority position so needs support from other political parties; hence, he may have to be generous in terms of the support programmes being provided.

Compared to other developed nations, Canada has been more conservative in terms of reopening its economy after its latest lockdown. The country is currently in 'Step 3', whereby some venues are back to 100% capacity, but proof of a double vaccine is required for customers to gain access. However, some restaurants are still operating at a reduced capacity, so there may be more ammunition to fuel economic growth once restrictions are eased further. Canadian provinces reopened their economies at different paces; those that were quicker than others have paid the price in terms of higher numbers of COVID cases such as in the conservative western Prairie region (Alberta, Manitoba and Saskatchewan).

The manager explains that the Canadian unemployment rate is improving, currently at 6.9% compared with a pre-pandemic low of 5.9%. Jobs have been added within the economy as evidenced by a higher participation rate, although Eckel says that the service sector remains under pressure. Economic growth in Canada, like in other regions, is being partially offset by higher energy prices and semiconductor shortages. The manager reports that some of the higher activity levels in the energy sector have not been evident for some time, although there are still transportation issues in terms of getting oil from the producing regions into the market.

Year to date in the Canadian stock market, the energy sector has been leading the way due to higher commodity prices for both oil and gas; a complete reversal compared with its significant underperformance in 2020. Eckel notes that the financial sector has also performed strongly. Returns have been concentrated with these two sectors making up c 70% of the S&P/TSX Composite Index's 2021 year to date gains. CGI is underweight both these sectors, but the manager says that since June/July there has been some reversion in sector performance. Eckel reiterates that the portfolio is constructed on a bottom-up basis, rather than by taking a view on the macro backdrop. He opines that it is 'extraordinary that CGI has kept up with the market this year given its sector weightings'. While there has been some market volatility in recent months, the manager says that both the US and Canadian stock markets are still 'grinding higher' as investors are climbing the 'wall of worry', which he considers to be encouraging. However, the manager acknowledges that there are market risks including higher interest rates, inflation and energy prices, and concerns about slowing growth and the property market in China. He says that the global economy is still growing but not at such an elevated rate as it was. Eckel suggests that stock markets can move higher, although 'choppiness is likely'. He notes that valuation multiples have come back a bit, which is positive and if energy and financial stocks continue to do well, it is supportive for further market gains given their weightings within the Canadian bellwether index.

Current portfolio positioning

At the end of October 2021, CGI's top 10 positions made up 38.1% of the fund, which was a lower concentration compared with 40.5% a year earlier; six positions were common to both periods. As shown in Exhibit 3, over the 12 months to the end of October 2021, there were modest changes in CGI's sector exposure, the largest being lower weightings in cash & equivalents (-3.9pp) and consumer discretionary (-3.8pp) with higher weightings in financials (+2.3pp) and energy (+2.1pp).

Compared with the benchmark, CGI retains a significant underweight position in financials (-21.3pp) with a large overweight in information technology (+16.6pp). Discussing the below-benchmark weighting in energy, Eckel believes that OPEC's control of the oil market could fall apart. He says that the 'stars are currently aligned' for the energy sector as there has been restricted capex and a change in sentiment as the major oil companies are now keener to return cash to shareholders; the manager is not sure if this will be sustained over the long term. He notes that the energy sector tends to be volatile, so he questions whether its strong performance will continue. Eckel is expecting a commodity surplus next year, so he thinks that the sector could pull back and within Canada, there are ongoing transportation issues due to a lack of pipeline capacity.

Exhibit 2: Top 10 holdings (at 31 October 2021)

			Portfolio weight %	
Company	**Country**	**Industry**	**31 October 2021**	**31 October 2020***
Shopify	Canada	Internet services	5.6	7.5
NVIDIA Corporation	US	Semiconductors	5.5	4.1
Lightspeed Commerce	Canada	Software	3.9	N/A
Canadian Pacific Railway	Canada	Railroads	3.8	4.4
First Quantum Minerals	Canada	Metals & mining	3.6	2.7
Franco-Nevada Corp	Canada	Gold mining	3.5	5.1
West Fraser Timber	Canada	Forest products	3.4	N/A
TFI International	Canada	Transport & logistics	3.3	N/A
Descartes Systems Group	Canada	Logistics software	2.8	2.8
WSP Global	Canada	Business services	2.7	N/A
Top 10 (% of portfolio)			**38.1**	**40.5**

Source: Canadian General Investments, Edison Investment Research. Note *N/A where not in end-September 2020 top 10.

