Canadian General Investments

Long-term record of outperformance

Investment companies

Canadian General Investments (CGI) is a Canadian investment corporation, providing investors with a broad exposure to primarily Canadian, but also selected US, equities. Manager Greg Eckel suggests the company may be considered a 'one-stop shop' for investment in Canada. CGI has a positive investment track record; it has outperformed its benchmark S&P/TSX Composite index over one, three, five and 10 years, and over much longer time periods. More recent performance has benefited from a repositioning of the portfolio at the beginning of 2016, which included increasing the materials exposure. Total annual distributions have remained stable for the last six years, but the manager is hopeful that annual dividends can increase in the future. CGI has a dividend yield of 3.4% (including a 4c special dividend).

12 months ending	Share price (%)	NAV (%)	S&P/TSX Composite (%)	MSCI Canada (%)	FTSE World (%)
31/03/14	17.7	19.8	16.0	16.4	28.4
31/03/15	19.7	8.7	6.9	8.5	21.4
31/03/16	(9.6)	(12.0)	(6.6)	(7.6)	(1.1)
31/03/17	20.6	24.1	18.6	19.2	19.2
31/03/18	16.5	16.3	1.7	2.1	11.2

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

Investment strategy: Unconstrained and bottom up

CGI is managed by Greg Eckel, who selects stocks on bottom-up basis, seeking companies with positive fundamentals and strong management teams trading on reasonable valuations. The manager is unconstrained by the benchmark's sector allocations and invests with a long-term focus. At end-March 2018, on a geographic basis CGI's portfolio was split broadly 80:20 between Canadian and US equities. Taking 0.6% cash and equivalents into account, net gearing was 17.4%; gearing is made up of C$75m Series 4, 3.75% preference shares and C$75m bank debt.

Market outlook: Canadian stocks relatively attractive

Higher levels of global stock market volatility so far in 2018, compared to benign levels in 2017, meant the majority of sectors in Canada generated negative total returns in Q118. This may have created attractive investment opportunities, particularly as Canadian equities are relatively inexpensive compared with US equities. They are trading at a 14.5% discount on a forward P/E multiple basis, which is considerably wider than the 10-year average discount of 3.5%.

Valuation: Discount similar to historical averages

CGI's current 30.1% discount to NAV is broadly similar to the averages of the last one, three and five years (range of 28.1% to 28.8%). The wide discount may be a result of the company's relatively low level of liquidity due to its majority insider ownership, or the high level of gearing. Due to CGI's favourable tax status as a Canadian investment corporation, the board is unable to repurchase shares to help manage the discount. In recent years, there has been more emphasis on regular quarterly rather than year-end special dividends; CGI's dividend yield is 3.4%.

25 April 2018

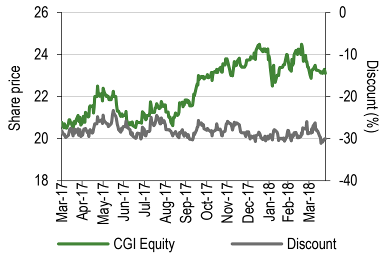
Price	**C$23.11**
Market cap	**C$482m**
AUM	**C$839m**

NAV*	C$33.04
Discount to NAV	30.1%
Yield**	3.2%
Yield***	3.4%

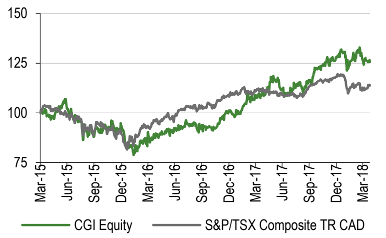
*Including income. As at 24 April 2018. **Excluding special dividend. ***Including special dividend.

Ordinary shares in issue	20.9m
Code	CGI
Primary exchange	LSE
AIC sector	North America
Benchmark	S&P/TSX Composite

Share price/discount performance



Three-year performance vs index



52-week high/low	C$24.49	C$20.52
NAV** high/low	C$34.75	C$28.42

**Including income.

Gearing

Gross*	18.0%
Net*	17.4%

*As at 31 March 2018.

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Edison profile page

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

Exhibit 1: Company at a glance

Investment objective and fund background

CGI's 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 income-generating instruments.

