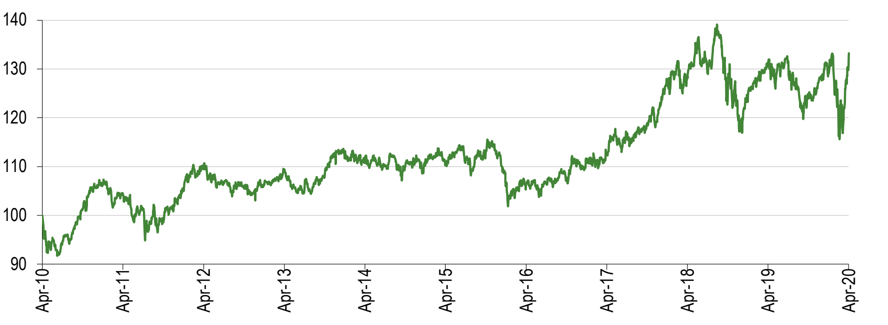
EDISON

Canadian General Investments

Sticking to the fundamental, long-term process

Canadian General Investments (CGI) is managed by Greg Eckel at Morgan Meighen & Associates. He stresses that despite the tough macro backdrop as a result of the coronavirus pandemic, he is sticking to the company's philosophy and fundamental investment process, which has generated a very long-term record of outperformance versus the Canadian market. The manager says: 'We will not veer off into unknown, dangerous territories and away from our core, proven strengths. It is easy to fall victim to near-term pressures, but doing so has proven to handicap and impair returns otherwise available. We rely on our experience and learnings of the past in an effort to avoid such pitfalls, and make every effort to provide our shareholders with the results to which they have become accustomed.'

Long-term NAV outperformance versus the benchmark



Source: Refinitiv, Edison Investment Research

The market opportunity

Stock prices have been under significant pressure as a result of the COVID-19 outbreak. However, if history is any guide, markets have recovered from all setbacks, regardless of their severity, and gone on to set new highs. The current weakness may thus provide an opportunity for investors to add to their exposure to high-quality, well financed businesses that can be held for the long term.

Why consider investing in CGI?

- Broad exposure to the Canadian stock market, along with selected exposure to US equities.
- Fundamental, long-term approach to bottom-up stock selection.
- Long-term NAV and share price outperformance versus the benchmark S&P/TSX Composite Index.
- Growing dividend, which can be paid out of capital gains as well as income.

Shares trade at a significant discount to NAV

CGI's shares are currently trading at a 31.1% discount to NAV, which is broadly in line with the 30.6%, 29.6%, 29.1% and 27.7% average discounts over the last one, three, five and 10 years, respectively. The company has moved away from paying special as well as regular quarterly dividends, and in FY19 the total distribution increased by 5.3% year-on-year. Based on its current share price, CGI offers a 3.6% dividend yield.

Investment companies
North American equities

6 May 2020

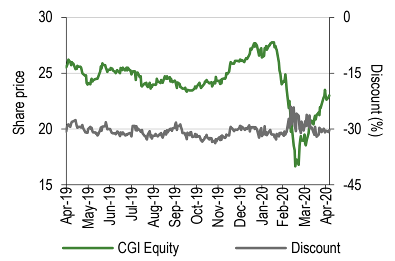
Price	**C$23.00**
Market cap	**C$480m**
AUM	**C$871m**

NAV*	C$33.36
Discount to NAV	31.1%

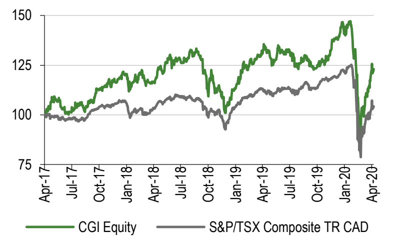
*Including income. As at 5 May 2020.

Yield	3.6%
Ordinary shares in issue	20.9m
Code	CGI
Primary exchange	TSX
AIC sector	North America
Benchmark	S&P/TSX Composite

Share price/discount performance



Three-year performance vs index



52-week high/low	C$27.75	C$16.65
NAV* high/low	C$40.52	C$22.83

*Including income.

