PANMURE GORDON & CO
INTEGRITY IN INVESTMENT BANKING SINCE 1876

3 December 2013

Investment Funds Research

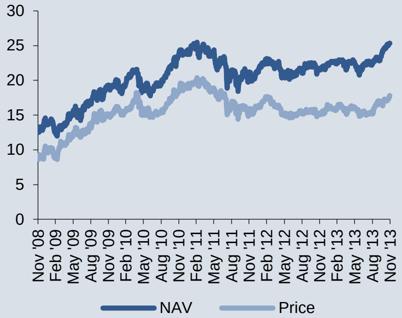
INITIATION OF COVERAGE

CANADIAN GENERAL INVESTMENTS N/R

CORE CANADIAN EXPOSURE

Key Data

Price	C$17.80
Est Dil. NAV	C$25.42
Dil. discount	(30.0)%
Price Target	n/a
Market Cap	C$371.3m
52-week range	C$14.70-17.80
52-week discount avg.	(29.5)%
Div. yield	4.4%
Sector	Investment Funds
Stock codes	CGI LN/ CGI CN
Gearing (debt/equity)	29.2%
Rating nature	Relative
Rating benchmark	S&P/TSX Composite TR Index
Last published research	Initiation



We initiate coverage of Canadian General Investments (CGI) believing the fund offers deeply discounted (30.0%), well managed core Canadian exposure. Reflecting the interests of its controlling shareholder, the fund is professionally managed and invested for the longer term.

We view the fund's lack of a stated dividend policy as unusual and its Achilles heel. In the absence of a well-articulated dividend strategy we see limited prospects for a fundamental re-rating. The 33% increase in the Q3 dividend may herald a new strategy, which could open the fund to a wider investor base and a fundamental re-valuation over the medium term.

- **Investment strategy**. The portfolio manager, Greg Eckel, describes the strategy as stock driven (65-75 securities) but macro aware, looking to provide diversified exposure to large capitalisation (75% of the portfolio >C$500m) Canadian equities. Sector exposures often differ materially from the wider market and the manager generally seeks to remain fully invested at all times.
- **Performance.** Over the last 5 years, the fund has outperformed our benchmark (S&P/TSX Composite TR index) on both an absolute and risk adjusted return basis; 6%pa and 3%pa respectively.
- **Controlling shareholder.** The existence of the controlling shareholder (52% of the issued share capital) is double edged. The shareholder's interest precludes the potential for arbitrage and discount management, but also ensures that the fund (which represents a substantial proportion of the family's wealth) is managed in such a way to avoid a blow up and in the interest of the longer term investor rather than being focused on performance over a particular 12 month period.

Cumulative performance data versus benchmark (CAD)

	YTD	1m	3m	6m	1 Yr	2 Yr	3 Yr	5 Yr
NAV (%)	*17.6*	*3.8*	*14.1*	*13.7*	*21.2*	*29.1*	*20.6*	*119.9*
*Benchmark (%)**	*10.8*	*0.5*	*6.7*	*7.6*	*12.9*	*16.7*	*12.8*	*67.6*
NAV Relative	6.8	3.3	7.5	6.1	8.3	12.4	7.7	52.2
Share price (%)	*14.8*	*3.4*	*18.0*	*12.5*	*24.2*	*26.4*	*13.8*	*135.1*

** S&P/TSX TR Index*

***Source** Morningstar, Bloomberg / Panmure Gordon calculations as of 30 November 2013*

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Our research is also available on our website www.panmure.com/panmureresearch/

Panmure Gordon & Co acts as corporate broker in the UK to Canadian General Investments

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Please refer to the important disclosures shown on the inside back cover