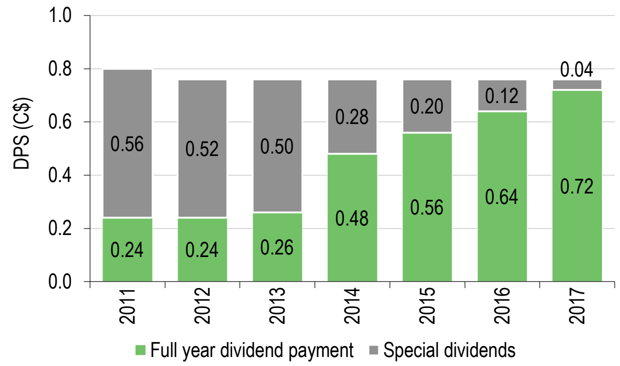
Recent developments

- 18 April 2018: Announcement of quarterly dividends – C$0.19 per common share and C$0.23438 per Series 4 preference share.
- 13 March 2018: Final report for 12 months ending 31 December 2017. NAV total return of +21.5% versus +9.1% for the S&P/TSX Composite Index. Share price total return +26.3%.
- 22 February 2018: Announcement of quarterly dividends – C$0.19 per common share and C$0.23438 per Series 4 preference share.

Forthcoming		Capital structure		Fund details	
AGM	April 2019	Ongoing charges	1.54% (see MER below)	Group	Morgan Meighen & Associates
Interim results	August 2018	Net gearing	17.4%	CEO	Jonathan A Morgan
Year end	31 December	Annual mgmt fee	1.0% (see page 7)	Address	10 Toronto Street, Toronto, Ontario, Canada M5C 2B7
Dividend paid	Mar, Jun, Sep, Dec	Performance fee	None		
Launch date	January 1930	Company life	Indefinite	Phone	+1 416 366 2931
Continuation vote	No	Loan facilities	C$150m (see page 7)	Website	www.mmainvestments.com

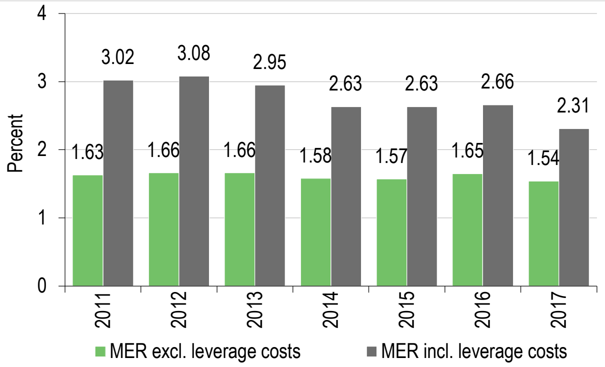
Dividend policy and history (financial years)

CGI revised its dividend policy in 2014 and intends to pay steady to rising quarterly dividends with less emphasis on the special final dividend declared in December.

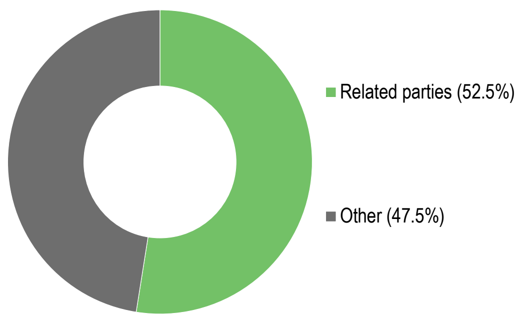


Management expense ratio (MER)

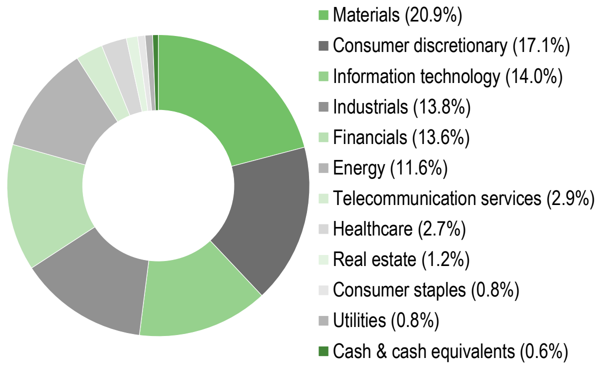
CGI pays a monthly management fee at 1.0% per year of gross assets. Leverage costs include preference share dividends, interest and financing charges.



