# Canadian General Investments

## Long-term growth and income

Investment companies

**Canadian General Investments (CGI) is a TSX- and LSE-listed investment company that provides selective broad exposure to Canadian equities. CGI's NAV total return has outperformed the S&P/TSX Composite benchmark over one, three, five and 10 years. In terms of risk-adjusted returns, Sharpe ratios of 2.0 and 0.5 over one and three years place CGI at or close to the top of the peer group. CGI's share price discount to NAV has gradually widened from c 20% in 2009 and has remained above 30% since January 2014. A recently revised approach to dividends to provide greater certainty to shareholders has the potential to reduce this discount.**

| 12 months ending | Total share price return (%) | Total NAV return (%) | S&P/TSX Composite TR C$ (%) | FTSE Canada TR C$ (%) | FTSE World TR C$ (%) | MSCI Canada TR C$ (%) |
|---|---|---|---|---|---|---|
| 31/05/11 | 26.4 | 32.4 | 20.4 | 15.5 | 19.2 | 18.0 |
| 31/05/12 | (16.3) | (10.7) | (14.2) | (14.3) | (5.5) | (15.1) |
| 31/05/13 | 12.1 | 11.3 | 13.3 | 13.4 | 27.2 | 13.7 |
| 30/05/14 | 20.8 | 24.5 | 19.0 | 18.4 | 24.4 | 19.1 |

Note: *Twelve-month rolling discrete performance.

### Investment strategy: Canadian stock selection

CGI targets broad exposure to Canadian equities using a bottom-up stock selection process based on fundamental research. A top-down overlay of the manager's macro outlook influences stock selection but no sector or geographic allocations are specifically targeted. Where broader investment themes are identified with no suitable opportunities in the Canadian market, within certain restrictions, exposure can be gained through foreign equities. CGI maintains a well-diversified exposure and new investments typically represent 1.0% to 1.5% of the portfolio. A long-term approach is taken and portfolio turnover has averaged 26% over the last five years. Investment decisions are driven by total return expectations rather than yield giving the portfolio a growth bias. C$150m nominal preference shares provide leverage.

### Market outlook: Continuing steady improvement

Having performed well in relation to other developed market economies during the global financial crisis and subsequent recovery, and outgrowing the US economy in 2010, 2011 and 2013, the Canadian economy looks set to be outpaced by the US in 2014 and 2015. However, as Canada's major export market, a strengthening US economy should benefit Canadian manufacturers and the weakness of the Canadian dollar over the last year provides further aid to exporters, supporting the outlook for continuing steady improvement in economic growth. The resources sector has lagged the broader market and an apparent stabilisation of the Chinese economy underpinning global commodity demand together with the increased capital discipline evident in the sector could lead to a medium-term recovery in this area of the market.

### Valuation: Discount has gradually widened

Over the last five years, CGI's share price discount to NAV has gradually widened from c 20% in 2009 to over 25% in 2012, and has remained above 30% since January 2014. The board implemented a revised approach to dividend payments in 2014 and this has the potential to narrow the discount.

**3 June 2014**

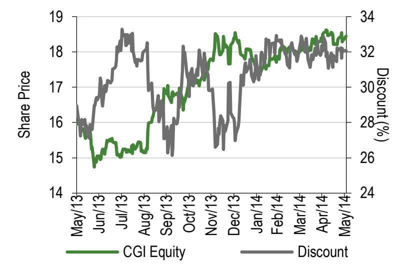
| | |
|---|---|
| **Price** | **C$18.45** |
| **Market cap** | **C$384.9m** |
| **AUM** | **C$721.5m** |

| | |
|---|---|
| NAV* | C$27.17 |
| Discount to NAV | 32.1% |
| Yield** | 2.6% |
| Yield*** | 4.1% |