- **Dividend & policy.** CGI has no articulated dividend policy. Over the last decade the fund made distributions averaging c5% of the share price via a series of small, static, quarterly dividends and an annual, special, capital gains dividend. We believe that it is likely that the use of special dividends and their variability renders the fund less attractive to income orientated investors than would be the case with a more clearly articulated policy. CGI's last quarterly dividend was substantially (30%) increased but no policy was announced, if this dividend represents a change in strategy that leads to an attractive articulated policy (e.g. income growth) this is potentially significant for the fund's long term valuation. We note that the implementation of a sustainable dividend policy may entail a reduction in the total yield.
- **Valuation.** Over the last decade, CGIs discount has ranged from 4.1-37.4%, averaging 22.2%. At its current discount (31.6%) and 12 months range (25-33%, average 29.5%) the fund is trading wider than its 1 and 10 year averages. Given the controlling shareholder and in the absence of any other factors, we see no reason for the fund to fundamentally re-rate. However, the scale of the discount and historic ranges does offer some potential for volatility trading. We note that CGI's UK comparator (Middlefield Canadian Income, MCT) is currently trading at a 2.5% discount.
- **Gearing.** CGI is geared (29.2% debt to equity ratio) via preference shares with a WACD of 3.83%. Discussing the use of gearing, the manager highlighted that it was their intention generally to remain fully invested at all times and that it represented a spread trade designed to enhance the return to shareholders. Eckel highlighted that since the strategy had been introduced the fund's NAV had outperformed the cost of gearing by c4-5%pa.

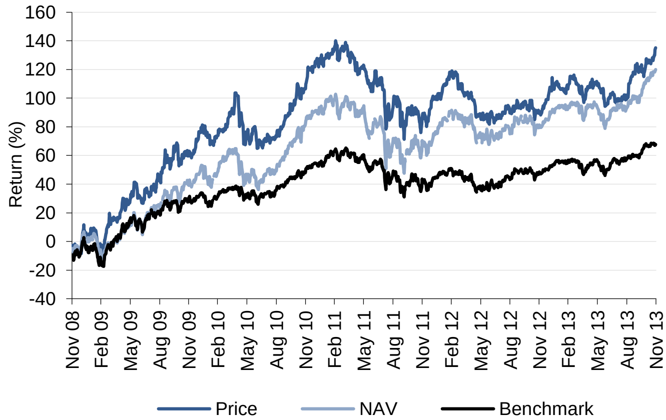
CATALYSTS

- **USA.** A resurgent US Economy should have a positive impact on the whole of North America.
- **Dividend.** The increase in the Q3 dividend may herald a wider re-vamp of CGI's dividend strategy, the articulation of a policy, potentially stimulating incremental demand for the fund.

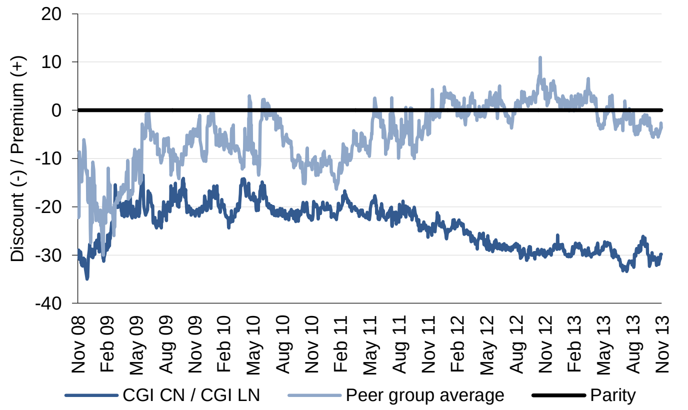
KEY RISK

- **Leverage.** As a levered investment, the fund's NAV is likely to exhibit great volatility than the market as a whole and during market corrections the gearing level will rise sharply as a proportion of shareholder funds.

NAV/Share price total return 5 years



Discount to peer group 5 years



__Source__ Bloomberg, Morningstar, Panmure Gordon calculations as of 30 November 2013

OVERVIEW AND INVESTMENT STRATEGY

Established in January 1930, CGI is a dual listed (London and Toronto) Canadian closed-end fund managed to provide medium to long term exposure to Canadian equities. Overseas exposure is limited to 15% of income and 25% of NAV to comply with the Income Tax Act (Canada) so as to maintain its status as an investment corporation.

