Canadian General Investments

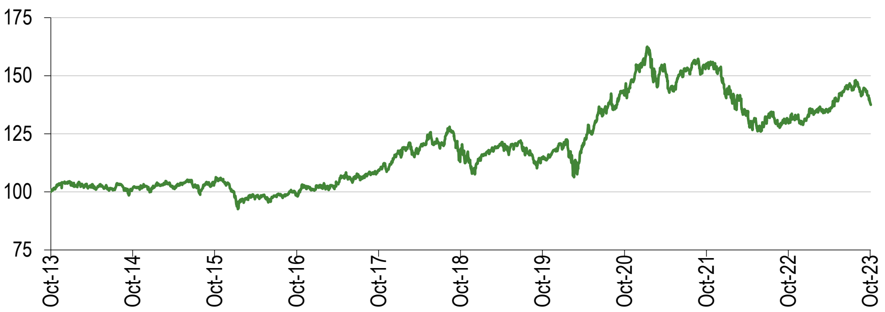
Outperformance from doing what it says on the tin

Investment companies
North American equities

8 November 2023

Canadian General Investments' (CGI's) manager Greg Eckel at Morgan Meighen & Associates (MMA) employs a steady, level-headed and patient approach to investing with low portfolio turnover. However, this strategy should not be underestimated as CGI has a very commendable long-term track record of outperformance. The manager is unconstrained by benchmark allocations and so far this year, CGI's performance has benefited from a meaningful above-market weighting in technology companies and a larger below-market allocation to financial stocks. Having had an underweight exposure to energy stocks for many years, Eckel has been added to the sector as he believes that the current favourable commodity supply/demand balance is sustainable, while strong cash generation is enabling increased return to shareholders.

Significant long-term NAV outperformance versus Canadian market



Source: Refinitiv, Edison Investment Research

Why consider CGI?

While 2022 was a difficult period for CGI's relative performance, primarily due to its sector positioning and a relatively high level of gearing, this should be put into context. A steady and patient investment approach has generated a 1.1pp annual share price outperformance over the last 25 years, and a greater 2.0pp annual outperformance over the last 50 years to the end of 2022 (source: MMA). Over the last decade to the end of October 2023, the fund has generated absolute annual NAV and share price total returns (TRs) of +10.2% and +10.4% respectively, compared with the benchmark's +6.7% annual TR.

Stock markets have been volatile this year during a period of rising interest rates and economic uncertainty. This has enabled Eckel to identify some new opportunities, at reasonable prices, which he is hoping to add to the portfolio. However, in keeping with his patient approach he is waiting until markets settle down before investing; he is mindful that during volatile periods often the best approach is to stick with what you already own.

CGI offers investors a broad Canadian exposure, while up to 25% of the fund may be invested in niche US businesses that are unavailable in Canada. It employs a progressive dividend policy, whereby the total dividend, of four regular interim payments, is on track for the sixth year of C$0.04 per share annual increases. Based on its current share price, CGI's dividend yield is 2.8%.

NOT INTENDED FOR PERSONS IN THE EEA

Price		**C$33.83**
Market cap		**C$706m**
Total assets		**C$1,277m**

NAV*		C$52.83
Discount to NAV		36.0%
*Including income. At 7 November 2023.		
Current yield		2.8%
Prospective yield		2.8%
Ordinary shares in issue		20.9m
Code/ISIN		CGI/CA1358251074
Primary exchange		TSX
Secondary exchange		LSE
Financial year end		31 December
AIC sector		North America
52-week high/low	C$36.92	C$31.30
NAV* high/low	C$57.61	C$47.68
*Including income		
Gross gearing*		16.6%
Net gearing*		16.2%
*At 31 October 2023.		

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.
- The relatively high level of gearing will amplify capital losses during a market sell-off.

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Edison profile page

Canadian General Investments is a research client of Edison Investment Research Limited