Gearing

Gross*	20.2%
Net*	16.8%

*As at 30 April 2020.

Analysts

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

Exhibit 1: Company at a glance

Investment objective and fund background

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.

Recent developments

- 15 April 2020: Announcement of the appointment of Marcia Lewis Brown as independent director at AGM.
- 15 April 2020: Announcement of quarterly dividends – C$0.21 per common share and C$0.23438 per Series 4 preference share.
- 17 March 2020: Annual report for 12 months ended 31 December 2019. NAV total return of +31.0% versus +22.9% for the S&P/TSX Composite Index. Share price total return +32.1%.

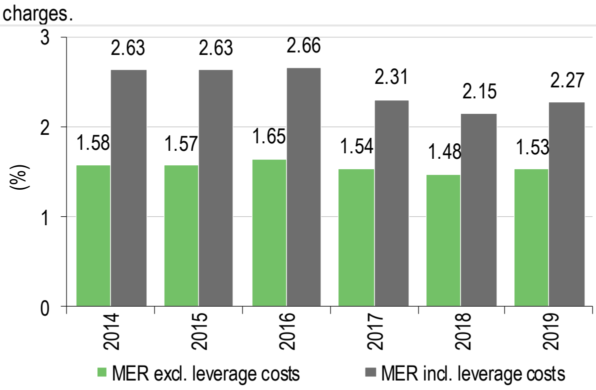
Forthcoming		Capital structure		Fund details	
AGM	April 2021	Ongoing charges	1.53% (see MER below)	Group	Morgan Meighen & Associates
Interim results	August 2020	Net gearing	16.8%	CEO	Jonathan A Morgan
Year end	31 December	Annual mgmt fee	1.0% (see page 8)	Address	10 Toronto Street, Toronto, Ontario, 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$175m (see page 8)	Website	www.mmainvestments.com

Dividend policy and history (financial years)

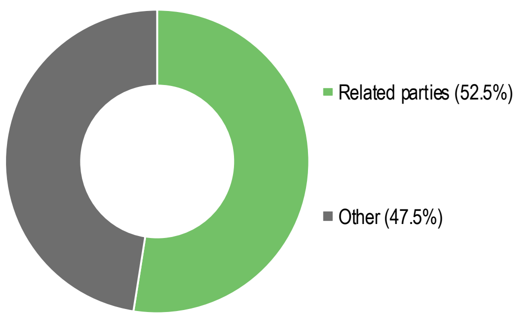
CGI revised its dividend policy in 2014, intending to pay steady to rising quarterly dividends while gradually eliminating the special final dividend. Note: 2020 is year-to-date.

Management expense ratio (MER)

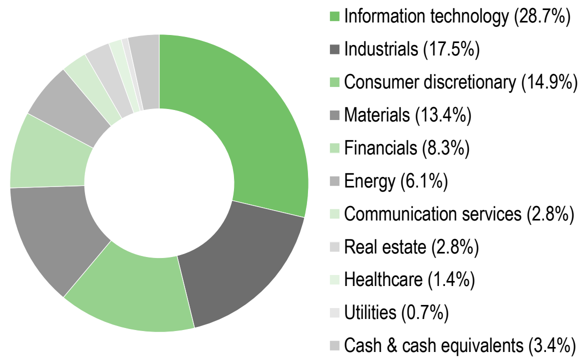
CGI pays a monthly management fee at 1.0% per year of gross assets. Leverage costs include preference share dividends, interest and financing charges.