Investment manager

Morgan Meighen & Associates (MMA) was established in 1955 and has managed CGI since 1956. MMA (majority owned by the controlling shareholders of CGI), is an independent investment manager with AUM of C$1.5bn with a range of mandates including closed-end and pooled funds, private charitable foundations, institutional funds and high net worth private clients. There are eight portfolio managers on staff within a total employee count of 21.

Greg Eckel (CGA, CFA), the named portfolio manager, has been CGI's lead portfolio manager since the beginning of 2009. Eckel has worked at MMA since 1989 and assumed portfolio management responsibilities in the mid 1990s including the Third Canadian General Investment Trust in 2000.

Investment style

MMA's investment approach is stock driven (but macro aware) and the company's sector weightings differ substantially from that of the Canadian market as a whole. The materials (chemicals, metals and mining), financials and energy sectors account for more than 75% of the Canadian stock market.

Eckel describes the fund as being invested to provide diversified core Canadian exposure with an intention to be fully invested at all times; average holding period 4-6 years.

The portfolio ranges from 65-75 securities (currently 70) with the top ten accounting for 30-35% of the portfolio and individual exposures being started at c1% and generally capped out at 5% of NAV; the 5% limit is subject to a comply or explain rule. Other investment restrictions include a 35% sector limit, owning more than 10% of a single company, maximum 15% foreign income and 25% interest income.

Asked to articulate their investment style, Eckel declined to be categorised noting that to an extent the fund's positioning at any one point in time reflected the market environment. He did however highlight that CGI is the principle investment vehicle for a wealthy Canadian family and that the portfolio was managed in accordance with their risk tolerance with a view to outperforming, on a total return basis, the Canadian equity market over the medium to long term.

Management fee and total expenses

CGI pays a 1% management fee on the market value of the company's investments adjusted for cash. The company on-going expenses total 1.7% per annum and the total expenses of the fund (including debt costs) represent 3.1% per annum. The management contract is subject to a 180 day notice period.

Gearing

The fund is geared (debt / equity ratio 29.2%) via c$150m of fixed dividend preference shares (two series) with an average coupon of 3.825%; the gearing program was started in 1998. The most recent series (series 4) was issued in 2013 with a coupon of 3.75% pa to replace series 2 (which had a coupon of 4.65%).

Discussing the attraction of the debt, the management team highlighted an attractive spread trade between the cost of debt (3.825%) and the average return from investing in Canadian equities over the last decade (8.4%).

Discount and discount management

CGI has traded on an average discount of 22.2% over the last decade. The fund is controlled (c52% shareholding) by the Morgan family (and associated foundation). Under Canadian law, if the controlling shareholders' stake in the company increases it will lose its ability to maintain it tax status. Reflecting this, the fund does not buy back its common shares or seek to manage its discount by any other means. The management team does however undertake extensive marketing activities to maintain investor interest in the company.

Dividend policy

Although the fund doesn't have a publically declared dividend policy, there is a substantive track record of paying quarterly income dividends and, most years, a capital gains dividend (normally declared in early December), i.e. four ordinary dividends and one special per annum.

Since the start of the century, the fund's total dividends have averaged a 4.8% yield on the year end share price with a capital gains dividends being paid in 10 of the last 12 years. The income component of the dividend has remained remarkably stable at C$0.06 per quarter (C$0.24 pa) until FY 2013 when it was increased to C$0.08 for the final quarter (i.e. C$0.26 for the year).

Commenting on the dividend increase, the management team felt that it represented the start of an evolution of the fund's distribution strategy towards distributions that are more evenly balanced over the year. When pushed, they highlighted that the dividend and associated policy is a matter for CGI's board, which to date hasn't publically articulated the policy.

The current lack of an explicit dividend policy is unusual. In our opinion, the articulation of a sustainable dividend policy could improve the fund's positioning and make the fund more attractive to income oriented investors; a core constituent of many equity markets.

AIFM

The fund reports that it expected to be grandfathered under AIFM as it has no intention of raising additional capital in the London market.