Within railroads, which forms part of the industrials sector, both Canadian Pacific Railway and Canadian National Railway have bid for US-listed Kansas City Southern. Canadian Pacific appears to be the front runner, but the deal is still under regulatory review. CGI has positions in both of the Canadian railroads (together they represent c 5% of the fund).

Exhibit 3: Portfolio sector exposure vs benchmark (% unless stated)

	Portfolio end October 2021	Portfolio end October 2020	Change (pp)	Index weight	Active weight vs index (pp)	Fund weight/ index weight (x)
Information technology	28.0	27.3	0.7	11.4	16.6	2.5
Industrials	20.9	19.7	1.2	11.9	9.0	1.8
Materials	16.1	15.0	1.1	11.3	4.8	1.4
Consumer discretionary	10.9	14.7	(3.8)	3.4	7.5	3.2
Financials	10.5	8.2	2.3	31.8	(21.3)	0.3
Energy	6.2	4.1	2.1	13.5	(7.3)	0.5
Real estate	4.1	3.5	0.6	3.1	1.0	1.3
Communication services	1.8	2.3	(0.5)	4.7	(2.9)	0.4
Healthcare	1.2	1.0	0.2	0.9	0.3	1.3
Utilities	0.0	0.0	0.0	4.4	(4.4)	0.0
Consumer staples	0.0	0.0	0.0	3.5	(3.5)	0.0
Cash & cash equivalents	0.3	4.2	(3.9)	0.0	0.3	N/A
	100.0	**100.0**		**100.0**		

Source: Canadian General Investments, Edison Investment Research. Note: Numbers subject to rounding.

Eckel participated in the May 2021 IPO of **Neighbourly Pharmacy**, which is the number three operator in Canada behind Shoppers Drug Mart and Rexall (a division of US-listed McKesson). The Canadian pharmacy industry is fragmented, with the top two players having a combined 16% market share. Neighbourly has just a 2% share and operates different formats in smaller underserviced communities and clinics, with more of a focus on the pharmacy rather than the front end of the business. The manager believes that Neighbourly has a long growth runway, both organically and via acquisitions. Its CEO has been in place since 2018 and has a pedigree background as he came from Shoppers Drug Mart, which has a 12% number one market share. Neighbourly currently has around 170 stores and this number is increasing, leading to strong growth in revenues and EBITDA; its Q222 revenues rose by 54.0% and EBITDA by 51.5%. Acquiring independent pharmacies means there are opportunities for procurement and scale from a central platform, so the deals are accretive to Neighbourly's earnings. The company is seen as an acquiror of choice as those businesses that are taken over can continue with their day-to-day operations. Neighbourly's liquidity is limited as the majority of its shares are held by the original shareholders. However, there was a recent secondary issuance, which Eckel took advantage of to add to CGI's position. Neighbourly's share price has rallied by more than 95% since the IPO at C$17 per share; the manager comments that this company is 'a good fit for CGI' and he considers that it has an astute management team.

CGI has a new holding in **Copper Mountain Mining**, which is expanding its operating mine in British Columbia and there could also be an increased focus on its Australian operations. The company's earnings are highly leveraged to the copper price. Eckel has been disappointed by this position, which he describes as a 'base metal, late-cyclical trade', although Copper Mountain's share price has been performing better recently. The manager explains that a reduction in economic activity, higher interest rates and slowing growth in China has weighed on copper prices but they are now rebounding, which is positively feeding through to the company's share price.

Two other new holdings are Enerplus and Interfor. **Enerplus** is a Canada-listed energy firm with more than 60% of its production in the US Bakken shale region; overall production is split 61:39 between liquids and natural gas. Enerplus has refocused its centralised operations leading to greater cost benefits, while the company has a strong balance sheet and liquidity position, along with a robust free cash flow outlook.