Shareholder base (as at 30 April 2020)



Portfolio exposure by sector (as at 30 April 2020)



Top 10 holdings (as at 30 April 2020)

Company	Country	Sector	Portfolio weight %	
			30 April 2020	30 April 2019*
Shopify	Canada	Internet services	9.2	6.2
Franco-Nevada Corp	Canada	Gold mining	6.2	3.0
Amazon.com	US	Online retail	4.6	3.2
NVIDIA Corporation	US	Semiconductors	4.2	N/A
Canadian Pacific Railway	Canada	Railroads	4.2	3.8
Mastercard	US	Financial transaction processing	3.8	3.9
Cash & cash equivalents	N/A	N/A	3.4	N/A
Apple	US	Technology	2.7	N/A
The Descartes Systems Group	Canada	Logistics software	2.7	N/A
WSP Global	Canada	Business services	2.5	N/A
Top 10 (% of portfolio)			**43.5**	**35.8**

Source: CGI, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in end-April 2019 top 10.

Market outlook: Be selective given macro backdrop

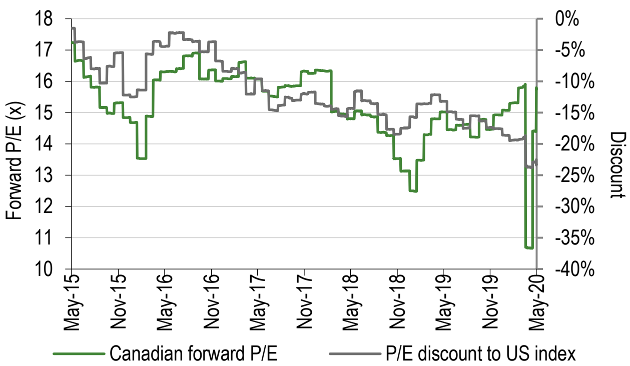
Canadian stocks have not been immune to the coronavirus-led market weakness. As shown in Exhibit 2 (LHS), in Q120 the benchmark Canadian index gave back most of its above-average total return achieved in 2019. However, stocks have rallied meaningfully from their lows as investors are turning their attention to the prospects for 2021. The Canadian authorities have been very supportive in terms of both monetary and fiscal policies to help mitigate the negative effects of the pandemic; however, due to the economic uncertainty, investors could be better served by focusing on high-quality companies with strong management teams and robust balance sheets.

Exhibit 2: S&P/TSX Composite Index data and valuation

S&P/TSX Composite Index data (as at 31 March 2020)

	Number of companies	Weight (%)	Q120 total return (%)	2019 total return (%)
Financials	26	32.0	(21.1)	21.4
Energy	30	13.2	(37.2)	21.7
Industrials	31	11.9	(15.0)	25.5
Materials	47	11.7	(18.8)	23.8
IT	10	7.0	(2.8)	64.8
Comm services	8	6.4	(8.1)	13.0
Utilities	16	5.7	(5.3)	37.5
Consumer staples	11	4.5	(9.3)	14.4
Cons discretionary	15	3.5	(32.8)	15.3
Real estate	26	3.1	(25.4)	22.6
Healthcare	10	1.0	(37.1)	(10.9)
Index	**230**	**100.0**	**(20.8)**	**22.8**

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



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

Fund profile: Broad exposure to Canada and US

Established in 1930, CGI is North America's second-oldest closed-end fund. It is listed on the Toronto Stock Exchange (since 1962) and the London Stock Exchange (since 1995). Since 1956, the company has been managed by Morgan Meighen & Associates (MMA), which has c C$1.7bn in assets under management for private and institutional clients and fund investors.

CGI's manager since 2009 is Greg Eckel, who aims to generate a better-than-average total return from a diversified portfolio of North American equities via prudent stock selection and timely recognition of capital gains and losses. The majority of the portfolio is invested in Canadian companies, but up to 25% of the fund may be held in US-listed businesses. Eckel has an unconstrained approach and invests without reference to the sector weightings of the benchmark S&P/TSX Composite Index, meaning the company's performance may differ from that of the benchmark. The manager has a medium- to long-term view, and some of CGI'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.

CGI has a long-term record of outperformance; data from MMA show that over the last 25 years (to end-December 2019) the fund generated a total return of +10.5% pa, 2.2pp higher than the benchmark's +8.3% pa total return. Over the last 50 years, the total return performance differential is 2.0pp (+11.1% pa for CGI versus +9.1% pa for the index).