PORTFOLIO AND CURRENT THEMES

The portfolio is currently invested in 70 stocks with a top 10 concentration of 31.8%, figure 2. The manager has been reducing the number of securities owned over the last few years, down from a high of c120.

The fund's sector exposures are limited to 35% of portfolio value, leaving it structurally underweight Financials (35.0% of the market) and a maximum of market weight in Energy (25% of the index), the 3rd largest sector in the market is Materials with a 14.4% weight. Reflecting its stock driven investment strategy, CGI operates material sector over and underweights relative to the market as a whole (figure 1). The fund's portfolio yields 2.0% versus the composites' 3.0%.

Figure 1: Sector allocations versus benchmark

	CGI	S&P/TSX	Differential
Financials	22.0	35.0	-13.0
Energy	19.5	25.0	-5.5
Consumer Discretionary	14.8	5.5	9.3
Materials	12.8	14.5	-1.7
Industrials	12.7	7.4	5.3
Information Technology	5.7	1.7	4.0
HealthCare	4.0	3.0	1.0
Telecommunication Services	3.8	5.0	-1.2
Other	4.0	2.9	1.1
Cash and Equivalents	0.7	0.0	0.7
Total	**100.0**	**100.0**	**0.0**

Source *Company data, S&P, Panmure calculations as of 31 October 2013*

Discussing the structural underweight to Financials, Eckel highlighted that this wasn't a particular issue given the nature of the Canadian banks. He noted that the Canadian banking system largely operated (by regulatory design) a utility type model which is designed to limit the macro risks to the Canadian economy rather than a high return to investors. Commenting specifically on their banking exposures, he reported that it represented about one third of the Financials exposure with property, lease finance, insurance and thrifts making up the bulk of the remainder.

Figure 2: Top 10 holdings and Sector Allocations

Top Holdings	Sector	Geography	% of NAV
Dollarama Inc.	Retail	Canada	*4.9*
Catamaran Corporation	Healthcare Technology	USA	*4.0*
Enbridge Inc.	N. American Pipelines etc, Energy	N. America	*3.4*
Bank of Montreal	Bank	Canada	*3.0*
Brookfield Canada Office Properties	Property	Canada	*3.0*
Canadian Pacific Railway Limited	Transport	Canada	*2.9*
Element Financial Corporation	Lease Finance	Canada	*2.9*
Royal Bank of Canada	Bank	Canada	*2.6*
Rogers Communications Inc.	Telecommunications Services	Canada	*2.6*
Methanex Corporation	Chemicals (methanol)	Canada	*2.5*
			31.8

Source *Company data as of 31 October 2013*

Reflecting on the fund's exposure to potentially volatile sectors (Energy and Materials), Eckel highlighted that the opportunities within Energy ranged from pipeline and storage companies such as Enbridge (3.4% of NAV) to pure micro capitalisation exploration companies., with low cost producers such as RMP Energy (oil) and Peyto Exploration and Development on the way through.

His point being that opportunities were sufficient to allow him to tilt CGI's risk profile according to the market conditions. He noted that there was a similar potential within Materials.

Commenting on the fund's overseas exposure (12.5% of NAV), he noted that roughly one third of the exposure was Catamaran (4.0%, listed in Canada) a health care technology stock and that the principle reason for investing overseas was for diversification i.e. exposure to sectors which were not available within the Canadian market such as technology, the US housing market and gaming.

Discussing recent portfolio activity, Eckel highlighted that he is a natural seller of his largest holdings (as they reached a 5% weighting) and Materials stocks such as Franco Nevada (gold royalties). Proceeds have been reinvested into industrials such as Stantec (diversified engineering services) and consumption oriented stocks such as Air Canada and BRP Inc (snow mobiles, jet skis, ATVs).

Eckel highlighted a willingness to buy special situations including turn-arounds (Air Canada) and potential takeout situations such as Algoma Central (great lakes freight railway) as and when they perceive them to be attractive.

Discussing the Canadian market and when the investment strategy performs best, the manager noted that they tend to outperform when the market movement is being driven by broad trends not sector/stock specific issues. The fund underperforms when very specific trends drive the market; the enthusiasm for Nortel in the late 1990s and potash (3 companies) in 2007 were cited as examples of when the market is has been driven by very specific trends.