Shareholder base (as at 31 March 2018)



Portfolio exposure by sector (as at 31 March 2018)



Top 10 holdings (as at 31 March 2018)

			Portfolio weight %	
Company	**Country**	**Sector**	**31 March 2018**	**31 March 2017***
NVIDIA Corporation	US	Semiconductors	4.8	2.9
Dollarama	Canada	Multiline retail	4.5	4.9
Amazon.com	US	Online retail	3.9	2.8
First Quantum Minerals	Canada	Metals & mining	3.9	3.4
Air Canada	Canada	Airlines	3.7	N/A
Shopify	Canada	Internet services	3.6	N/A
Franco-Nevada Corporation	Canada	Metals & mining	3.3	3.7
Bank of Montreal	Canada	Banks	3.2	3.7
Canadian Pacific Railway	Canada	Railroads	3.1	3.0
Royal Bank of Canada	Canada	Banks	2.9	3.2
Top 10			**36.9**	**33.9**

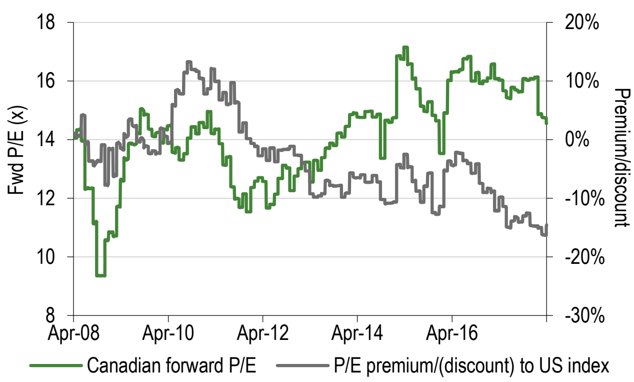
Source: Canadian General Investments, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in March 2017 top 10.

Market outlook: Volatility may provide opportunities

Following a particularly benign period in 2017, global stock markets have been more volatile so far in 2018. As shown in the table in Exhibit 2, Canadian equities have not been immune to this change in investment backdrop. During Q118, almost all of the sectors in the S&P/TSX Composite index generated negative total returns; the exceptions were IT (+10.2%) and to a lesser extent real estate (+0.5%). This may offer the potential for attractive investment opportunities. Canadian stocks, measured by the Datastream Canada index, are trading at a forward P/E multiple of 14.6x, which is broadly in line with its 10-year average. However, this is a 14.5% discount compared with US equities, which is a much larger differential than the 10-year average of 3.5%. While investors may associate the Canadian stock market with resource companies, as shown below, only 41% of the companies and 30% of the market cap of the bellwether Canadian index are in the energy and materials sectors. This suggests that Canada offers investors broader investment opportunities than may be widely envisaged.

Exhibit 2: Valuation and S&P/TSX Composite index data

Valuation of DS Canada index versus DS US index



S&P/TSX Composite index data (as at 31 March 2018)

	No of cos	Weight (%)	Q118 total return (%)	2017 total return (%)	2018e P/E (x)
Financials	27	34.8	(3.5)	13.3	11.7
Energy	49	18.5	(9.4)	(7.0)	19.2
Materials	53	11.5	(4.3)	7.5	18.3
Industrials	27	9.7	(2.6)	19.7	17.8
Cons. discretionary	22	5.5	(2.9)	22.8	14.5
Telecoms	3	4.6	(6.7)	14.8	15.6
IT	12	3.8	10.2	16.8	24.5
Utilities	15	3.7	(5.9)	10.8	18.2
Consumer staples	11	3.6	(5.9)	7.8	16.9
Real estate	22	3.0	0.5	11.2	15.4
Healthcare	9	1.2	(13.5)	34.2	17.4
Index	**250**	**100.0**	**(4.5)**	**9.1**	**15.1**

Source: Thomson Datastream, Bloomberg, Edison Investment Research

Company profile: Broad exposure to Canadian equities

CGI was established in 1930 and is North America's second-oldest closed-end fund. The company is listed on the Toronto Stock Exchange (since 1962) and the London Stock Exchange (since 1995). Since 1956, CGI has been managed by Morgan Meighen & Associates (MMA), which has c C$1.8bn assets under management. Manager (since 2009) Greg Eckel invests for the medium to long term in a diversified portfolio (currently 56 positions) of primarily Canadian equities, aiming to generate higher total returns than its benchmark S&P/TSX Composite index. The company has delivered a very long-term record of outperformance. Over the last 25 years, it has generated average annual total returns of 10.6% compared with 9.0% for the benchmark. CGI's 50-year record is even better, generating average annual total returns of 11.4% compared with 9.3% for the benchmark (source: CGI).