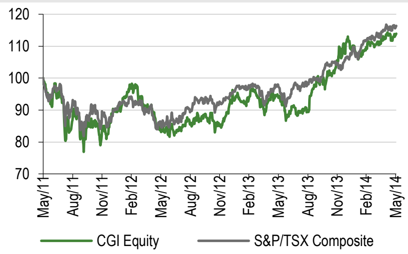
*As at 2 June 2014. **12 months projected, excluding special capital gains dividend. ***FY13 total, including special capital gains dividend.

| | |
|---|---|
| Ordinary shares in issue | 20.9m |
| Code | CGI |
| Primary exchange | TSX |
| Secondary exchange | LSE |
| AIC sector | North America |

**Share price/discount performance***




**Three-year cumulative perf. graph**




| | | |
|---|---|---|
| 52-week high/low | C$18.63 | C$14.74 |
| NAV high/low | C$27.62 | C$20.75 |

**Gearing**

| | |
|---|---|
| Gross* | 26.6% |
| Net* | 26.4% |

*As at 30 April 2014.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Edison profile page

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

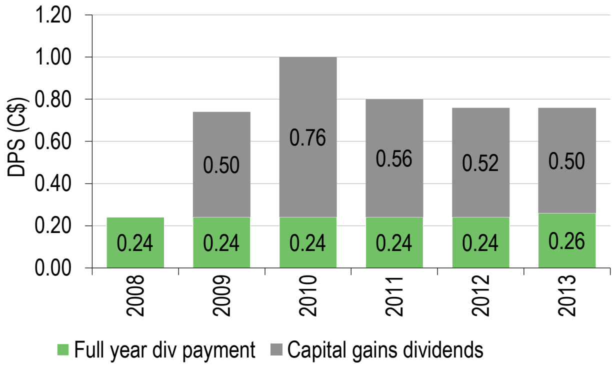
## Exhibit 1: Company at a glance

| Investment objective and fund background | Recent developments |
|---|---|
| Canadian General Investments' investment objective is to provide better than average returns to investors 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. | 11 February 2014: 50% q-o-q increase in quarterly dividend to C$0.12 per share.<br>11 February 2014: Change in dividend policy – intention to pay steady to rising quarterly dividends.<br>22 October 2013: 33% q-o-q increase in quarterly dividend to C$0.08 per share. |

| Forthcoming | | Capital structure | | Fund details | |
|---|---|---|---|---|---|
| AGM | April 2015 | Mgmt. expense ratio | 1.66% (2.95%) – see below | Group | Morgan Meighen & Associates |
| Preliminary results | February 2015 | Net gearing | 26.4% | CEO | Jonathan A. Morgan |
| Year end | 31 December | Annual mgmt fee | 1.0% of gross assets | Address | 10 Toronto Street,<br>Toronto, Ontario, Canada M5C 2B7 |
| Dividend paid | Quarterly | Performance fee | None | | |
| Launch date | January 1930 | Company life | Indefinite | Phone | +1 416 366 2931 |
| Continuation vote | N/A | Loan facilities | C$150m preference shares | Website | www.mmainvestments.com |

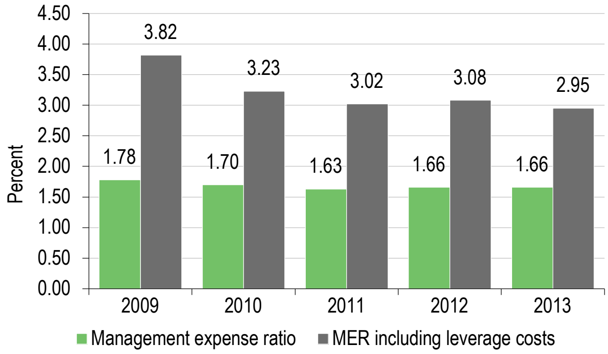
**Dividend policy and history**

CGI revised its dividend policy in 2014 and intends to pay steady to rising quarterly dividends. Capital gains dividends are also distributed annually.