The fund manager: Greg Eckel

The manager's view: Looking towards an economic recovery

The manager says that prior to the coronavirus outbreak, the Canadian economy was 'humming along very fine, thank you', with the lowest unemployment rate in generations. GDP growth was 1.6% in 2019, with a stronger first half and declining growth rates in the third and fourth quarters, so essentially the economy was in 'maintenance mode'.

Eckel says that gauging the actual impact of the COVID-19 pandemic on the Canadian economy is 'guesswork'; although there are some economists and strategists who have taken a stab at it, the manager says that any of their estimates about the negative economic impact and the extent of a potential recovery in the second half of the year 'should be taken with a grain of salt'. However, he believes that while the economic drop will be steep, it could be followed by a sharp improvement in 2021. Eckel does not have a view on the shape of an economic recovery, but he is confident that there will be an improvement, which 'should be beneficial for CGI', he adds.

The manager suggests that the fiscal and monetary policy responses to COVID-19 in Canada have been better than those in the US and UK and observes that unlike in the US, there has been no backlash against lockdown measures, and hospitals have not been swamped. He notes an upsurge in entrepreneurship during the outbreak, as companies have found different ways to utilise their staff and make money. Also, the government has been directly sending support money to people; they have been encouraged to take it and if it transpires that they are ineligible, 'things will be sorted out at tax payment time'. Eckel say there have not been signs of panic in Canada, except perhaps in Alberta, where the economy was already struggling due to its heavy resource exposure. The Canadian government has been stepping in to ensure supply chains are maintained, including personal protective equipment (PPE). Air Canada and Cargojet have redirected flights to China to bring in supplies, while auto companies and clothing manufacturers have been making healthcare equipment. The Bank of Canada has reduced its overnight rate by 50bp three times, to the current level of 0.25%, and there have been multi-billion-dollar liquidity measures and fiscal initiatives. While these are large numbers, Eckel says Canada's finances are in relatively good shape compared with other G7 countries. The manager comments that 'many developed countries' governments cannot afford to bankroll their economies for very long; they have an inescapable need to get their economies going again'.

Commenting on the recent oil price weakness, Eckel says that the expiry of May 2020 futures caused the bellwether West Texas Intermediate (WTI) oil price to move into negative territory, but this was an anomaly, as there was 'no place for the oil to go'. There has since been a lift in contract prices from very low levels, but the benchmark Western Canadian Select (WCS) continues to trade at a discount to WTI due to a lack of sufficient transportation infrastructure. In Canada, energy companies have been curtailing their capex budgets, cancelling their dividends and in some cases, activity has ground to a halt; some businesses are operating in 'survival mode'. The manager says that the industry has 'gone from bad to worse'; this negative view is reflected in CGI's portfolio, which has had an underweight exposure to energy versus the index since 2011 (currently less than half weighted). While acknowledging that there could be a recovery in oil company share prices, Eckel expects the sector to remain volatile. He has not been actively trading energy shares, noting that while they looked enticing at the end of March, the relief rally following the resolution of the price war between Saudi Arabia and Russia means they are now looking less attractive. The manager says there is no change to his long-term cautious view on the energy sector.

Asset allocation

Investment process: Bottom-up, long-term approach

Eckel aims to generate an above-average total return for investors by selecting stocks on a bottom-up basis, while taking account of the macro environment. The manager seeks companies with favourable fundamentals and strong management teams, that are trading on reasonable valuations. While the majority of CGI's portfolio is invested in Canadian companies, up to 25% of the fund may be held in US equities, primarily in companies with niche businesses or those that are under-represented in the Canadian market. The asset split at the end of April 2020 was 72.9% Canada, 23.7% US and 3.4% cash/equivalents. Eckel invests with a long-term focus; in FY19 portfolio turnover was 8.0%, which is towards the lower end of the 2.3% to 21.5% five-year range. Over this period, turnover averaged 11.7% pa, which implies an 8.5-year average holding period, although portfolio positions are regularly reassessed to ensure that they are sized correctly and that the investment cases still hold true. The manager's unconstrained approach is illustrated by the sector deviations versus the benchmark S&P/TSX Composite Index in Exhibit 3. CGI's portfolio has a bias to large and mid-sized, rather than small-cap stocks, and some of its holdings are higher yielding, such as the Canadian banks, to help support the fund's own dividend payments. Eckel has a history of successively backing good management teams, who may change employers due to mergers and acquisitions.