CGI is designated as an investment corporation under the Income Tax Act (Canada), which eliminates a layer of taxation, as capital gains are only taxed at the shareholder level, and enables CGI's capital gains to be paid as dividends to shareholders. However, to maintain investment corporation status, CGI is unable to repurchase its shares to help manage the share price discount to NAV. No more than 25% of its gross revenue may be from interest income and at least 85% of gross revenue must be from Canadian sources. More than 50% of CGI's shares are held by related parties, ensuring that management's and shareholders' interests are aligned. However, this may also contribute to CGI's wide share price discount to NAV. Gearing of C$150m is made up of

C$75m Series 4, 3.75% preference shares and C$75m bank debt; at end March 2018, net gearing was 17.4%. CGI has followed a levered strategy since its first issue of preference shares in 1998.

The fund manager: D Greg Eckel

The manager's view: Market in a holding pattern

Eckel suggests that like other markets around the world, the Canadian stock market is in a holding pattern, having generated a negative total return in Q118. He attributes this to ongoing macro events, which include fears of a trade war led by US threats of protectionism, questions over the sustainability of global corporate earnings given the strength in recent quarters, and the transition to higher interest rates and less accommodative central bank monetary policy. Eckel suggests that alleviation of some of the macro overhangs should lead to better stock market performance; this may include favourable news from NAFTA negotiations. However, he says equity gains are likely to be driven by earnings growth, rather than by further multiple expansion.

While the manager invests on a stock-specific basis, he suggests the energy sector could be a 'dark horse' in 2018. Despite oil prices rallying to c $70, energy stocks in general have not followed suit, suggesting potential for a catch-up with an improvement in investor sentiment towards the sector. Energy was one of the largest underperforming sectors in Q118, but is still c 20% of the S&P/TSX Composite index. Hence, a meaningful improvement in the performance of Canadian energy shares could have a positive influence on the overall performance of the Canadian index.

Asset allocation

Investment process: Selecting stocks with a longer-term focus

CGI selects stocks on a bottom-up basis, while considering the wider sector, economic and global environments. Eckel is able to draw on the resources of MMA's seven other investment professionals to select companies with good fundamentals and strong management teams, that are trading on reasonable valuations. The focus is on long-term investment and many of CGI's holdings have been in the portfolio for many years, although positions are continually reassessed to ensure that individual exposures remain appropriate. Eckel also has a history of successively backing good management teams, who may change employers as a result of M&A. While the majority of the fund is invested in Canadian equities, up to 25% may be invested in US equities to gain exposure to niche operations or business areas that are unavailable for investment in Canada. Current US holdings include top 10 positions in semiconductor manufacturer NVIDIA and online retailer Amazon.com. A maximum of 35% may be invested in a single sector. Some of CGI's positions are higher yielding, such as the banks (Bank of Montreal, Royal Bank of Canada and Toronto-Dominion Bank), which supports the company's own dividend payments. CGI has a bias to mid- and large-cap stocks. The median market cap is c C$8bn and more than 95% of the portfolio (by value) has a market cap above C$1bn.

Current portfolio positioning

At end-March 2018, CGI's top 10 positions made up 36.9% of the portfolio. This was an increase in concentration versus 33.9% at end March 2017, and eight holdings were common to both periods. The asset mix was: 80.1% Canadian equities, 19.3% US equities and 0.6% cash and equivalents. Over the last 12 months, US exposure has increased by c 3pp due to the outperformance of CGI's US holdings. The fund's unconstrained, bottom-up investment approach is illustrated in Exhibit 3; the company has meaningful sector deviations versus the benchmark, such as a 21.2pp underweight exposure in financials (this is a longstanding underweight as the manager believes there are better investment opportunities elsewhere) and 11.6pp and 10.2pp overweight exposures in the consumer discretionary and technology sectors respectively, which include holdings in US companies, operating in businesses that are unavailable in Canada.