CGI: Canadian specialist with select US exposure

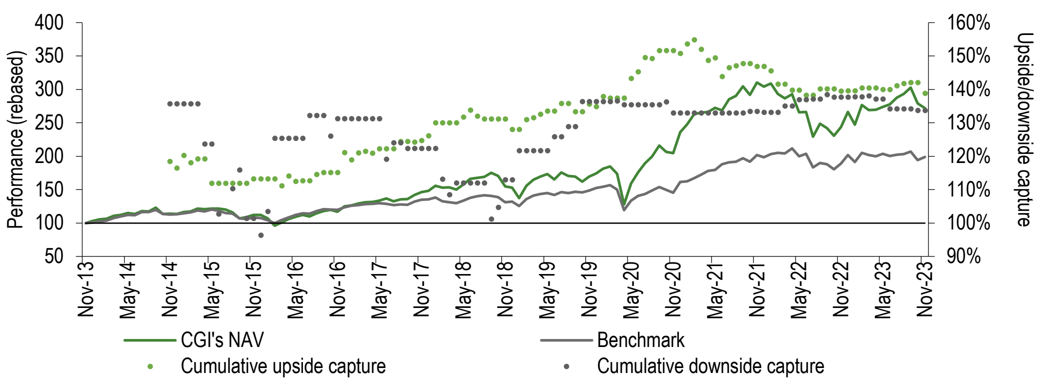
CGI has a very strong pedigree as the second oldest closed-end fund in North America. It offers investors a broad exposure to Canada, which is a country with favourable attributes, such as the highest International Monetary Fund 2024 growth estimate of the G7 nations, that can be overlooked by global investors. Also, up to 25% of the fund can be invested in US companies to enable the manager take advantage of opportunities that are not necessarily available in Canada.

The company has an admirable very long-term record of outperformance. Data from MMA show that over the 25 years to the end of December 2022, the fund generated a +8.1% annual TR versus the benchmark's +7.0% annual TR; with dividends reinvested, a C$10k investment in CGI would have grown to more than c C$70k. Over the 50 years to the end of 2022, the fund generated an +11.0% per year annual TR versus the benchmark's +9.0% annual TR; with dividends reinvested, a C$10k investment in CGI would have grown to more than c C$1.8m.

CGI's's upside/downside capture

Exhibit 1 shows CGI's upside/downside capture over the last 10 years. Its upside capture rate of 139% suggests that the company will outperform its benchmark in months when Canadian shares rise. CGI's downside capture rate of 134% means that the company is likely to underperform its benchmark in months when the Canadian market is weak, but to a moderately lesser degree. It is unsurprising that CGI does not move in line with its benchmark given the manager's unconstrained approach to investing as well as the company having a relatively high level of gearing.

Exhibit 1: CGI's upside/downside capture



Source: Refinitiv, Edison Investment Research. Note: Cumulative upside/downside capture calculated as the geometric average NAV total return (TR) of the fund during months with positive/negative reference index TRs, divided by the geometric average reference index TR during these months. A 100% upside/downside indicates that the fund's TR was in line with the reference index's during months with positive/negative returns. Data points for the initial 12 months have been omitted in the exhibit due to the limited number of observations used to calculate the cumulative upside/downside capture ratios.

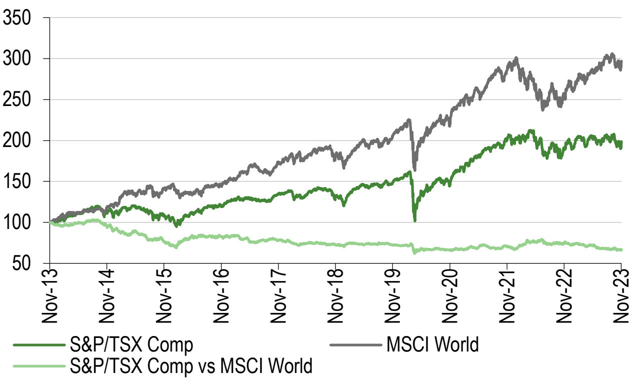
Market performance and valuation

Exhibit 2 (left-hand side chart) shows that over the last decade, the world market has outpaced the Canadian market. A large part of this is due to the very strong performance of US large-cap technology stocks in most of the last few years. This has increased the US's dominance in global indices to around 60–70% (depending on the specific index). Despite this, Canadian stocks have roughly doubled over the last decade, which represents an annual TR of more than 7%, which is higher than some other major asset classes such as bonds or cash.

Canadian stocks continue to look attractively valued as measured by Datastream indices (Exhibit 2, right-hand side chart). On a forward P/E basis in absolute terms they are c 30% and c 15% less expensive than US and global stocks respectively. The Canadian market is also trading at a more noticeable discount to its 10-year average (14%) than the US (which is trading at a small 1% premium) and world markets (5%). In terms of dividend yield, in aggregate, Canadian stocks offer double the return of US stocks.