Current portfolio positioning

At end-April 2020, CGI's top 10 positions made up 43.5% of the portfolio, which was a higher concentration compared with 35.8% a year before; five positions were common to both periods. As shown in Exhibit 3, in terms of sectors, over the last 12 months to the end of April the largest changes are a higher IT weighting (+6.9pp), with lower exposure to the healthcare (-4.0pp) sector. There are two significant deviations versus the benchmark: an overweight exposure to IT (+20.6pp) and an underweight position in financials (-20.9pp). It is also worth noting the 14.9pp exposure to the consumer discretionary sector, which is 4x that of the benchmark's.

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

	Portfolio end April 2020	Portfolio end April 2019	Change (pp)	Index weight	Active weight vs index (pp)	Fund weight/ index weight (x)
Information technology	28.7	21.8	6.9	8.1	20.6	3.5
Industrials	17.5	15.9	1.6	11.7	5.8	1.5
Consumer discretionary	14.9	14.4	0.5	3.7	11.2	4.0
Materials	13.4	15.8	(2.4)	14.1	(0.7)	1.0
Financials	8.3	10.3	(2.0)	29.2	(20.9)	0.3
Energy	6.1	9.3	(3.2)	13.5	(7.4)	0.5
Communication services	2.8	3.0	(0.2)	5.8	(3.0)	0.5
Real estate	2.8	1.2	1.6	3.1	(0.3)	0.9
Healthcare	1.4	5.4	(4.0)	1.0	0.4	1.4
Utilities	0.7	0.8	(0.1)	5.3	(4.6)	0.1
Consumer staples	0.0	0.0	0.0	4.3	(4.3)	0.0
Cash & cash equivalents	3.4	2.1	1.3	0.0	3.4	N/A
	100.0	**100.0**		**100.0**		

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

Eckel highlights the important portfolio changes in recent months. There is a new position in **BRP** (Bombardier Recreational Products), which is a leader in power sports vehicles, all-terrain vehicles and snowmobiles; it is the number two player behind Polaris. The manager explains that the company had been a good performer, but around four quarters ago suffered operational difficulties, which have since been worked through. BRP announced a five-year operational plan at the end of last year and Eckel believes that the company has good potential to further increase its market share. Another addition to the portfolio is **Boyd Group Services**, one of the largest operators of non-franchised collision repair centres in North America in terms of number of locations and sales.

The manager says the company has done a good job in a highly fragmented market, where the top three players have only around a 15% share, and provides desirable exposure to the US. Eckel explains that insurance companies are more likely to deal with national players to ensure consistent quality of repairs and for cost benefits. **FirstService Group**, which provides residential property management and residential/commercial property services, is also a new position. The company has grown via a series of mergers and acquisitions in a very fragmented market. Eckel explains that he has 'admired this company from afar for a very long time', and is confident that FirstService's management team can continue to deliver. More than 90% of its revenues are derived in the US and the manager believes that the company can generate mid- to high-teens percentage revenue and earnings growth. He says there is good visibility and the company has a repeatable business model. Eckel reduced CGI's US exposure as it exceeded the 25% limit, selling online education company **Pluralsight**, which is experiencing a difficult sales environment, and cosmetics/skincare retailer **Ulta Beauty**, while trimming the long-term holding in financial services firm **Mastercard.**