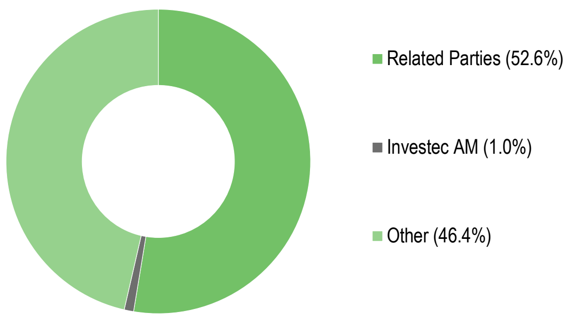



**Management expense ratio (MER) and history**

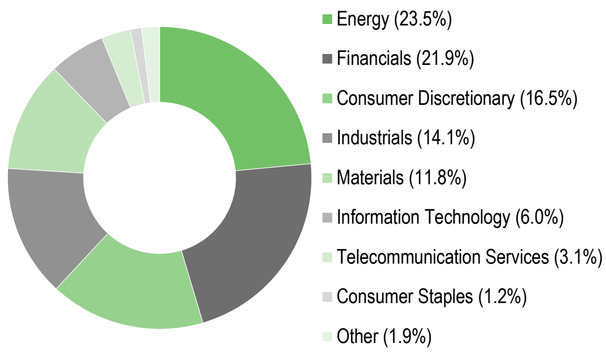
CGI pays a monthly management fee at 1.0% pa of gross assets. Leverage costs include preference share dividends, interest and financing charges.




**Shareholder base (as at 8 May 2014)**




**Distribution of portfolio (as at 30 April 2014)**




**Top 10 holdings (as at 30 April 2014)**

| | | | Portfolio weight % | | Active weight % |
|---|---|---|---|---|---|
| **Company** | **Country** | **Industry** | **30 April 2014** | **30 April 2013*** | **30 April 2014** |
| Dollarama | Canada | Consumer Discretionary | 4.6 | 4.3 | 4.3 |
| Enbridge | Canada | Energy | 3.7 | 4.1 | 1.5 |
| Canadian Pacific Railway | Canada | Industrials | 3.1 | 2.6 | 1.6 |
| Bank of Montreal | Canada | Financials | 2.9 | 2.8 | 0.5 |
| Element Financial | Canada | Financials | 2.6 | N/A | 2.5 |
| Methanex | Canada | Materials | 2.6 | N/A | 2.3 |
| Royal Bank of Canada | Canada | Financials | 2.5 | 2.4 | (2.7) |
| Brookfield Canada Office Properties | Canada | Financials | 2.3 | 3.7 | 2.3 |
| Stantec | Canada | Industrials | 2.3 | N/A | 2.2 |
| Home Capital Group | Canada | Financials | 2.3 | N/A | 2.1 |
| **Top 10** | | | **28.9** | **N/A** | |

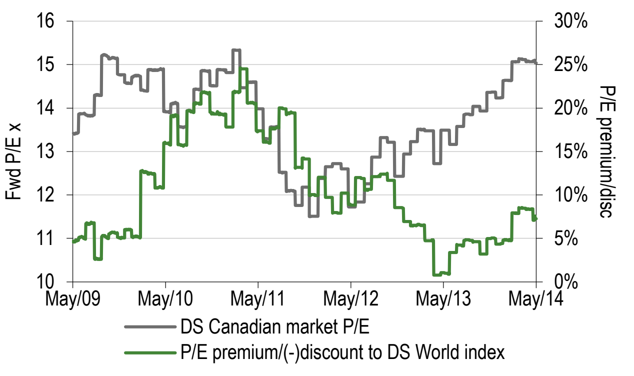
Source: Canadian General Investments, Bloomberg, Edison Investment Research. Note: *Where no figure is shown for 2013 portfolio weight, the stock was not in the top 10.