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

	Portfolio end March 2018	Portfolio end March 2017	Change (pp)	Index weight	Active weight vs index (pp)	Fund weight/ index weight (x)
Materials	20.9	19.2	1.7	11.5	9.4	1.8
Consumer discretionary	17.1	16.3	0.8	5.5	11.6	3.1
Information technology	14.0	12.4	1.6	3.8	10.2	3.7
Industrials	13.8	11.3	2.5	9.7	4.1	1.4
Financials	13.6	13.6	0.0	34.8	(21.2)	0.4
Energy	11.6	17.5	(5.9)	18.5	(6.9)	0.6
Telecommunication services	2.9	3.2	(0.3)	4.6	(1.7)	0.6
Healthcare	2.7	0.0	2.7	1.2	1.5	2.3
Real estate	1.2	2.6	(1.4)	3.0	(1.8)	0.4
Consumer staples	0.8	1.9	(1.1)	3.6	(2.8)	0.2
Utilities	0.8	1.0	(0.2)	3.7	(2.9)	0.2
Cash & cash equivalents	0.6	1.0	(0.4)	0.0	0.6	N/A
	100.0	**100.0**		**100.0**		

Source: Canadian General Investments, Edison Investment Research

Following an above-average level of turnover in 2016 due to portfolio repositioning in the early part of the year, in 2017 turnover was 10.4%, which is considerably lower than the 17.0% five-year average. Reflecting the manager's comfort with the structure of CGI's portfolio, turnover is currently running at an even lower rate of c 9%, which is at the bottom of the historical range of 9% to 25%. However, Eckel notes that he is always on the lookout for new investment opportunities.

Additions to the portfolio in 2017 include two building supply companies, Installed Building Products and SiteOne Landscape Supply. Installed Building Products is one of the US's largest insulation installers for the residential new construction market and an installer of complementary building products throughout the country. The company is benefiting from both organic and acquired growth. SiteOne Landscape Supply is the largest and only national wholesale distributor of landscape supplies in the US, with a growing presence in Canada. It primarily supplies residential and commercial landscape professionals from a network of c 500 stores in 44 US states and five Canadian provinces.

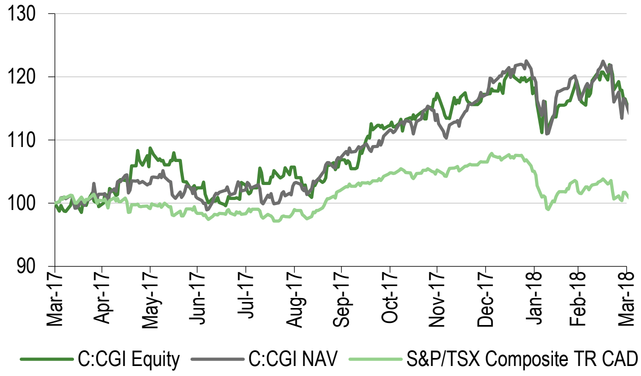
CGI has added two cannabis producers to the portfolio, Aphria and Canopy Growth, which the manager believes will benefit from new legislation in upcoming months regarding recreational usage in Canada. If approved, Canada would be the first G7 nation to permit the consumption of cannabis for recreational purposes; it is already allowed for medical purposes. Aphria recently reported its quarterly results, showing the extent of its low-cost operations. The manager says this is important, as over time the cannabis business will become commoditised, meaning the low-cost operators will be in a better competitive position. Canopy Growth is the largest Canadian cannabis producer, with the biggest international footprint. Eckel acknowledges that these two positions are not without risk, but he notes that cannabis as an investment theme is gaining greater traction. Aphria, with a market cap of c $2bn, has given up some of its c 250% 2017 share price gains in 2018, while c $6bn cap Canopy Growth's share price is broadly flat year to date, having rallied by c 200% in 2017.