Interfor is the largest Canadian pure-play lumber producer. Eckel explains that as a rule, on a seasonal basis, 'it pays to buy lumber stocks in the autumn as they tend to rally into the following April'. However, due to low levels of liquidity in Interfor's shares the manager has been 'buying a bit too early; nibbling away to build a position'. While the company is smaller than West Fraser Timber (also held in CGI's portfolio), it has a strong focus in the southeast US, which is enabling Interfor to participate in the US housing boom (c 80% of its revenues are generated in the US). Eckel reports that there has been volatility in both lumber and oriented strand board (OSB) prices, although these are now rebounding.

The manager sold CGI's residual position in **Methanex** due to his negative outlook for methanol pricing. Eckel explains that this had been a long-term holding in the portfolio, but Methanex's share price was not responding positively to higher oil prices as it had done historically, nor to the reopening of the economy. The manager suggests that this company is generally not a core holding for investors and its share price can be volatile. Eckel sold CGI's holding in **Canopy Growth** into the rally in cannabis stocks, which occurred due to an expectation that cannabis use in the US will be decriminalised, although the manager believes that this process will take time. He made money in Canopy Growth and since exiting the portfolio its share price has declined.

Eckel has taken some further profits in **Dollarama** to raise cash for other opportunities, such as adding to the holding in **Tourmaline Oil** to increase the fund's energy exposure. The manager says that Tourmaline is an important natural gas producer which complements CGI's higher oil exposure via the purchase of Enerplus. Tourmaline is a long-term holding in the portfolio and its share price has performed very strongly this year. Eckel comments that the company is the largest, easily traded gas stock in Canada, and is seen as a 'go-to' name.

Performance: Very long-term outperformance record

Exhibit 4: Five-year discrete performance data

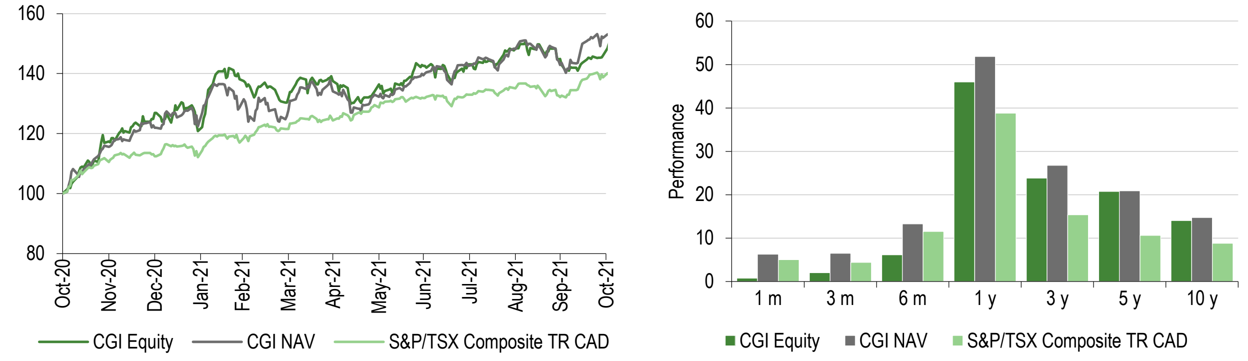
12 months ending	Share price (%)	NAV (%)	S&P/TSX Composite (%)	MSCI Canada (%)	MSCI World (%)
31/10/17	32.2	23.0	11.5	12.1	18.7
31/10/18	2.2	3.1	(3.4)	(3.4)	3.6
31/10/19	8.3	10.6	13.2	12.5	13.4
31/10/20	20.0	21.3	(2.3)	(3.9)	6.4
31/10/21	46.0	51.9	38.8	39.5	31.1

Source: Refinitiv. Note: All % on a total return basis in Canadian dollars.

CGI has a very long-term record of outperformance; data from MMA show that over the 25 years to the end of December 2020, the fund generated a total return of +11.3% pa versus the benchmark's +8.0% pa total return (with dividends reinvested, a C$10k investment would have grown to c C$147k). Over the 50 years to the end of 2020, the fund generated a total return of +12.0% pa, versus the benchmark's +9.3% pa total return (with dividends reinvested, a C$10k investment would have grown to more than C$2.9m).