PERFORMANCE AND DISCOUNT

Figure 3 analyses 5 years monthly returns data for CGI and iShares Canada (EWC UP) against the benchmark, the S&P/TSX Composite TR Index.

The analysis highlights that over this period the strategy has generated 3.0%pa of non-beta return (alpha + noise) resulting in a substantial outperformance (89.2% period return versus 59.0% for our benchmark). Consistent with the fund's gearing, CGI has an above market risk profile (beta 1.1 and volatility of 16.6% versus 13.1%) and is taking a reasonable amount of non-market risk (R-squared 0.8, Tracking error 8%) but isn't massively aggressive.

We note that iShares MSCI Canada has underperformed our Canadian benchmark, the S&P/TSX Composite TR Index.

Figure 3: Five year peer group risk & return analysis (CAD)

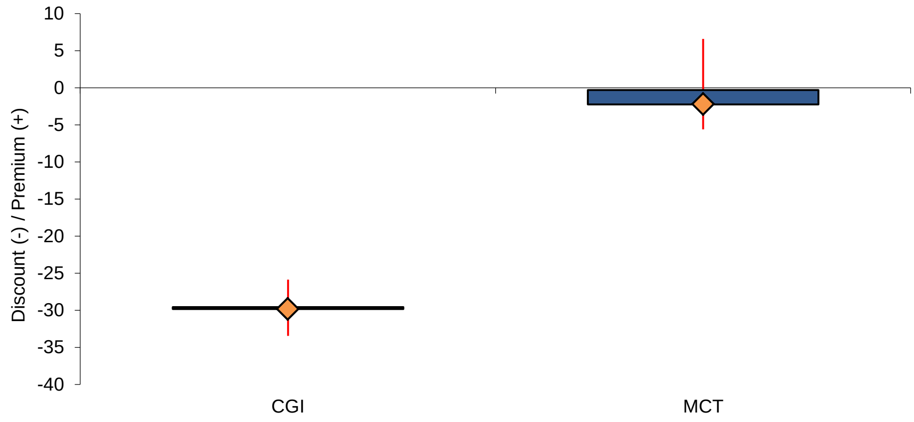
	CGI CN	EWC UP	Benchmark*
Annualised return (%)	*13.6*	*8.1*	*9.7*
Beta return (%)	*10.7*	*9.5*	*9.7*
Non-beta return (%)	*3.0*	*-1.3*	*0.0*
Beta	*1.1*	*1.0*	*1.0*
R-Squared	*0.8*	*1.0*	*1.0*
Volatility (%)	*16.6*	*12.9*	*13.1*
Tracking error (%)	*8.0*	*2.2*	*0.0*
Information ratio	*0.5*	*-0.7*	*0.0*
Return / volatility	*0.8*	*0.6*	*0.7*
% outperformed	*58.3*	*36.7*	*100.0*
% underperformed	*41.7*	*63.3*	*0.0*
Max gain (%)	*10.2*	*10.8*	*11.5*
Max loss (%)	*-10.8*	*-7.7*	*-8.7*
Period return (%)	*89.2*	*47.9*	*59.0*
Dividend yield (%)	*4.9*	*2.3*	*3.0*

***Source** Panmure Gordon calculations as of 31 October 2013*

A potential comparator (Middlefield Canadian Income, MCT) has not been included in the comparison due to its use of a cross-currency swap (until late 2011) to provide tax efficient currency hedged exposure to its underlying portfolio. The use of the swap limits our ability to analyse its return profile over the last 5 years and the current un-hedged track record is limited in its duration.

The two years of MCT unhedged performance data that exists shows MCT underperforming CGI in absolute terms (23% versus 26.7%) but outperforming on a risk adjusted basis reflecting its beta of 0.53 versus CGI's beta of 1.17. MCT's R-Squared is estimated at 0.22 versus CGI's 0.8.