Exhibit 2: Market performance and valuation

Performance of indices (C$ TR) last 10 years



Valuation metrics of Datastream indices (at 7 November 2023)

	Last	High	Low	10-year average	Last as % of 10-year average
Forward P/E (x)					
Canada	12.8	17.8	10.7	14.9	86
US	18.2	23.4	14.1	18.0	101
World	14.8	19.9	12.5	15.6	95
Dividend yield (%)					
Canada	3.2	4.7	2.4	2.9	110
US	1.6	2.7	1.2	1.9	84
World	2.4	3.4	1.8	2.4	100

Source: Refinitiv, Edison Investment Research

Drilling down into the Canadian stock market in more detail (Exhibit 3), the benefits of having a diversified portfolio are evidenced by looking at some of the sector performances over a multi-year period. Technology stocks performed very well during 2019 and 2020, and again this year. However, their fortunes were very different in 2022. Another sector with mixed results is energy, which jumped from the bottom of the pack in 2020, to the top in 2021, and it was pretty much 'the only game in town' in a declining market in 2022 due to the Russian invasion of Ukraine.

Investors may associate Canada with financial and commodity stocks; however, while the financial, energy and materials sectors in aggregate made up around 60% of the S&P/TSX Composite Index at the end of September 2023, these companies were just around 50% of the index names. Hence, there may be a broader range of opportunities available in Canada than generally perceived. It is interesting to note, for example, that the industrials sector is larger than the materials sector.

Exhibit 3: S&P/TSX Composite Index performance data (% unless stated)

Sector	2023 (to end Oct)	2022	2021	2020	2019	Number of cos	Index weight
Information technology	28.1	(52.0)	18.5	80.7	64.9	11	7.3
Energy	8.0	30.9	49.0	(26.6)	21.7	40	19.4
Consumer staples	7.7	10.1	22.4	4.3	14.4	11	4.5
Healthcare	1.4	(61.6)	(19.6)	(23.0)	(10.9)	4	0.3
Consumer discretionary	1.4	(6.0)	18.5	17.1	15.3	14	3.7
Industrials	0.6	1.5	16.5	17.0	25.5	26	13.5
Financials	(4.0)	(9.4)	36.6	1.7	21.4	28	29.7
Materials	(7.2)	1.8	4.1	21.2	23.9	52	11.5
Real estate	(9.2)	(21.5)	37.5	(8.7)	22.7	21	2.3
Communication services	(11.2)	(2.6)	24.7	(3.7)	13.0	5	3.8
Utilities	(11.5)	(10.6)	11.7	15.3	37.5	15	4.0
S&P TSX Composite	**0.1**	**(5.8)**	**25.2**	**5.6**	**22.9**	**227**	**100**

Source: Bloomberg. Note: Performance in Canadian dollar terms. At 31 October 2023.

The manager's view on the investment backdrop

Eckel comments that CGI's performance was negatively affected in recent weeks by market volatility due to negative investor sentiment on the realisation that interest rates will be higher for longer. He suggests there is a balancing act between higher interest rates and weaker economic growth, so the stock market is trying to find a footing.

The manager explains that compared with the US, Canadian households have higher debt loads, especially in mortgages, which have increased as house prices have skyrocketed. Mortgage structure terms in Canada are shorter than in the US; mortgage loans tend to be five years (either fixed or variable) and while variable rates have increased, fixed mortgages are now rolling over at higher interest rates. These higher rates are having a negative effect on the Canadian economy, whereas the US economy is looking more resilient.

Eckel believes that the Canadian base rate has either peaked or is close to the peak of the current interest rate cycle. Inflation has been persistent, although it has fluctuated since April 2023 and is apparent in multiple areas of the economy including labour and housing costs. The Bank of Canada has stated that interest rate decisions will be based on economic data, and the base rate has remained at 5.0% following the last three central bank meetings due to an awareness about household debt and the lagging negative impact that higher interest rates are having on the Canadian economy. According to the manager, sell-side economists are talking about peak interest rates, and they expect rates to start coming down in H124.

Discussing the start of the Q323 corporate earnings season, Eckel says that results have been mixed, but there is a clear trend of slowing economic activity. Supply chains have improved, and the labour market remains tight, but is getting better; however, there is negative sentiment at both the consumer and the business levels. Two portfolio companies, Shopify and Lightspeed Commerce, reported earnings after market hours on 1 November, and the following day their share prices both rallied by more than 20%. In contrast, Air Canada did not meet consensus expectations as the airline industry is facing economic headwinds.