## Market outlook: Continuing steady improvement

Having performed well in relation to other developed market economies during the global financial crisis and subsequent recovery and outgrowing the US economy in 2010, 2011 and 2013, the Canadian economy looks set to be outpaced by the US in 2014 and 2015. However, as Canada's major export market, a strengthening US economy should benefit the Canadian manufacturing sector and the weakening of the Canadian dollar over the last 12 months should provide a further aid to Canadian exporters. These factors support expectations for a continuing steady improvement in the Canadian economic growth rate from 1.7% in 2012 and 2.0% in 2013, and the IMF's April 2014 World Economic Outlook projects growth of 2.3% and 2.4% in 2014 and 2015.

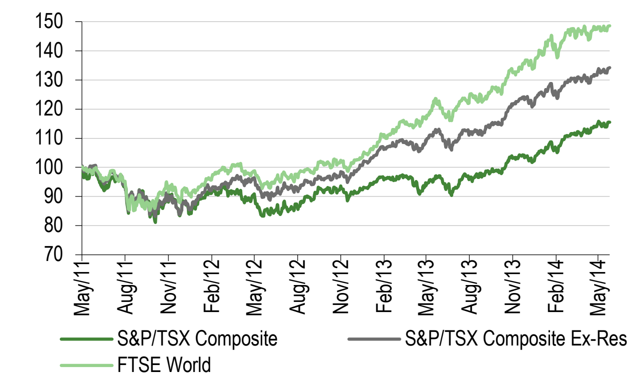
As illustrated in Exhibit 2, the Canadian market has benefited from a steady re-rating over the last two years and the market's forward P/E multiple is currently at the upper end of its five-year range. This implies that earnings growth will need to be delivered in order for the market to maintain its upward trajectory. However, the Canadian market's valuation premium to world markets is at the lower end of its five-year range, suggesting that growth expectations for the Canadian economy are more conservative than for many other markets. On a forward P/E multiple basis, the Canadian market is trading at a 5% discount to the US market, having seen a steady relative de-rating from the peak 16% premium reached in September 2010.

**Exhibit 2: Canadian market P/E ratio over five years**




Source: Thomson Datastream, Edison Investment Research

**Exhibit 3: Canadian and World indices over three years**




Source: Thomson Datastream, Edison Investment Research

Exhibit 3 illustrates the Canadian market's relatively weaker performance compared to world markets in general over the last three years and highlights the impact of the resources sector, which has significantly lagged the rest of the Canadian market over the last 18 months.

## Fund profile: Canadian equities focus

Canadian General Investments (CGI) is a TSX- and LSE-listed closed-end equity fund launched in January 1930, focused on medium- to long-term investments primarily in Canadian corporations. Its objective is to provide better than average returns to investors through prudent security selection, timely recognition of capital gains/losses and appropriate income generating instruments. Since 1998, with the issuance of its Series 1 preference shares, CGI has employed gearing with the aim of enhancing returns to common shareholders. CGI has been managed since 1956 by Morgan Meighen & Associates (MMA) and it is majority-owned by directors of MMA. D Greg Eckel, senior vice-president of MMA, is the portfolio manager responsible for the management of CGI's investment portfolio.

# The fund manager: D Greg Eckel

## The manager's view: Increased focus on exporters

Greg Eckel considers that the Canadian market is likely to continue to make steady progress driven increasingly by its exposure to economies outside of Canada, particularly the US, which are expected to outpace the domestic economy in the near term. He sees continuing signs of improvement in the US economy, Canada's main export market, with the housing recovery continuing and declining unemployment. He also considers that the Chinese economy is showing signs of stabilisation, which should benefit major resource exporters such as Canada.

The manager believes the portfolio is well positioned to benefit from economic recovery outside of Canada with top 20 holdings in companies such as automotive parts supplier Magna International, infrastructure and facilities consultancy Stantec, and commercial finance provider Element Financial. In addition, he expects continuing strength in the energy sector, considering oil and gas prices to be resilient due to robust global oil demand driven by economic recovery and gas demand being supported by sustained re-stocking activity particularly evident in the US, where gas storage levels are at five-year lows. While there have been limited signs of recovery in the materials sector, he anticipates mining sector investment opportunities potentially arising towards the end of 2014 with concerns over Chinese commodity demand receding and supply constrained by improved capital discipline with the sector.