Exhibit 5: Investment company performance to 31 October 2021

Price, NAV and benchmark total return performance, one-year rebased | **Price, NAV and benchmark total return performance (%)**



Source: Refinitiv, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

During H121 (ending 30 June), CGI's NAV and share price total returns of +14.3% and +12.3% respectively trailed the benchmark's +17.3% total return. The energy and financials stocks led the market and CGI has meaningful underweight exposures to both these sectors (Exhibit 3). Stocks that contributed positively to the company's performance in H121 included NVIDIA Corporation (graphics chips, share price +49.1%), TFI International (transport and logistics, +73.0%) and goeasy (financial services, +56.8%). Positions that detracted from CGI's performance included Xebec Adsorption (air purification equipment, -54.1%), Ballard Power Systems (fuel cells, -24.5%) and Methanex Corporation (methanol producer, -29.8%).

Exhibit 6: Share price and NAV total return performance, relative to indices (%)

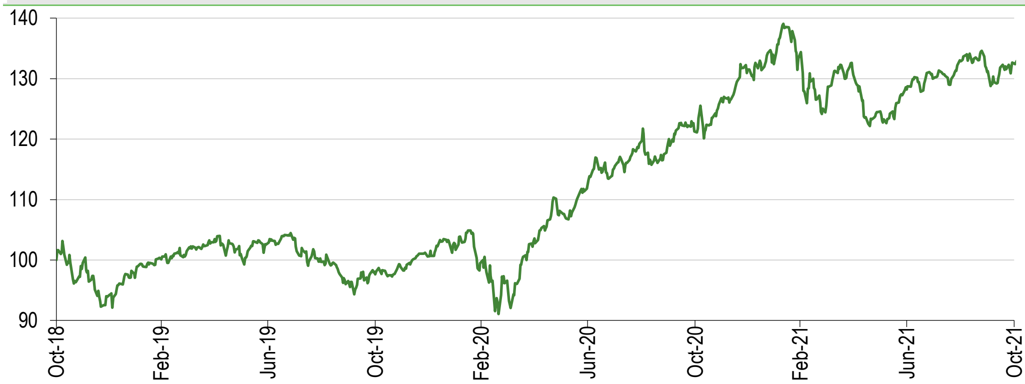
	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to S&P/TSX Composite	(4.1)	(2.3)	(4.8)	5.2	23.6	55.1	59.8
NAV relative to S&P/TSX Composite	1.2	2.1	1.6	9.4	32.7	56.3	70.9
Price relative to MSCI Canada	(4.4)	(2.3)	(5.0)	4.6	25.8	56.9	60.7
NAV relative to MSCI Canada	0.9	2.0	1.4	8.8	35.1	58.1	71.8
Price relative to MSCI World	(2.6)	(1.1)	(3.4)	11.3	19.8	31.6	(11.0)
NAV relative to MSCI World	2.8	3.2	3.1	15.8	28.7	32.6	(4.8)

Source: Refinitiv, Edison Investment Research. Note: Data to end-October 2021. Geometric calculation.

Exhibit 6 shows CGI's relative performance; the fund's NAV is ahead of the S&P/TSX Composite Index over all periods shown, while its share price is ahead over one, three, five and 10 years. In recent years, the fund has benefited from its US exposure, which is primarily in technology stocks. Eckel is very encouraged that CGI's NAV total return is ahead of the benchmark's total return in

2021 given the fund's significant underweight positions in financials and energy; these are the third and best performing sectors respectively in Canada this year. Although CGI has an above-index weighting in materials it is underweight gold stocks, which have been relatively weak. The fund only has one gold holding, and its share price is in positive territory in 2021. Eckel notes that the share prices of CGI's four copper producers have been disappointing, but he is confident in these companies' prospects, especially as some economies are yet to fully reopen post COVID-induced lockdowns. The manager highlights some of CGI's best-performing positions this year. He says that 'goeasy has been magnificent'; the position was initiated in November 2020 and, since then, the company's share price has doubled. Other positions that have performed well in 2021 include: BRP (a recreational products manufacturer), Brookfield Asset Management, TFI International (a logistics company), Tourmaline Oil and West Fraser Timber.