Figure 4: Relative discount chart



Vertical lines indicate discount range over one year; highest to lowest. Funds sorted by current discount (absolute) from left to right. Blue bar indicates the current discount is [above] 12m average. Grey bar indicates the current discount is [below] the 12m average.

***Source** Panmure calculations as of 2 December 2013*

CGI (30.0% discount) trades as a substantial valuation differential to MCT (2.5% discount).

We attribute MCT's rating to the fund's income growth mandate and its clearly articulated dividend strategy.

We attribute CGI's discounted valuation (a 10 year average of 22.2%) to its strategic shareholder whose presence restricts the possibility of both arbitrage and discount management. Absent a compelling reason to fundamentally re-appraise the fund, we would describe the long term average discount as the norm. If, however, the fund's tentative moves on its dividend translates into a concrete, attractive and well communicated dividend policy this could signal the potential for a fundamental re-rating. The potential for such a re-rating is currently moot but investors should monitor the situation.

Figure 5: Peer group summary

	Canadian General (CGI)	Middlefield Canadian Income (MCT)	iShares MSCI Canada (EWC)
Summary			
Mandate	Total return	Equity income	MSCI Canada TR Index tracker
Size bias	Large cap	Diversified	Tracker
Company Benchmark	S&P/TSX Composite TR Index	S&P/TSX Equity Income TR Index	MSCI Canada TR Index
Launch	1930	August 2006	December 1996
Age (years)	83.5	7.3	17.0
Management house	Morgan Meighen & Associates	Middlefield	Blackrock
Appointed	1956	August 2006	December 1996
Lead Manager	Greg Eckel	D. Orrico, R. Faiella and A. Nasr	Team
Tenure (years)	4.9	7.3	17.0
Domicile	Canada	UK (for tax purposes)	USA
Market data			
Total NAV (£m)	302.8	115.7	2,170
Market Cap (£m)	205.7	111.1	2,170
Premium / (Discount) to NAV	(30.0)%	(2.5)%	Nil
Net gearing/(cash)	29.2%	13.4%	Nil
Management fee	1.0% of assets	0.867% of net asset	0.49%
Performance fee	Nil	Nil	Nil
On-going charges	1.70%	1.55%	0.49%
Continuation vote frequency	None	None	None
Last vote	n/a	n/a	n/a
Next vote	n/a	n/a	n/a
Risk / Return			
5 year return (CAD) (%)	119.9	108.7	53.0
2 year return (CAD) (%)	29.1	22.5	15.2
Volatility (2 years) (%)	12.5	9.7	10.3
Risk / Return (2 years)	1.09	1.10	0.71

Source *Company data / Panmure Gordon as of 30 November 2013*

TAXATION

CGI is managed so as to satisfy the requirements of being an investment corporation for the purposes of the Income Tax Act (Canada).

As a corporate entity, CGI is subject to tax on its taxable income – primarily realized gains on the sale of investments – at an effective rate of approximately 20%. As a result of its investment corporation status under Canadian tax law, CGI can recover taxes paid or payable on its realized taxable capital gains through the payment of capital gains dividends to shareholders. The company is also subject to a special tax of 33.33% on taxable dividends received from corporations resident in Canada. This special tax is refundable on payment of taxable dividends to shareholders at the rate of $1 for each $3 of such dividends paid.

Circa 50% of the company's equity is in the form of unrealised capital gains; because any potential deferred tax liability on these gains are recoverable on distribution to the equity shareholders, there is no requirement to provide for deferred taxation. This remains true under IFRS.

Its status as an investment corporation in part relies on grandfathering provisions. Absent the grandfathering provisions, a shareholding owing more than 25% of the company would disqualify it for the purposes of investment corporation status. The Morgan family cannot increase its stake without impacting its tax status as a Canadian Investment Corporation and a reduction in their interest would result in a loss of control.

UK shareholders are understood to be liable to income tax on all dividends (whether categorised as income or capital by the company). We understand that CGI's income dividends attract a tax credit of 15% and the capital gains dividend is paid gross.