Illustrating the manager's long-term approach are the investments in Element Financial and Methanex that have contributed significantly to CGI's performance over the last year. The investment in Element Financial was made at its 2011 IPO and Methanex has been a portfolio holding since 2009. Both have risen to become top 10 holdings during the last 12 months and remain core holdings with their exposure to growth outside of Canada. Element Financial is a North American commercial finance provider that has been broadening its offering and increasing its presence in the fast-growing US market. Methanex is a leading methanol producer that has been rapidly growing its global market share while Chinese demand for fuel-blending has been a major factor driving market growth.

# Asset allocation

## Investment process: Bottom-up with top-down overlay

CGI's investment process is primarily based on bottom-up stock selection within the Canadian market. The manager first seeks to identify individual companies with attractive investment potential then assesses broader industry and global trends affecting those companies. Where broader investment themes are identified and suitable opportunities cannot be identified in the Canadian market, exposure can be gained through foreign equities (predominantly US-listed) with the restriction that CGI's investment corporation status requires at least 85% of its gross revenues to be derived from Canadian sources. New investments typically represent 1.0% to 1.5% of the portfolio and holdings larger than this reflect investment gains. A long-term approach is taken and portfolio turnover has averaged 26% over the last five years. CGI's ability to pay dividends from capital gains as well as dividend income means that investment decisions are driven by total return expectations rather than yield. This investment approach can lead to sector weightings differing substantially from those of the benchmark. CGI attempts to mitigate risk by maintaining a well-diversified portfolio.

## Current portfolio positioning

As illustrated in Exhibit 4, CGI's portfolio sector allocations can vary considerably over time and may also diverge substantially from the benchmark index. As at 30 April 2014, similar to a year earlier, energy and financials sectors were the largest exposures and together currently represent 45% of the portfolio's equity exposure. There have been significant changes to portfolio weightings across other sectors, with the largest being a 5.5 point increase in the consumer discretionary sector weighting and a 6.2 point reduction in the materials sector weighting. Portfolio concentration can also vary over time, as reflected by the weighting of the top 10 holdings reducing from 34.6% at 30 April 2013 to 28.9% at 30 April 2014. Although portfolio turnover increased markedly to 23.8% in 2013 from 13.1% in 2012, it remains below the five-year average of 26.0%. Despite portfolio turnover increasing and portfolio weightings changing significantly, the portfolio remains relatively stable with six of the current top 10 portfolio investments having been top 10 holdings a year ago (see Exhibit 1), reflecting the fund's medium- to long-term investment approach. The manager reports that the portfolio yield is around 1.9% compared with the yield on the S&P/TSX Composite index of 2.8%, which indicates that there is something of a growth bias to the portfolio.

**Exhibit 4: Portfolio, benchmark and relative sector weightings**

| | End April 2014 | End April 2013 | Change | S&P/TSX Composite index weight | Active weight vs benchmark | Portfolio weight/Index weight |
|---|---|---|---|---|---|---|
| Energy | 23.5 | 21.3 | 2.2 | 27.0 | -3.4 | 0.9 |
| Financials | 21.9 | 22.3 | -0.4 | 32.9 | -11.0 | 0.7 |
| Consumer Discretionary | 16.5 | 11.0 | 5.5 | 6.2 | 10.3 | 2.7 |
| Industrials | 14.1 | 9.8 | 4.3 | 7.1 | 7.0 | 2.0 |
| Materials | 11.8 | 18.0 | -6.2 | 11.4 | 0.4 | 1.0 |
| Information Technology | 6.0 | 4.3 | 1.7 | 1.7 | 4.3 | 3.5 |
| Telecommunication Services | 3.1 | 4.2 | -1.1 | 4.6 | -1.5 | 0.7 |
| Consumer Staples | 1.2 | 0.7 | 0.5 | 3.9 | -2.7 | 0.3 |
| Utilities | 1.1 | 3.4 | -2.3 | 2.3 | -1.2 | 0.5 |
| Health Care | 0.7 | 5.1 | -4.4 | 2.8 | -2.1 | 0.2 |
| | **100.0** | **100.0** | | **100.0** | | |

Source: Canadian General Investments, Edison Investment Research. Note: Portfolio figures represent sector weightings excluding cash.