The manager reports that he is working on some potential new names for the fund; however, for now, portfolio turnover is very low as there is too much 'noise' in the stock market. In periods of high volatility Eckel believes it is generally better to 'stick with what you know' and focus on those businesses that can navigate a choppy economic environment. Conditions in the housing market are getting more difficult, with developers holding off on new projects, and banks are extending loan terms to stop foreclosures and are increasing reserves; however, as there is so much loan-to-value in properties, the manager suggests that the risk of foreclosures for the banks is low.

Eckel opines that Canada could be experiencing a mild recession, but with the Canadian stock market performance considerably behind that of the US so far this year (0.1% versus 10.7% TR respectively at end-October 2023), any bad news is already priced in. The Canadian market is more interest rate sensitive, with financials making up 29.7% of the S&P/TSX Composite Index, compared with 12.8% for the US S&P 500 Index at the end of October 2023. Other notable sector differences are information technology (7.3% in Canada versus 28.1% in the US) and energy (19.4% in Canada versus 4.5% in the US).

Current portfolio positioning

At end-October 2023, CGI's top 10 positions made up 40.0% of the fund, which was a higher concentration compared with 37.5% 12 months earlier.

Exhibit 4: Top 10 holdings (at 31 October 2023)

Company	Country	Industry	Portfolio weight %	
			31 October 2023	31 October 2022*
NVIDIA Corporation	US	Semiconductors	7.1	N/A
Canadian Pacific Kansas City	Canada	Railroads	4.6	5.0
TFI International	Canada	Transport & logistics	4.4	3.7
Apple	US	Technology	4.0	3.8
Franco-Nevada Corp	Canada	Gold mining	4.0	4.2
WSP Global	Canada	Business services	3.5	3.4
Mastercard	US	Financial transaction processing	3.3	3.0
The Descartes Systems Group	Canada	Logistics software	3.3	3.2
West Fraser Timber	Canada	Forest products	3.2	4.5
Enerplus Corp	Canada	Oil & gas production	2.6	N/A
Top 10 (% of portfolio)			**40.0**	**37.5**

Source: CGI, Edison Investment Research. Note: *N/A where not in end-October 2022 top 10.

There were two companies that were not represented in both periods, one of which is the largest holding, NVIDIA Corporation. Its share price has performed very strongly, as the company has been a beneficiary of the high demand for semiconductors used in the development of artificial intelligence; at the time of writing, year-to-date, NVIDIA's shares had risen by c 220%. Eckel is mindful of the size of the NVIDIA position, as there is a 5% single holding soft limit in place, above which the manager must regularly discuss the position with the board; there is a hard 10% limit on a single holding.

Exhibit 5 shows CGI's sector breakdown. Over the 12 months to 31 October 2023, the largest changes were a 5.8pp increase in information technology, which is unsurprising given how well technology stocks have performed. There are more modest reductions in materials (-3.1pp) and financials (-1.7pp). The fund's largest active weights are unchanged, with a significant underweight in financials (-20.2pp) and a large overweight position in information technology (+16.0pp). The manager is not concerned about CGI's large information technology weighting given strong secular growth trends for many technology businesses.

Exhibit 5: Portfolio sector exposure versus benchmark (% unless stated)

	Portfolio end October 2023	Portfolio end October 2022	Change (pp)	Index weight	Active weight vs index (pp)	Fund weight/ index weight (x)
Information technology	23.3	17.5	5.8	7.3	16.0	3.2
Industrials	22.0	21.2	0.8	13.5	8.5	1.6
Energy	13.3	12.4	0.9	19.4	(6.1)	0.7
Materials	12.9	16.0	(3.1)	11.5	1.4	1.1
Consumer discretionary	11.7	12.3	(0.6)	3.7	8.0	3.2
Financials	9.5	11.2	(1.7)	29.7	(20.2)	0.3
Real estate	4.3	5.2	(0.9)	2.3	2.0	1.9
Communication services	1.8	2.3	(0.5)	3.8	(2.0)	0.5
Healthcare	0.8	1.1	(0.3)	0.3	0.5	2.7
Consumer staples	0.0	0.0	0.0	4.5	(4.5)	0.0
Utilities	0.0	0.0	0.0	4.0	(4.0)	0.0
Cash & cash equivalents	0.4	0.8	(0.4)	0.0	0.4	N/A
	100.0	**100.0**		**100.0**		

Source: CGI, Edison Investment Research. Note: Numbers subject to rounding.