Exhibit 7: NAV total return performance relative to benchmark over three years



Source: Refinitiv, Edison Investment Research

Peer group comparison

Exhibit 8: Selected peer group at 12 November 2021 (C$)*

% unless stated	Market cap (C$m)	NAV TR one year	NAV TR three year	NAV TR five year	NAV TR 10 year	Discount (cum-fair)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
Canadian General Investments	855.3	44.4	103.5	165.1	294.7	(35.8)	1.4	No	113	2.1
Middlefield Canadian Income	208.5	42.7	43.8	51.5	131.1	(11.7)	1.3	No	118	4.2
Average	**531.9**	**43.6**	**73.6**	**108.3**	**212.9**	**(23.7)**	**1.4**		**115**	**3.1**
Fund rank in sector	**1**	**1**	**1**	**1**	**1**	**2**	**1**		**2**	**2**

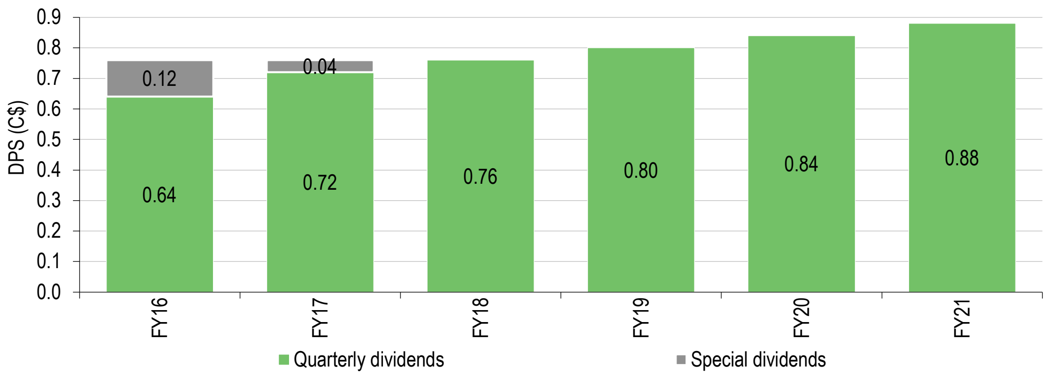
Source: Morningstar, Edison Investment Research. Note: *Performance to 11 November 2021 based on ex-par NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

There are just two funds in the AIC North America sector with significant Canadian exposure; CGI is around four times larger than its peer. The two companies follow different investment mandates – CGI has a total return focus, while Middlefield Canadian has an income bias. CGI's NAV total returns are higher over all periods shown, particularly over the last three, five and 10 years. The company has a lower level of gearing, its discount is considerably wider, perhaps reflecting its limited free float, it has a modestly higher fee structure and a lower dividend yield, which is unsurprising given its total return rather than income focus.

Dividends: Regular quarterly payments

CGI changed its dividend strategy, as since FY18 no special dividends have been paid. Regular quarterly dividends are paid in March, June, September and December. For FY21, a C$0.88 annual dividend has been declared, made up of two regular taxable dividends and two capital gains dividends (each quarterly payment was C$0.22 per share); it was 4.8% higher than C$0.84 in FY20. Eckel believes the strategy of gradually increasing CGI's annual dividend can continue given the company has more than C$900m in unrealised capital gains; only six out of CGI's 57 holdings have unrealised losses. He says that the board will make prudent decisions as they aim to at least maintain, and hopefully increase, the annual dividend. Based on its current share price, CGI offers a 2.1% dividend yield.

Exhibit 9: Dividend history since FY16



Source: Bloomberg, Edison Investment Research

Valuation: Discount wider than historical averages

Exhibit 10: Share price discount to NAV (including income) over three years (%)

Source: Refinitiv, Edison Investment Research

CGI's shares are currently trading at a 35.8% discount to NAV, which is towards the wider end of the 26.5% to 37.0% range of discounts over the last 12 months. It is wider than the 32.6%, 31.7%, 30.8% and 29.5% average discounts over the last one, three, five and 10 years respectively. Despite CGI's very long-term record of outperformance versus the benchmark, its shares continue to trade at a considerable discount, which may be due to the high (52.5%) level of family ownership. The board is unable to repurchase shares to help manage the discount as this would invalidate the company's favourable Canadian investment corporation tax status. There have been brief periods when CGI's shares traded at a premium to NAV; the last time was in 1998, while they traded very close to par in 2006, a period when CGI outperformed its benchmark and there was a commodities super-cycle and a rising oil price.