Performance: Mid- and long-term outperformance

Exhibit 4: Five-year discrete performance data

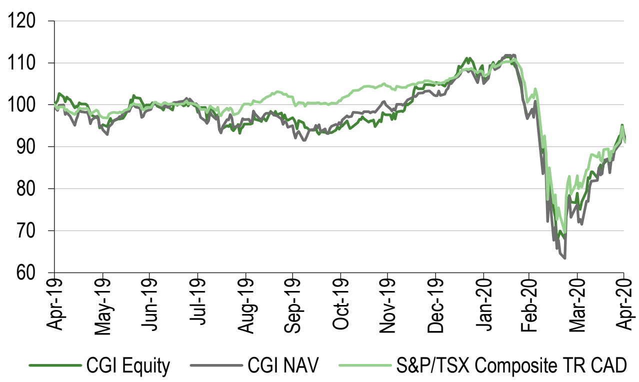
12 months ending	Share price (%)	NAV (%)	S&P/TSX Composite (%)	MSCI Canada (%)	MSCI World (%)
30/04/16	(9.0)	(9.0)	(5.4)	(6.6)	(0.3)
30/04/17	21.6	21.8	14.9	15.7	25.9
30/04/18	16.7	17.6	3.1	3.7	6.7
30/04/19	13.1	12.1	9.6	9.7	12.4
30/04/20	(6.8)	(7.8)	(7.9)	(9.1)	(0.3)

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

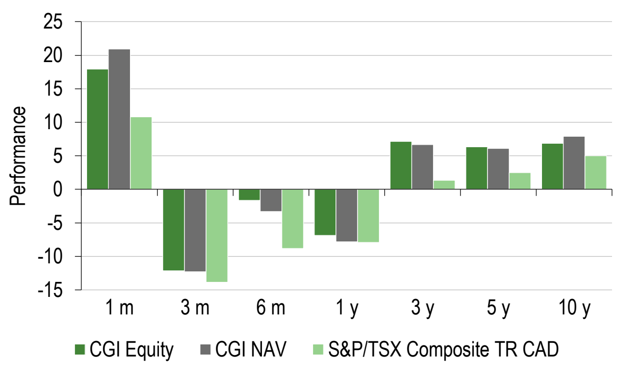
During FY19 (ending 31 December), CGI's NAV and share price total returns of +31.0% and +32.1% respectively were considerably ahead of the benchmark's +22.9% total return. Six out of the top 10 return generators were in the IT sector, led by largest holding Shopify, whose share price appreciated by more than 2.5x during the year. Other positive contributors included Air Canada, NVIDIA (IT hardware), Mastercard (financial services), TC Energy (energy infrastructure) and Parex Resources (oil exploration & production). Holdings that detracted from performance included Secure Energy Services (oil services), Teck Resources (natural resources) and Vermillion Energy (oil & gas exploration & production).

Exhibit 5: Investment company performance to 30 April 2020

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



Price, NAV and benchmark total return performance (%)



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

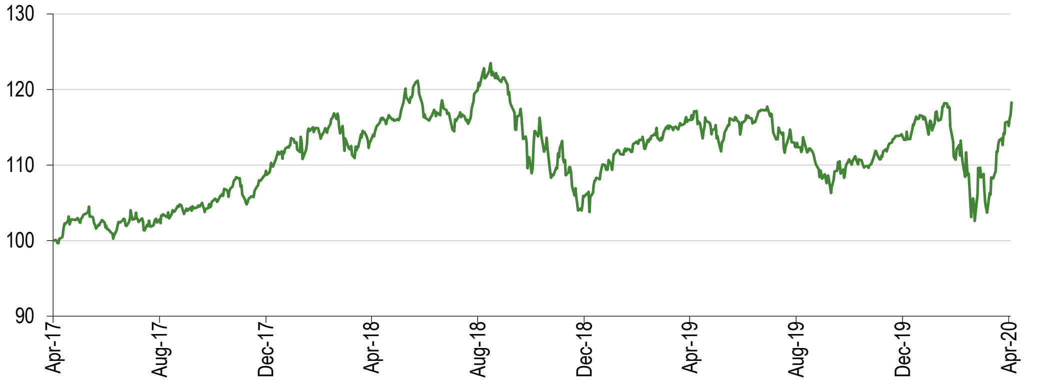
CGI's relative returns are shown in Exhibit 6. It has outperformed its benchmark over all periods shown in both NAV and share price terms. Looking at year-to-date performance to end-April, Eckel notes that CGI is also ahead of the index over this period, which he considers a very acceptable result given the magnitude of equity declines, and the negative impact of leverage in a falling market. While the company's unconstrained approach means that there will be variances between the total returns of CGI and the index, the manager is comfortable with the portfolio structure, although all positions are constantly reviewed with the aim of optimising shareholder returns.

