

Canadian General Investments

‘One-stop-shop’ for investment in Canada

Canadian General Investments (CGI) is registered as a Canadian investment corporation, which confers favourable tax status; it is listed on both the Toronto and London stock exchanges. Given its broad exposure to primarily Canadian equities, the fund may be considered as a ‘one-stop-shop’ for investment in Canada. CGI’s NAV total return has outperformed the S&P/TSX Composite index benchmark over one and five years. The manager’s high ownership of CGI ensures that all shareholders’ interests are aligned; however, this may be a factor in the size of the discount. Emphasis is moving more towards regular, quarterly rather than year-end special dividends; CGI’s current dividend yield is 3.6%.

12 months ending	Share price (%)	NAV (%)	S&P/TSX Composite (%)	MSCI Canada (%)	FTSE World (%)
31/03/13	(0.6)	5.4	6.1	5.9	13.5
31/03/14	17.7	19.9	16.0	16.4	28.4
31/03/15	19.7	8.4	6.9	8.5	21.4
31/03/16	(9.6)	(14.0)	(6.6)	(7.6)	(1.1)
31/03/17	20.6	27.2	18.6	19.2	19.2

Source: Thomson Datastream. Note: All % on a total return basis in C\$.

Investment strategy: Diversified Canadian exposure

Manager Greg Eckel selects stocks on a bottom-up basis, with a consideration of the macro environment. He seeks companies with good fundamentals and strong management teams, which are trading on reasonable valuations. Exposure is broad and the major active positions on a sector basis are overweight consumer discretionary, technology and materials, while the fund remains underweight financials. The majority of holdings are Canadian equities, although exposure of up to 20% is permitted in US equities to take advantage of investing in business areas that are unavailable in Canada. Gross gearing is C\$150m, split equally between preference shares and bank debt.

Market outlook: Broader stock market leadership

During 2016, shareholders enjoyed outsized returns from Canadian equities – the S&P/TSX Composite index total return was 21.1%. However, stock market leadership was narrow, led by materials, energy, financials and industrials. So far in 2017, the Canadian market leadership has broadened out; this may continue for the balance of the year. For investors wanting exposure to Canada, a fund with diverse exposure and the ability to make meaningful sector bets may be appealing.

Valuation: Scope for discount to narrow

CGI’s shares are currently trading at a discount of 29.2%; this compares to the averages of the last one, three, five and 10 years of 30.2%, 28.6%, 28.9% and 24.5% respectively. The discount may narrow if CGI’s relative investment performance continues to improve or there is increased demand for Canadian equities. CGI is unable to use share repurchases to help narrow the discount as this would jeopardise its favourable tax status.

Investment companies

27 April 2017

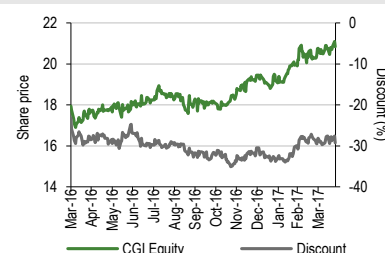
Price C\$20.84
Market cap C\$435m
AUM C\$764m

NAV* C\$29.45
Discount to NAV 29.2%
Yield** 3.1%
Yield*** 3.6%

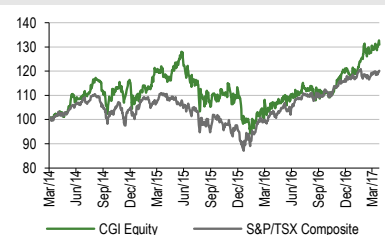
*Including income. As at 25 April 2017. **FY16 excluding special dividend. ***FY16 including special dividend.

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\$21.10 C\$17.35
NAV** high/low C\$29.67 C\$23.66

**Including income.

Gearing

Gross* 20.1%
Net* 19.1%

*As at 31 March 2017.

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Exhibit 1: Company at a glance
Investment objective and fund background

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.

Recent developments

- 20 April 2017: Announcement of quarterly dividends – C\$0.18 per common share and C\$0.23438 per Series 4 preference share.
- 15 February 2017: Announcement of quarterly dividends – C\$0.18 per common share and C\$0.23438 per Series 4 preference share.
- 7 December 2016: Announcement of C\$0.12 special dividend per common share.
- 19 October 2016: Announcement of quarterly dividends – C\$0.16 per common share and C\$0.23438 per Series 4 preference share.