Equity Research Ratings Tariff Guideline (return targets may be modified by risk or liquidity issues)		*Distribution of investment ratings for equity research (as of 8 Apr 13)*		
Buy	Expected to produce a total return of 15% or better in the next 12 months	Overall Global Distribution (Banking Client*)		
Hold	Fairly valued: total return in the next 12 months expected to be ±10%	Buy	Hold	Sell
Sell	Stock is expected to decline by 10% or more in the next 12 months	54% (34%)	33% (9%)	13% (0%)

** Indicates the percentage of each category in the overall distribution that were banking and/or corporate broking clients*

Investment Funds Research Rating Tariff

Relative Return (12 month outlook*)			Absolute Return (12 month outlook)		
Buy	Hold	Sell	Buy	Hold	Sell
>3%	-3 to +3%	<-3%	>10% total shareholder return	5% to 10% total shareholder return	<5% total shareholder return

*Measured on a total shareholder return basis

Note corporate Investment Fund stocks are not rated

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Investment Objective

To provide a better than average return (long term capital growth and income) to investors by investing in a diversified portfolio of, primarily, Canadian corporations; foreign income is limited to 15% by its status as an investment corporation and at least 75% of the portfolio must be invested in companies with market capitalisation in excess of C$500m.

Investment Style

The investment strategy is macro aware, diversified, bottom up and medium to long term (c25% portfolio turnover). Sector exposures are limited to 35% of portfolio value and there is a 5% single stock exposure guideline (explain or comply).

Portfolio

Largest stock holdings	*% of NAV*	Sector weights	*% of NAV*
Dollarama Inc.	*4.9*	Financials	*22.0*
Catamaran Corporation	*4.0*	Energy	*19.5*
Enbridge Inc.	*3.4*	Consumer Discretionary	*14.8*
Bank of Montreal	*3.0*	Materials	*12.8*
Brookfield Canada Office Properties	*3.0*	Industrials	*12.7*
Canadian Pacific Railway Limited	*2.9*	Information Technology	*5.7*
Element Financial Corporation	*2.9*	HealthCare	*4.0*
Royal Bank of Canada	*2.6*	Telecommunication Services	*3.8*
Rogers Communications Inc.	*2.6*	Other	*4.0*
Methanex Corporation	*2.5*	Cash and Equivalents	*0.7*
Total	***31.8***		***100.0***

Source *Company filings, 31 October 2013*

Portfolio statistics	2010	2011	2012
No. of holdings	81	81	78
Top 10 concentration (%)	*38.8*	*43.9*	*44.8*
Turnover (%)	*38.9*	*34.3*	*14.6*
Total expense ratio (%)	*1.7*	*1.6*	*1.7*
All-in-cost ratio (%)	*3.2*	*3.0*	*3.1*

***Source** Company filings, Panmure Gordon calculations*

Directors

Director	Role	Shareholding	Date appointed	Tenure (yrs)
Richard Whittall	Non-Exec Director	4,000	Apr 2004	9.6
James Billett	Non-Exec Director	3,500	Apr 2005	8.6
James Cook	Non-Exec Director	4,500	Feb 2001	12.6
Jonathan Morgan	President & CEO	*10,954,269	Dec 2001	12.6
Vanessa Morgan	Chairman	*10,954,269	Apr 1997	16.6
R Neil Raymond	Non-Exec Director	6,000	Aug 2002	11.6
Michael Smedley	Executive Director	10,000	Aug 1989	24.6

***Source** Company filings. *common holding*

Management Contract

Investment manger	Morgan Meighen & Associates
Fund manager	Greg Eckel
Tenure	4.4 yrs
Manager location	Toronto
Management fee	1%pa of Investments
Capital/revenue split	0 / 100
Performance fee	na
Company benchmark	S&P/TSX Composite Index
Management contract	180 days
Continuation resolution	No
Last continuation vote	na
Discount management	No
Treasury facility	na
Issuing authority	na
Website	www.mmainvestments.com

***Source** Company filings*

Major Shareholders (%)

Morgan Family and Foundation	*52.51*

***Source** Company data as of 15 March 2013*

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