Recent portfolio activity

CGI has a relatively new position in ATS Corporation, which provides automation systems around the world. The company has 50 manufacturing facilities across the globe and most its revenues are generated in North America (c 50%) and Europe (c 40%). ATS has an attractive growth profile and should be a beneficiary of changing supply chains, which are moving away from global towards 'onshoring' and 'friendshoring' strategies (sourcing locally or from allied countries). The company should also benefit from the ongoing trend of higher levels of automation as businesses seek ways to increase efficiencies in a tight labour market. ATS is shifting from lower- to higher-margin businesses (such as pharma and EV batteries), has record backlogs and there is potential upside from mergers and acquisitions to fill gaps in the company's technology. A new management team in recent years is having a positive impact on ATS's performance, while a new listing in the US could increase the company's appeal to a broader range of investors.

Having had an underweight position for many years, Eckel has been adding to the energy sector (increasing CGI's Canadian Natural Resources and Precision Drilling Corp positions) as he believes there is increased sustainability of a stable supply/demand balance. He explains that energy companies are being disciplined with regards to capex so there is a lack of major supply additions, coupled with stable demand. Despite the move to renewable sources, the manager believes that carbon-based energy production will be in place for a long time. He adds that energy company valuation metrics are favourable and global investors are underweight the energy sector. Eckel notes that strong cash flow generation is enabling cash returns to shareholders; for example, Tourmaline Oil has just announced another special dividend. The manager prefers companies to pay out their excess cash as dividends rather than returning cash via share repurchases.

Eckel has taken some profits in the forest products sector by reducing the West Fraser Timber position, as new housing activity has been weak. However, he adds that there tends to be a seasonal trade in timber, so he will continue to hold the stock. The manager trimmed CGI's StorageVault Canada position due to its interest rate sensitivity.

Performance: Positive trend is gaining momentum

CGI is a member of the AIC North America sector. It is significantly larger than Middlefield Canadian Income (ticker: MCT), which is the only other Canadian fund in the peer group. Considering the whole sector, where the data are presented in sterling, CGI's NAV TRs are above average over the last 12 months and five years, ranking third out of seven funds in both periods, and also over the last decade, ranking second out of five funds. The sector's five-year numbers are skewed by the outsized performance of Pershing Square. At 7 November 2023, CGI had the widest discount in a group where no fund was trading at a premium. It has the second-highest ongoing charge and the second highest level of net gearing; close peer MCT has the highest. CGI's dividend yield is in line with the sector average despite its focus on TR rather than income.

Comparing CGI with MCT, the funds follow different strategies; as its name suggests, MCT has an income bias and therefore a higher dividend yield. Both companies generally have an allocation to US equities, but currently MCT has no US stocks in its portfolio. CGI has superior NAV TRs over one, five and 10 years by a considerable margin. Its discount is much wider than MCT's, which is perhaps due to its limited free float, and CGI has a slightly higher fee structure.

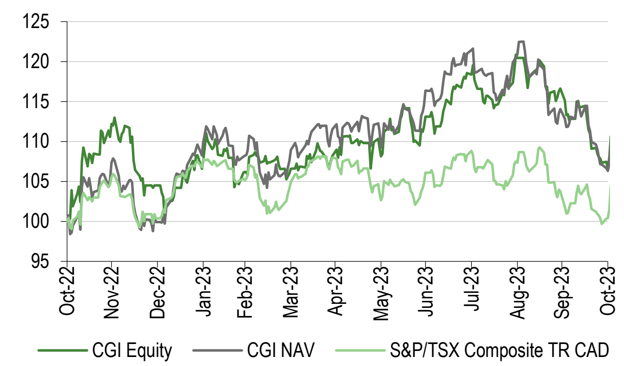
Exhibit 6: AIC North America sector at 7 November 2023 (£)*

% unless stated	Market cap (£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	419.3	0.7	26.5	78.5	170.4	(36.0)	1.4	No	116	2.8
Baillie Gifford US Growth	438.8	(2.9)	(30.0)	64.0		(20.4)	0.7	No	106	0.0
BlackRock Sustainable Amer Inc	143.2	(5.0)	36.1	40.9	156.8	(8.3)	1.0	No	100	4.4
JPMorgan American	1,444.2	8.7	43.9	83.4	284.8	(3.4)	0.4	No	103	0.9
Middlefield Canadian Income	99.4	(13.0)	41.6	32.5	73.3	(17.6)	1.3	No	122	5.5
North American Income Trust	368.0	(8.2)	37.9	26.1	147.2	(12.9)	0.9	No	109	4.2
Pershing Square Holdings	5,563.8	1.6	57.1	221.3		(34.0)	1.6	Yes	103	1.4
Simple average (7 funds)	**1,211.0**	**(2.6)**	**30.4**	**78.1**	**166.5**	**(18.9)**	**1.0**		**108**	**2.8**
Fund rank in sector	**4**	**3**	**6**	**3**	**2**	**7**	**2**		**2**	**4**