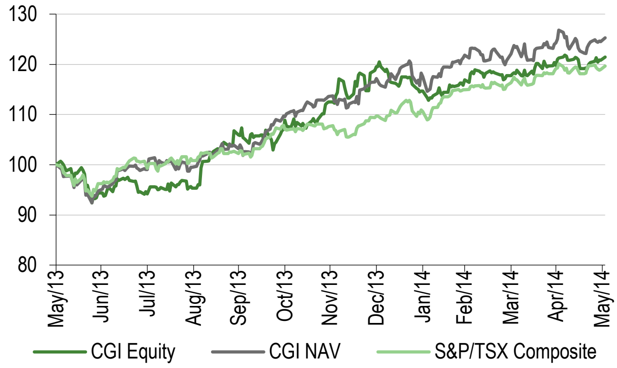
At 30 April 2014, the portfolio's 16.5% consumer discretionary and 14.1% industrials sector exposures represented CGI's highest active weightings relative to its benchmark index. Although the financials sector comprised the portfolio's second largest sector exposure at 21.9%, it is CGI's largest underweight position relative to the benchmark index. Although exposure to the energy sector has increased, the portfolio remains underweight compared with the benchmark. A sharp reduction in exposure to the health care sector reflects the sale of the investment in Catamaran, which had been the portfolio's largest holding.

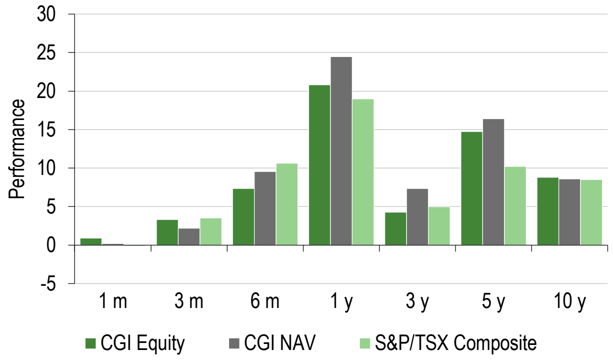
# Performance: Outperformance over one to 10 years

As Exhibit 5 illustrates, CGI has outperformed its S&P/TSX Composite benchmark in terms of NAV total return over one, three, five and, marginally, 10 years. CGI's share price performance has lagged NAV performance over one, three, five and 10 years due to the gradually widening discount. As illustrated by Exhibit 7, CGI experienced a period of relative underperformance from mid-2007 to mid-2009, which the manager reports as being due to its overweight small-cap and underweight potash sector exposures. In contrast, from mid-2004 to mid-2007 and from mid-2009 to date, CGI delivered steady outperformance. In terms of risk-adjusted returns, CGI's Sharpe ratios of 2.0 and 0.5 over one and three years are at or close to the top of the peer group range. Over five years CGI's Sharpe ratio of 1.2 is ahead of the peer group average.

**Exhibit 5: Investment company performance**

| 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.

**Exhibit 6: Share price and NAV total return performance, versus benchmarks (percentage points)**

| | One month | Three months | Six months | One year | Three years | Five years | 10 years |
|---|---|---|---|---|---|---|---|
| Price relative to S&P/TSX Composite | 1.0 | (0.2) | (3.3) | 1.8 | (2.4) | 36.3 | 5.4 |
| NAV relative to S&P/TSX Composite | 0.3 | (1.3) | (1.0) | 5.5 | 7.9 | 51.3 | 1.6 |
| Price relative to FTSE Canada | 1.1 | (0.2) | (2.6) | 2.4 | (1.8) | 50.8 | 4.9 |
| NAV relative to FTSE Canada | 0.4 | (1.3) | (0.3) | 6.1 | 8.5 | 65.7 | 1.1 |
| Price relative to FTSE World | (0.1) | 1.5 | (1.9) | (3.6) | (36.2) | 3.0 | 57.8 |
| NAV relative to FTSE World | (0.8) | 0.4 | 0.3 | 0.1 | (25.9) | 18.0 | 54.0 |

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-May 2014 and indices C$ adjusted.