Fund profile: North American equity specialist

CGI was established in 1930 and is North America's second-oldest closed-end fund. It has been listed on the Toronto Stock Exchange since 1962 and has been listed on the London Stock

Exchange since 1995. MMA took over management of CGI in 1956; the firm has c C$3.0bn of assets under management for both private and institutional clients. Greg Eckel has managed CGI's portfolio since 2009, aiming to generate a better-than-average total return from a diversified portfolio of North American equities via prudent stock selection and timely recognition of capital gains and losses. While the majority of the fund is invested in Canadian companies, up to 25% (22.4% at end-September 2021) may be held in US-listed businesses. The manager has an unconstrained approach, within the remit that a maximum 35% of the portfolio may be held in a single sector, and invests without reference to the sector weightings of its benchmark, meaning CGI's performance may differ from that of the S&P/TSX Composite Index. Eckel has a medium- to long-term view, so some of the fund's holdings have been in the portfolio for many years.

The company is designated as an investment corporation under the Income Tax Act (Canada). This eliminates a layer of taxation, as capital gains are only taxed at the shareholder level, allowing them to be paid as dividends to shareholders. However, to maintain this favourable tax status, CGI is unable to repurchase its shares to help manage the share price discount to NAV. A maximum 25% of its gross revenue may come from interest income and at least 85% of gross revenue must be from Canadian sources.

Investment process: Bottom-up stock selection

Eckel's stock selection process is primarily bottom-up, although he does take the macro environment into account. The manager aims to generate an above-average total return for investors, seeking reasonably valued companies with favourable fundamentals and strong management teams; he also takes firms' economic social and governance credentials into account. While the majority of CGI's portfolio is invested in Canadian companies, up to 25% of the fund may be held in US equities, which are primarily in niche operations or business areas that are under-represented in the Canadian market. The broad exposures at the end of September 2021 were 77.3% Canada, 22.4% US and 0.3% cash/equivalents.

There are currently 57 holdings in the portfolio with a bias to large- and mid-sized stocks, some of which are higher yielding, such as the Canadian banks, helping to support CGI's own dividend payments. Eckel has a long-term focus; annualised portfolio turnover is running at c 8% versus the 2.3–21.5% five-year range. Over the last five years, turnover averaged 10.5% pa, implying a c 10-year average holding period; however, positions are reassessed regularly to ensure they are sized correctly and investment cases are still valid. The manager has a history of successively backing good management teams, who may change employers due to mergers and acquisitions.

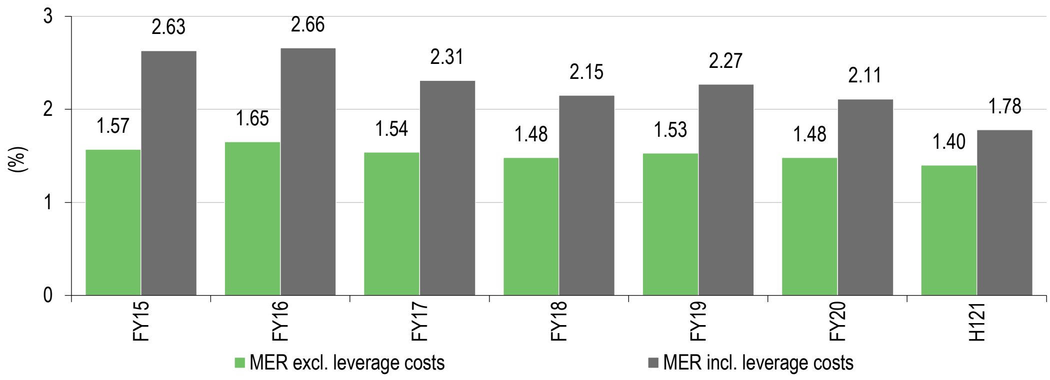
Gearing: Preference shares and margin borrowing