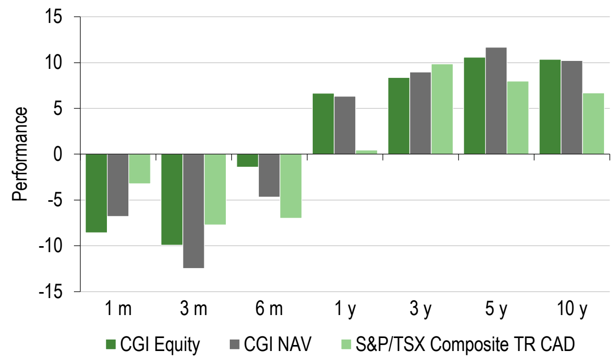
Source: Morningstar, Edison Investment Research. Note: *Performance to 6 November 2023 based on ex-par NAV. TR, total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

Exhibit 7: Investment company performance to 31 October 2023

Price, NAV and benchmark TR performance, one-year rebased



Price, NAV and benchmark TR performance (%)



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

CGI's solid record of outperformance is shown in Exhibit 8. It is ahead of the S&P/TSX Composite Index over one, five and 10 years in both NAV and price terms The 10-year results are particularly notable, including the relatively modest underperformance versus the MSCI World Index over the last decade, despite the strong performance of the US market, which dominates this index (c 70% at end-October 2023).

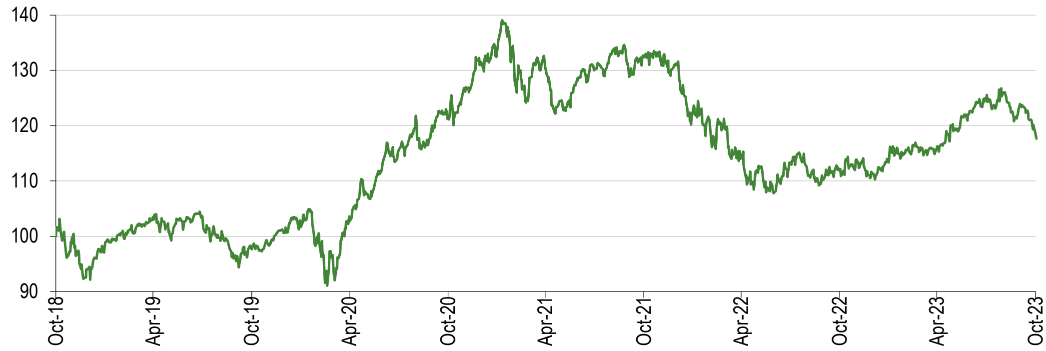
Exhibit 8: Share price and NAV TR performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to S&P/TSX Composite	(5.5)	(2.4)	6.0	6.2	(4.0)	12.8	40.2
NAV relative to S&P/TSX Composite	(3.7)	(5.1)	2.5	5.9	(2.4)	18.4	38.3
Price relative to MSCI Canada	(5.7)	(2.8)	5.2	5.2	(5.7)	13.3	39.2
NAV relative to MSCI Canada	(3.9)	(5.6)	1.7	4.9	(4.2)	18.9	37.3
Price relative to MSCI World	(8.3)	(5.9)	(2.4)	(5.6)	(4.7)	2.6	(7.7)
NAV relative to MSCI World	(6.5)	(8.6)	(5.6)	(5.9)	(3.1)	7.6	(8.9)

Source: Refinitiv, Edison Investment Research. Note: Data to end October 2023. Geometric calculation.

Discussing CGI's performance this year, Eckel notes that there have been some stocks in the portfolio that have bounced back from underperformance in 2022. These include: Parex Resources and Tourmaline Oil (both oil & gas production); Boyd Group Services (commercial services); FirstService Corp (real estate); and WSP Global (construction & engineering). Stocks that have performed less well include Rogers Communications, and the banks, which are interest rate sensitive, while recession concerns have a had a negative impact on the share prices of industrial companies, including the railroads.