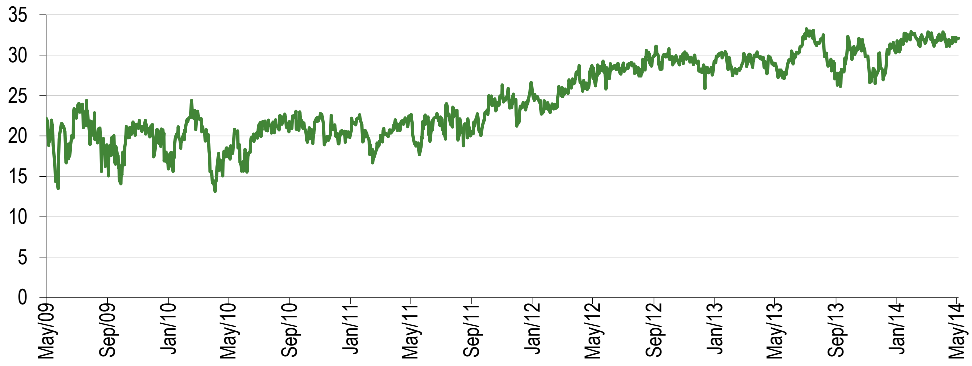
**Exhibit 7: NAV total return performance relative to benchmark**


Source: Thomson Datastream, Edison Investment Research

## Discount: Gradual widening over five years

Exhibit 8 illustrates that, over the last five years, CGI's share price discount to NAV has gradually widened from c 20% in 2009, moving to over 25% in 2012 and has remained above 30% since January 2014. As an investment corporation, CGI is restricted from repurchasing its shares to manage the discount. We note that the revised approach to dividends implemented in 2014 (see Dividend policy) has the potential to narrow this discount though a positive change in sentiment towards the Canadian market or resource sector would be likely to be more decisive.

**Exhibit 8: Discount over five years (%)**




Source: Thomson Datastream, Edison Investment Research. Note: Positive values indicate a discount.

## Capital structure and fees

CGI has 20.9m common shares and C$150m nominal cumulative, redeemable Class A preference shares in issue. C$75m nominal 3.90% Series 3 preference shares are redeemable in June 2016. C$75m nominal 3.75% Series 4 preference shares redeemable in June 2023 were issued in May 2013 following the redemption of Series 2 preference shares. CGI is authorised to issue an unlimited number of common shares while its investment corporation status restricts it from repurchasing shares.

Structural gearing is provided by the preference shares and CGI does not hold any bank debt. In May 2013, CGI entered into a credit agreement giving it access to a C$75m credit facility to fund the redemption of Series 2 preference shares. The C$75m was repaid in full and the credit facility cancelled. At 30 April 2014, CGI had gross gearing of 26.5% and net gearing of 26.4%.

CGI pays MMA a monthly management fee at a rate of 1.0% pa of the market value of CGI's investments adjusted for cash, portfolio accounts receivable and portfolio accounts payable. These fees cover portfolio management as well as provision of administrative services. No performance fees are payable. The officers of CGI are remunerated by MMA in their capacity as directors and/or officers of MMA and receive no compensation from CGI. In 2013, the management expense ratio (MER) was 1.66% excluding preference share dividends, interest and finance charges (more comparable with the UK ongoing charge) and 2.95% including these costs (see Exhibit 1).