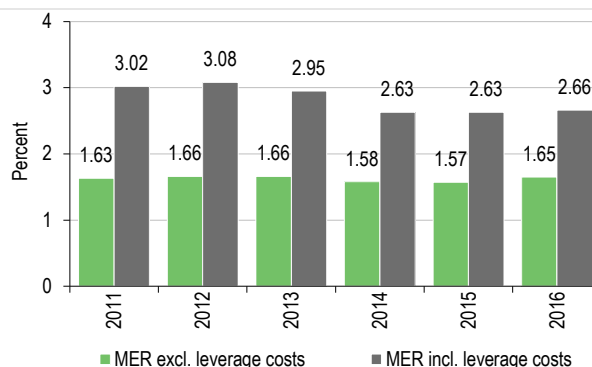
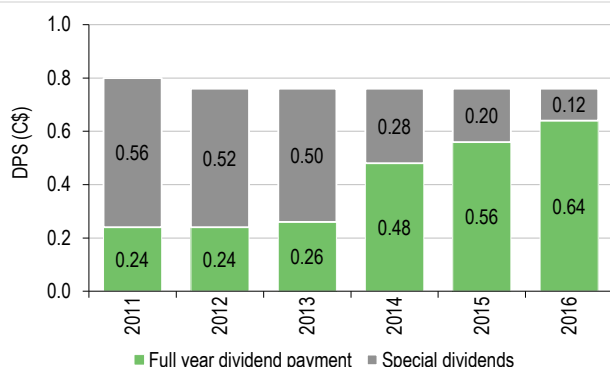
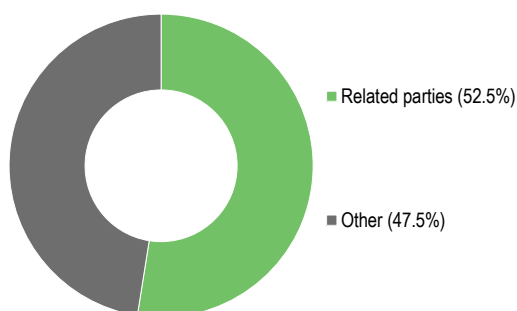
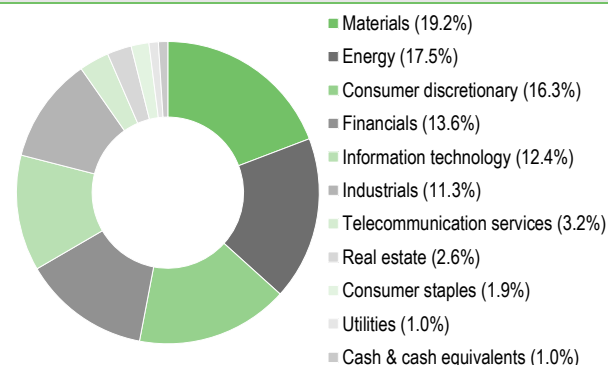
Forthcoming		Capital structure		Fund details	
AGM	April 2018	Ongoing charges	1.65% (see MER below)	Group	Morgan Meighen & Associates
Interim results	August 2017	Net gearing	19.1%	CEO	Jonathan A Morgan
Year end	31 December	Annual mgmt fee	1.0% of gross assets	Address	10 Toronto Street, Toronto, Ontario, Canada M5C 2B7
Dividend paid	Mar, Jun, Sep, Dec	Performance fee	None	Phone	+1 416 366 2931
Launch date	January 1930	Trust life	Indefinite	Website	www.mmainvestments.com
Continuation vote	No	Loan facilities	C\$150m (see page 7)		

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% pa of gross assets. Leverage costs include preference share dividends, interest and financing charges.


Shareholder base (as at 28 February 2017)

Portfolio exposure by sector (as at 31 March 2017)

Top 10 holdings (as at 31 March 2017)

Company	Country	Sector	Portfolio weight %	
			31 March 2017	31 March 2016*
Dollarama	Canada	Multiline retail	4.9	5.8
Franco-Nevada Corporation	Canada	Metals & mining	3.7	3.9
Bank of Montreal	Canada	Banks	3.7	3.4
First Quantum Minerals	Canada	Metals & mining	3.4	N/A
Open Text Corporation	Canada	Software & technology	3.4	2.9
Royal Bank of Canada	Canada	Banks	3.2	2.8
Canadian Pacific Railway	Canada	Road & rail	3.0	3.1
NVIDIA Corporation	US	Semiconductors	2.9	N/A
CCL Industries	Canada	Speciality packaging	2.9	3.6
Amazon.com	US	Online retail	2.8	N/A
Top 10			33.9	33.8

Source: Canadian General Investments, Edison Investment Research, Morningstar. Note: *N/A where not in March 2016 top 10.