Exhibit 9: NAV TR performance relative to benchmark over five years



Source: Refinitiv, Edison Investment Research

Exhibit 10: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	S&P/TSX Composite (%)	MSCI Canada (%)	MSCI World (%)
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
31/10/22	(18.2)	(19.8)	(4.9)	(4.5)	(9.9)
31/10/23	6.7	6.3	0.4	1.4	13.0

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

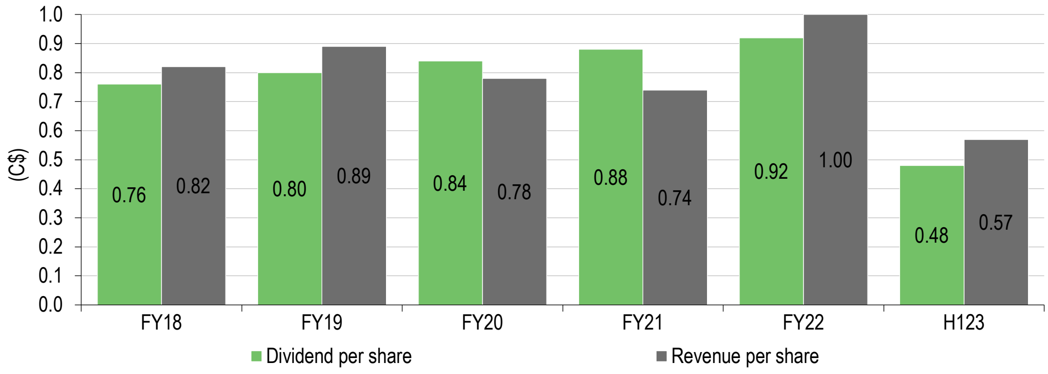
Dividends: Increasing by C$0.04 each year

CGI pays regular quarterly dividends in March, June, September and December. The company historically also distributed special dividends, but none have been paid since FY17. In FY22, the annual dividend of C$0.92 per share (four regular taxable dividends of C$0.23 per share) was 4.5% higher year-on-year (C$0.88 made up of two regular taxable dividends and two capital gains dividends of C$0.22 per share). There was a notable 35.1% increase in CGI's revenue per share in FY22. This was helped by large special distributions from Tourmaline Oil Corp and Economic Investment Trust, along with general dividend increases.

In H123, CGI's revenue per share of C$0.57 was 18.8% higher year-on-year, helped by special distributions from Tourmaline Oil Corp and Constellation Software, and general dividend increases.

Four quarterly dividends of C$0.24 have been announced in respect of FY23 (three regular taxable dividends and one capital gains dividend). In total they are 4.3% higher than the FY22 distribution. The manager considers that given the company's high level of unrealised gains (c C$0.7bn), the strategy of rising annual dividends is sustainable.

Exhibit 11: Dividend history since FY18



Source: Bloomberg, Edison Investment Research

Valuation: Wider than historical averages

Investment companies in general have wider-than-average discounts reflecting elevated investor aversion in an uncertain economic environment. CGI has the added consideration that it is unable to repurchase shares to help manage its discount as this would invalidate the company's favourable Canadian investment corporation tax status.

The latest 36.0% discount is at the wider end of the 30.5% to 38.4% (decade-high) range over the last 12 months. It is also wider than the 35.6%, 32.8%, 32.2% and 30.5% average discounts over the last one, three, five and 10 years, respectively.

Exhibit 12: Share price discount to NAV (including income) over three years (%)

Source: Refinitiv, Edison Investment Research

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 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. Eckel has managed CGI's portfolio since 2009, aiming to generate a better-than-average TR from a diversified portfolio of North American equities via prudent stock selection and timely recognition of capital gains and losses. While most of the fund is invested in Canadian companies, up to 25% 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 he invests without reference to the sector weightings of its benchmark, meaning CGI's performance may differ meaningfully 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 macroeconomic environment into account. The manager aims to generate an above-average TR 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 most 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 October 2023 were 76% Canada, 24% US.

There are currently 57 holdings in the portfolio with a bias to large- and mid-sized stocks. Some of these are higher yielding, such as the Canadian banks, helping to support CGI's own dividend payments. Eckel has a long-term focus; over the last five financial years, portfolio turnover has averaged c 5.7% pa (range of 2.1% in FY22 to 10.14% in FY20), which implies a c 17-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 that may move companies due to mergers and acquisitions.