Performance: Very long-term outperformance

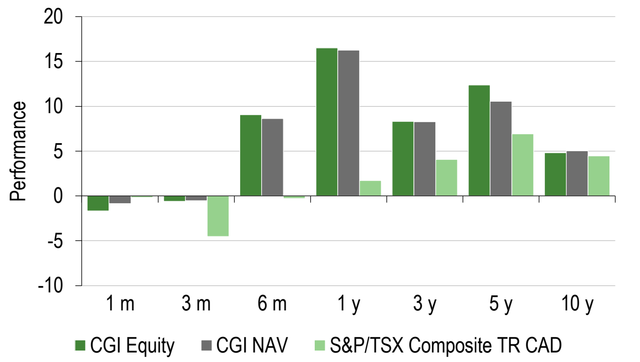
As highlighted in the company profile section, CGI has a very long track record of outperformance. Over the last 50 years, it has generated average annual total returns of 11.4% versus 9.3% for the benchmark (source: CGI). The company's shorter-term investment performance is shown in Exhibits 4, 5 and 6 below. Over the last 12 months, CGI's NAV and share price total returns of 16.3% and 16.5% respectively are significantly ahead of the benchmark's 1.7% total return. The manager says that “a lot came our way” and the outperformance is due to both successful stock picking and good sector allocation, such as an overweight technology exposure. On a stock-specific basis, positive contributors to CGI’s performance include global e-commerce platform Shopify, whose share price doubled in 2017, and other top 10 holdings Air Canada and discount retailer Dollarama. CGI participated in Dollarama’s initial public offering (IPO) in 2009, and at the end of 2017, its share price was 15x the fund’s unit cost. Over this period, CGI has generated C$44m in realised gains and was sitting on a further C$35m in unrealised gains from this single position.

Exhibit 4: Investment company performance in Canadian dollars to 31 March 2018

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



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

CGI’s relative returns are shown in Exhibit 5. The company suffered a period of underperformance during the global financial crisis due to the negative effects of leverage in a declining stock market and underperformance of its small-cap holdings. However, the underperformance has been more than recouped in recent years and the company has now outperformed its benchmark and the MSCI Canada index over the last one, three, five and 10 years.

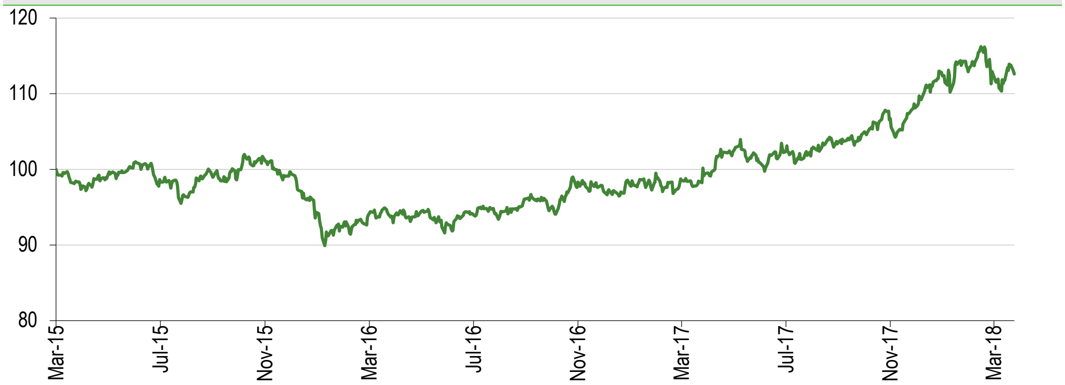
Exhibit 5: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to S&P/TSX Composite	(1.5)	4.1	9.3	14.6	12.7	28.1	3.4
NAV relative to S&P/TSX Composite	(0.7)	4.2	8.9	14.3	12.6	18.3	5.4
Price relative to MSCI Canada	(1.4)	4.1	9.1	14.1	12.9	26.0	4.7
NAV relative to MSCI Canada	(0.6)	4.2	8.7	13.8	12.8	16.3	6.8
Price relative to FTSE World	(0.3)	(2.5)	0.9	4.8	(3.1)	(12.4)	(31.1)
NAV relative to FTSE World	0.6	(2.5)	0.5	4.5	(3.2)	(19.1)	(29.8)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end March 2018 in C$ terms. Geometric calculation.

Exhibit 6 shows CGI’s performance relative to the benchmark over the last three years. The positive effect of repositioning the portfolio in early 2016 is clearly visible; actions included increasing exposure to the materials sector.