## Dividend policy

From 1999 to 2013, CGI paid common shareholders a flat C$0.06 per share quarterly dividend as well as an annual capital gains dividend, whereby CGI is able to recoup capital gains taxes. In February 2014, the board announced a change in approach to dividend payments and henceforth intends to provide shareholders with steady to rising quarterly dividends. At the same time, the quarterly dividend was increased to C$0.12 per share. The distribution of capital gains dividends will continue but year-end special dividends will be de-emphasised. The board believes that payment of a greater proportion of annual distributions through the four quarterly dividends should provide shareholders with greater reliability as to their expected dividend income and potentially greater scope for share price appreciation.

## Peer group comparison

Exhibit 9 illustrates a closed-ended peer group comparison across a selected group of funds investing primarily in Canadian equities. CGI's NAV total returns over one, three and five years rank it at the higher-end of the peer group, comfortably ahead of peer group averages. In terms of risk-adjusted returns, CGI's 1-year Sharpe ratio of 2.0 is above the peer group average and, although low, its 3-year Sharpe ratio of 0.5 leads the peer group. CGI's 32.1% share price discount to NAV is the highest in the peer group and is appreciably wider than the 15.2% average, while its 1.66% management expense ratio is at the top of the peer group range. CGI's 2.6% dividend yield, which reflects only the quarterly dividend, ranks it at the median of the peer group but below the 3.6% average. Including the special capital gains dividend CGI's FY13 dividend yield was 4.1%.

**Exhibit 9: Canadian equities peer group**

| % unless stated | Market cap C$m | NAV TR 1 year | NAV TR 3 year | NAV TR 5 year | Sharpe 1y (NAV) | Sharpe 3y (NAV) | Discount (ex par) | MER | Net Gearing | Dividend yield |
|---|---|---|---|---|---|---|---|---|---|---|
| Canadian General Investments Ord | 384.9 | 7.6 | 11.6 | 106.8 | 2.0 | 0.5 | (32.1) | 1.66 | 113 | 2.6 |
| Canoe EIT Income Fund Ord | 1,016.1 | 3.5 | 3.4 | 85.4 | 2.4 | 0.4 | (16.4) | 1.33 | 111 | 9.6 |
| Central Fund of Canada Ord | 3,642.5 | (21.5) | (36.9) | 21.8 | (0.6) | (0.5) | (6.8) | 0.31 | 99 | 0.1 |
| Economic Investment Trust Ord | 505.4 | | | | | | (25.0) | 0.36 | 100 | 0.7 |
| Middlefield Canadian Income Ord | 223.3 | 3.5 | 10.3 | 148.8 | 0.3 | 0.2 | 1.1 | 1.37 | 82 | 4.4 |
| Mint Income Fund Ord | 131.6 | (0.5) | 2.0 | 94.3 | 2.3 | 0.5 | (3.9) | 1.63 | 113 | 6.7 |
| United Corporations Ord | 948.3 | | | | | | (23.3) | 0.47 | 103 | 1.0 |
| **Simple average** | | **(1.5)** | **(1.9)** | **91.4** | **1.3** | **0.2** | **(15.2)** | **1.02** | **103** | **3.6** |
| **Weighted average** | | **(13.2)** | **(22.9)** | **46.8** | **0.3** | **(0.2)** | **(13.0)** | **0.62** | **102** | **2.1** |

Source: Morningstar 2 June 2014. Note: TR=total returns, MER=management expense ratio excluding preference share dividends, interest and finance charges. The Sharpe ratio is a measure of risk-adjusted return. The ratios we show are calculated by Morningstar for the past 36-month period by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash/cash equivalents as percentage of shareholders' funds.

## The board

The board comprises seven directors, four of whom are independent of the investment manager. The non-independent directors are Vanessa Morgan (chairman of CGI and president and CEO of MMA), Jonathan Morgan (president and CEO of CGI and executive vice president of MMA) and Michael Smedley (executive vice president and CIO of MMA). The independent directors are James Billett, James Cook, R Neil Raymond and Richard O'C Whittall. The average length of service as a director is 14 years and there have been no changes to the board composition since 2005.



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