CGI has employed a leveraged strategy since its first issue of preference shares in 1998. Since then, its total return has averaged 6.96% per year above its cost of debt. The company has a C$100m margin borrowing facility via a prime brokerage services agreement with a Canadian chartered bank at an interest rate of the one-month Canadian dollar offer rate plus 0.6% pa. CGI also has C$75m of 3.75% cumulative, Series 4 preference shares, which are redeemable, at par, on or after 15 June 2023. The weighted average cost of its C$175m debt is c 2.2% and at end-October 2021, CGI's net gearing was 13.3%, which is relatively low versus history due to the increase in its NAV over the last year.

Fees and charges

MMA is paid a management fee that is calculated and paid monthly at 1.0% pa of the market value of CGI's investments, adjusted for cash, portfolio accounts receivable and portfolio accounts payable; no performance fee is payable. In H121, the annualised management expense ratio (MER) including leverage costs was 1.78%, which was 33bp lower compared with 2.11% in FY20. Excluding leverage costs, which make the MER more comparable with the ongoing charge figure used in the UK, in H121, it was 1.40%, which was 8bp lower than 1.48% in FY20.

Exhibit 11: MER since FY15

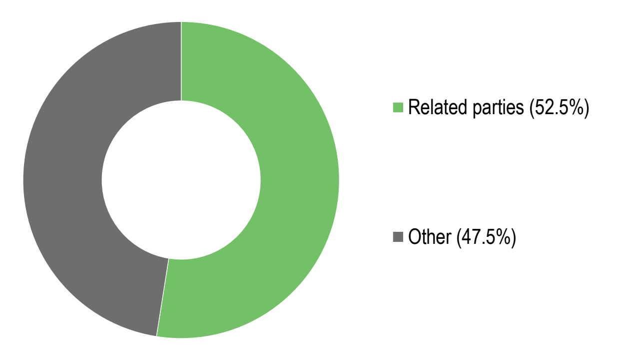


Source: Bloomberg, Edison Investment Research. Note: Leverage costs include preference share dividends, interest and financing charges.H121 figures are annualised.

Capital structure

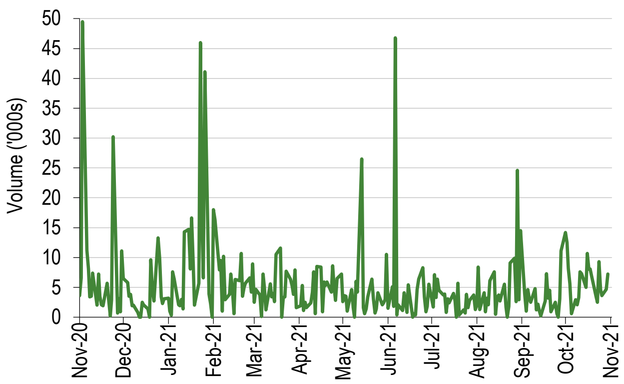
CGI has 20.9m ordinary shares in issue, 52.5% of which are directly or indirectly owned by two of the company's directors Jonathan Morgan and Vanessa Morgan. Hence, CGI has a free float of 9.9m shares (47.5% of the total) with these holders located as follows: Canada (c 50%), UK (c 30), Europe ex-UK (c 10%) and other (c 10%). The company has an average daily trading volume of c 5.6k shares on the Toronto Stock Exchange.

Exhibit 12: Major shareholders



Source: Bloomberg, at 30 September 2021

Exhibit 13: Average daily volume



Source: Refinitiv. Note: 12 months to 12 November 2021.

The board

CGI's board has three non-independent and four independent directors, who collectively have an average tenure of c 17 years. Vanessa Morgan is chair of CGI and president and CEO of MMA; she joined CGI's board in 1997. Jonathan Morgan, president and CEO of CGI, and executive vice-president and COO of MMA, joined the board in 2001. Michael Smedley is CGI's longest-serving director, having been appointed in 1989; he is executive vice-president and CIO of MMA. The four independent directors and their years of appointment are Neil Raymond (2002), James Billett (2005), Michelle Lally (2015) and Marcia Lewis Brown (2020).

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