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

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to S&P/TSX Composite	6.5	2.0	7.8	1.2	18.2	20.3	19.4
NAV relative to S&P/TSX Composite	9.2	1.8	6.0	0.1	16.7	19.0	31.5
Price relative to MSCI Canada	7.5	2.1	8.3	2.5	18.9	21.7	22.2
NAV relative to MSCI Canada	10.2	1.9	6.5	1.4	17.4	20.5	34.6
Price relative to MSCI World	8.9	(5.2)	0.1	(6.5)	2.9	(9.3)	(36.0)
NAV relative to MSCI World	11.7	(5.4)	(1.6)	(7.5)	1.6	(10.2)	(29.6)

Source: Refinitiv, Edison Investment Research. Note: Data to end-April 2020. Geometric calculation.

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

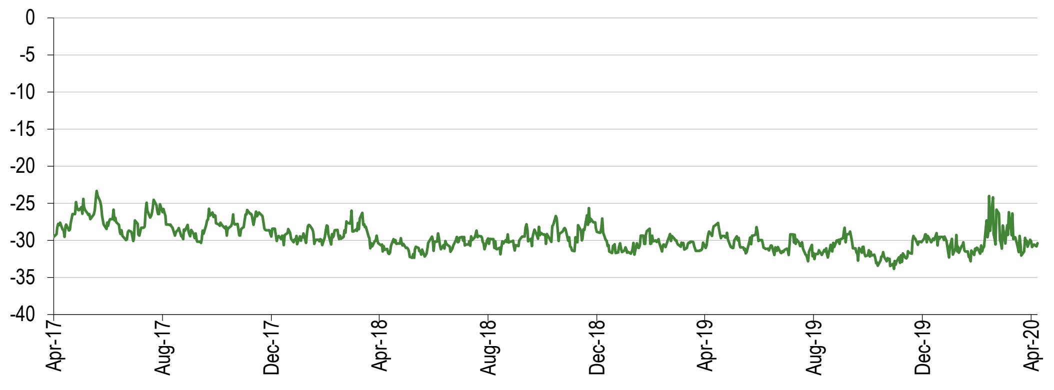


Source: Refinitiv, Edison Investment Research

Valuation: Discount remains wide

As shown in Exhibit 8, CGI's discount to NAV remains consistently wide, despite the company's long-term record of outperformance. This may be due to the high 52.5% insider ownership or the level of gearing, affecting investor perceptions about liquidity and risk. However, it should be noted that there have been brief periods when the fund traded at a premium; the most recent was in 2006.

Exhibit 8: Share price discount to NAV (including income) over three years (%)



Source: Refinitiv, Edison Investment Research

CGI's shares are currently trading at a 31.1% discount to NAV, which compares with the 24.0% to 33.9% range of discounts over the last 12 months. The discount has averaged 30.6%, 29.6%, 29.1% and 27.7% over the last one, three, five and 10 years, respectively. The board is unable to repurchase shares to help manage the discount as this would invalidate CGI's favourable Canadian investment corporation tax status.