Gearing: Bank debt only, no preference shares

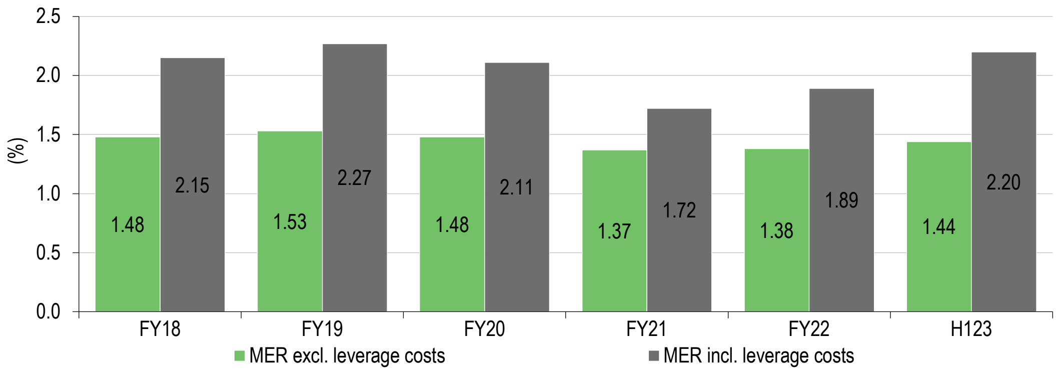
CGI has employed a leveraged strategy since its first issue of preference shares in 1998. Since then, to end October 2023, its TR has averaged 6.10% per year above its cost of debt. Its C$75m 3.75% cumulative Series 4 preference shares were redeemed in June 2023, and for economic reasons, the company increased the amount borrowed under its margin facility rather than issue new preference shares. CGI has a margin borrowing facility via a prime brokerage services agreement with a Canadian chartered bank, at a one-month Canadian dollar offer interest rate plus 0.6% per year. During H123, the amount borrowed ranged from C$75m, which was before the preference shares were redeemed, to C$175m.

The manager is happy to run a relatively high level of gearing, aiming to make a meaningful positive impact on CGI's TR in a rising market, although he is mindful of the opposite effect during periods of stock price weakness. At the end of October 2023, net gearing was 16.2%.

Fees and charges

MMA is paid a management fee that is calculated and paid monthly at 1.0% per year of the market value of CGI's investments, adjusted for cash, portfolio accounts receivable and portfolio accounts payable; no performance fee is payable. In H123, the annualised management expense ratio (MER) including leverage costs was 2.20%, which was 31bp higher than in FY22. Excluding leverage costs, which makes the MER more comparable with the ongoing charge figure used in the UK, in H123 it was 1.44%, which was 6bp higher than 1.38% in FY22.

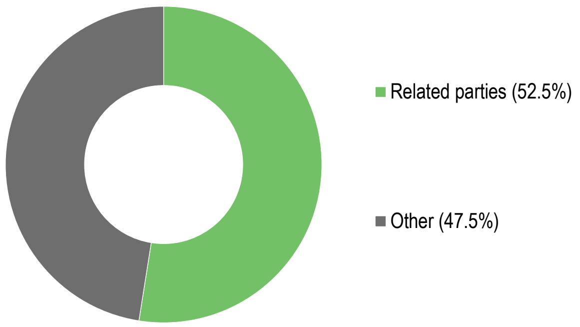
Exhibit 13: Management expense ratio since FY18



Source: CGI, Edison Investment Research. Note: Leverage costs include preference share dividends, interest and financing charges.

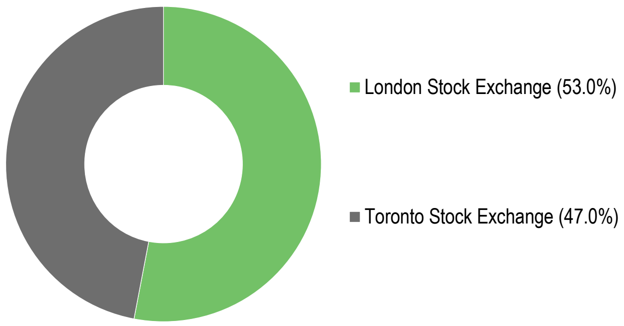
Capital structure

Exhibit 14: Major shareholders



Source: CGI. Note: At 31 October 2023.

Exhibit 15: Average daily volumes



Source: Bloomberg. Note: 12 months to 7 November 2023.

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 split broadly 35:65 between Canada and international. Over the last 12 months, the company had an average daily trading volume of c 3.6k shares on the London Stock Exchange and c 3.2k shares on the Toronto Stock Exchange.

The board

CGI's board has two non-independent and five independent directors, who with the addition of two new directors in 2023 now collectively have an average tenure of c 11 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. The five independent directors and their years of appointment are James Billett (2005), Michelle Lally (2015), Marcia Lewis Brown (2020), Michael Walke (2023) and Sanjay Nakra (2023).

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