Exhibit 6: NAV total return performance relative to benchmark over three years



Source: Thomson Datastream, Edison Investment Research

Discount: Broadly in line with historical averages

CGI is trading at a 30.1% discount to NAV, which is broadly in line with the averages of the last one, three and five years of 28.1%, 28.2% and 28.8% respectively. Despite the fund's long-term record of outperformance versus the benchmark, its discount remains persistently wide. This could be due to the relatively high level of gearing or the majority inside ownership, which may affect investor perceptions regarding liquidity. However, it should be noted that there have been times in the past when the fund traded at a premium. The board is unable to repurchase any of CGI's shares as this would invalidate its favourable Canadian investment corporation tax status.

Exhibit 7: Share price discount to NAV (including income) over three years (%)

Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

CGI has 20.9m ordinary shares in issue and gearing of C$150m (C$75m Series 4, 3.75% preference shares and C$75m bank debt). The bank debt facility was entered into in June 2016 ahead of the redemption of C$75m Series 3, 3.90% preference shares. It has an interest rate of 2.28%, which lowered CGI's average cost of debt from 3.825% to 3.015%, leading to a C$1.215m reduction in annual interest costs. At end March 2018, taking 0.6% cash and equivalents into account, net gearing was 17.4%.

CGI pays an annual management fee of 1.0% of the market value of its investments, net of cash, portfolio accounts receivable and portfolio accounts payable. No performance fee is payable. For 2017, the annualised management expense ratio was 2.31% including leverage costs (a meaningful reduction versus 2.66% in 2016) and 1.54% excluding leverage costs (1.65% in 2016). The management expense ratio excluding leverage costs is more comparable with the ongoing charge figure used in the UK.

Dividend policy and record

CGI's board revised the fund's dividend policy in 2014 to place more of an emphasis on regular quarterly dividends and less on the year-end special dividend, which declined from C$0.50 in 2013 to $0.04 in 2017. The manager suggests that 2018 could mark the first year when there is no special dividend paid, and he is hopeful that the annual distribution of regular quarterly dividends will rise over time. In 2017, the total dividend was C$0.76 (C$0.72 regular plus C$0.04 special); this annual distribution has been maintained for the last six financial years. So far in 2018, two regular interim dividends of C$0.19 have been declared. CGI's current dividend yield (including the 2017 special dividend) is 3.4%.

Peer group comparison

Exhibit 8 highlights the funds in the AIC North America sector with significant Canadian exposure, although it should be noted that they have different investment mandates. CGI has significantly better NAV total return performance over one, three and five years, while lagging over 10 years. Its performance was negatively affected during the global financial crisis by its high level of gearing and an overweight exposure to small-cap stocks. CGI trades at a wide discount to its NAV, despite its strong record of outperformance versus the benchmark; this may be due to the high level of insider ownership. Both funds currently have a similar level of net gearing. CGI has a higher ongoing charge and a lower dividend yield, due to its emphasis on total return rather than income.

Exhibit 8: Selected peer group as at 20 April 2018 (C$)*

% unless stated	Market cap	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (ex-par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield (%)
Canadian General Investments	482.1	18.6	27.2	77.4	54.7	(30.8)	1.5	No	117	3.2**
Middlefield Canadian Income	98.2	3.0	13.6	48.2	89.8	(15.6)	1.0	No	118	5.5
Average	**290.1**	**10.8**	**20.4**	**62.8**	**72.2**	**(23.2)**	**1.3**		**118**	**4.4**
Fund rank in sector	**1**	**1**	**1**	**1**	**2**	**2**	**1**		**2**	**2**

Source: Morningstar, Edison Investment Research. Note: *Performance data to 19 April 2018. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets. **Excludes special dividend.

The board

There are seven directors on the board of CGI, four of whom are independent of the investment manager. Chairman Vanessa Morgan was appointed in 1997; she is president and CEO of MMA. Jonathan Morgan was appointed in 2001; he is president and CEO of CGI and executive vice president of MMA. The other non-independent director is Michael Smedley; he was appointed in 1989 and is executive vice president and CIO of MMA. The four independent directors and their years of appointment are: Neil Raymond (2002), Richard Whittall (2004), James Billett (2005) and Michelle Lally (2015). The average tenure of the seven directors is c 16 years.