Capital structure and fees

CGI has 20.9m ordinary shares in issue and has employed a leveraged strategy since its first issue of preference shares in 1998. On 5 June 2019, the company entered into an amended and restated agreement for a C$100m one-year non-revolving credit facility (replacing C$75m in bank debt). Amounts may be borrowed through prime rate loans, which bear interest at the greater of the bank's prime rate and the Canadian Deposit Offered Rate (CDOR) plus 1.00% pa, or bankers' acceptances, which bear interest at the CDOR plus 0.75% pa. The facility has an evergreen feature, allowing continued use of the loan facility indefinitely beyond the initial one-year term, provided the bank has not given CGI one year's notice of termination. The company also has C$75m of 3.75% cumulative, Series 4 preference shares, which are redeemable, at par, on or after 15 June 2023. At end-April 2020, CGI's total debt of C$175m equated to gross gearing of 20.2% (16.8% net of cash and equivalents). The manager is comfortable with the company's level of gearing, with asset coverage well above the levels required by its loan covenants, and notes that employing debt should be beneficial to CGI's returns during any market recovery.

MMA is paid an annual management fee of 1.0% of the market value of CGI's investments, net of cash, portfolio accounts receivable and portfolio accounts payable; there is no performance fee. In FY19, the annualised management expense ratio (MER) including leverage costs was 2.27% (+12bp year-on-year). Excluding leverage costs makes the MER more comparable with the ongoing charge figure used in the UK. In FY19, it was 1.53% (+5bp year-on-year).

Dividend policy and record

CGI pays quarterly dividends in March, June, September and December. In FY19 there were four equal payments of C$0.20 per share, two as regular taxable dividends and two as capital gains dividends. The annual dividend of C$0.80 per share was 5.3% higher year-on-year and follows six years where the distribution was flat at C$0.76 per share (paid via a combination of regular and special dividends). So far in FY20, two quarterly dividends of C$0.21 per share have been declared, which are 5.0% higher year-on-year. Based on its current share price, CGI offers a 3.6% dividend yield.

Despite companies cutting their dividends as a result of the coronavirus pandemic, the manager remains comfortable that CGI will not have to reduce or miss a dividend payment. There is more than C$300m in unrealised capital gains in the portfolio, which along with income can be used to pay dividends. 'CGI has never missed paying a regular dividend, and we do not plan on starting now,' Eckel adds.

Peer group comparison

CGI is one of two funds in the AIC North America sector with significant Canadian exposure, although each follows a different investment mandate. The company has the higher NAV total return over all periods shown. CGI's discount remains persistently wide, perhaps reflecting its high insider ownership or its level of gearing. Reflecting its focus on total return rather than income, CGI's dividend yield is lower than that of its peer.

Exhibit 9: Selected peer group as at 30 April 2020 (C$)*

% unless stated	Market cap (C$m)	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (cum-fair)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
Canadian General Investments	472.1	(7.8)	21.4	34.6	114.2	(30.5)	1.5	No	121	3.6
Middlefield Canadian Income	154.2	(10.3)	(2.8)	9.3	103.1	(8.9)	1.3	No	100	6.2
Average	**313.1**	**(9.0)**	**9.3**	**22.0**	**108.6**	**(19.7)**	**1.4**		**110**	**4.9**
Fund rank in sector	**1**	**1**	**1**	**1**	**1**	**2**	**1**		**1**	**2**

Source: Morningstar, Edison Investment Research. Note: *Performance data to 29 April 2020 based on ex-par NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

CGI's board has seven directors, with an average tenure of c 16 years. Three board members are non-independent: Vanessa Morgan (appointed in 1997 – chairman of CGI, president and CEO of MMA); Jonathan Morgan (appointed in 2001 – president and CEO of CGI, executive vice-president of MMA); and Michael Smedley (appointed in 1989 – executive vice-president and CIO of MMA).

The four independent directors and the years they joined the board are Neil Raymond (2002), James Billett (2005), Michelle Lally (2015) and Marcia Lewis Brown (2020). Brown has held senior positions at Canadian and international financial institutions and financial media companies. She is chairman of Sistema Toronto, a director of the Canadian Opera Company, chairman of the Independent Review Committee at CIBC Asset Management and chairman of the Massey Hall & Roy Thomson Hall Foundation.

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