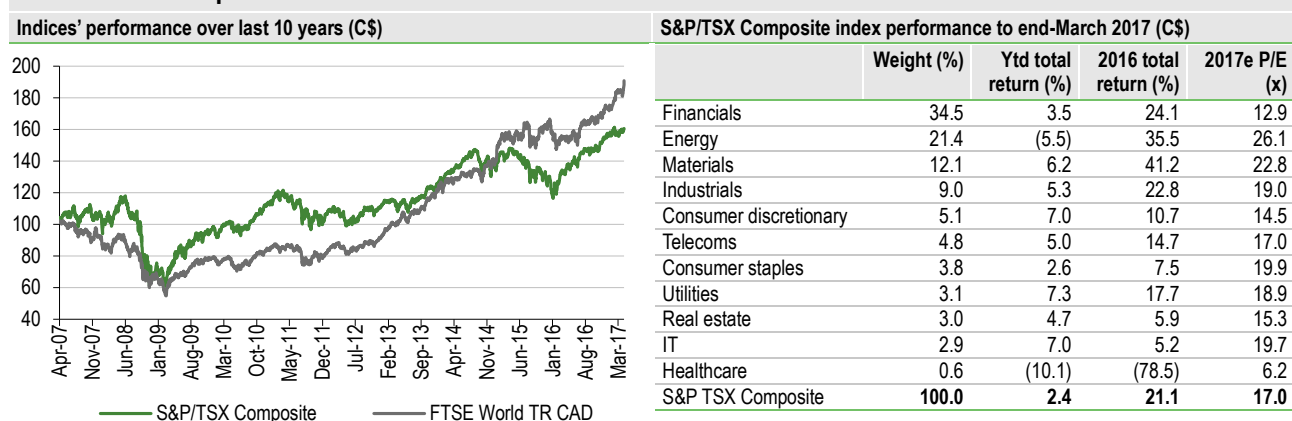
Market outlook: Broader leadership likely in 2017

Exhibit 2 (left-hand side) shows the performance of the S&P/TSX Composite and FTSE World indices (in Canadian dollar terms) over the last 10 years. Over the long term, global equities have appreciated more than Canadian stocks; however, in 2016, Canadian stocks outperformed, with a total return of 21.1% compared to 5.7% for world equities (in Canadian dollar terms).

As shown in Exhibit 2 (right-hand side), stock market leadership in 2016 was fairly narrow – the four outperforming sectors are all cyclical and were led by materials, which had a total return of more than 40%. As a result of the strong performance of financial, energy and materials stocks in 2016, these three sectors now make up more than two-thirds of the S&P/TSX Composite index.

So far in 2017, Canadian stock market leadership is broader than in 2016 and this may continue for the balance of the year. To the end of March 2017, the best performing sector is utilities. Energy, which was one of the strongest-performing sectors in 2016, has declined year to date; this is due to a near-term pullback in the oil price as higher commodity prices in 2016 have encouraged some US shale operators to resume production, which has led to an inventory build despite good compliance from OPEC oil producers following the November 2016 agreement to cut oil production. For investors looking to gain exposure to Canada, a fund with a broad exposure across all the major sectors, including a diversified exposure to resources, may be of interest.

Exhibit 2: Market performance and valuation



Source: Thomson Datastream, Edison Investment Research, Bloomberg

Fund profile: Diversified exposure to Canada

CGI is North America's second oldest, closed-end fund, established in 1930. Since 1956, it has been managed by Morgan Meighen & Associates (MMA), which has assets under management approaching C\$2bn. CGI is listed on the Toronto Stock Exchange (since 1962) and the London Stock Exchange (since 1995). It invests over the medium to long term in a broad selection of primarily Canadian equities, aiming to generate a total return higher than the benchmark S&P/TSX Composite index. 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. Gearing of C\$150m is C\$75m Series 4, 3.75% preference shares and C\$75m bank debt.

The fund manager: D Greg Eckel

The manager's view: Constructively optimistic for 2017

From a macro perspective, Eckel suggests that the election of President Trump has led to a level of uncertainty about timing and changes to US policy and the effects they will have on the Canadian economy. He comments that there is a chance that the North American Free Trade Agreement (NAFTA) could be rewritten or opened up, plus there is a risk of a US-imposed border adjustment tax, which would be very influential on the level of Canada's trading activity given that the US is its number one trading partner. Eckel suggests that, were either of these events to occur, there would be a greater impact on Mexico rather than Canada, but that there could be unintended consequences for the Canadian economy. Given that the US president has had problems getting approval for his proposed changes to the US healthcare bill, this pushes other legislative changes further out. As a result of the uncertainty, the manager has been relatively inactive in CGI's portfolio so far this year and states that he is happy with its current sector weightings.

The manager says that the Canadian economy is "chugging along" and that the outlooks he is getting from companies are generally relatively positive. He notes that conditions in the energy sector have improved as a result of more robust commodity prices. The manager suggests that the export market, including imports into the US, is steady and housing sector fundamentals are generally robust. He believes that the Canadian economy can probably grow around 1.7% in 2017 and between 1.9% and 2.0% in 2018.

Eckel is constructively optimistic on the outlook for Canadian equities in 2017; CGI's portfolio has a cyclical bias given improving global growth, which is evidenced by strengthening purchasing manager indices. He notes copper and zinc prices are very strong due to higher industrial production. The manager may look to increase his exposure to the materials sector, but will do so opportunistically, as he suggests that, following the outperformance of these stocks in 2016, the sector may be due for a healthy pause.

Asset allocation

Investment process: Bottom-up stock selection

CGI invests on a bottom-up basis, while taking account of the prevailing macro environment. The manager invests for the medium to long term, seeking companies with solid fundamentals and strong management teams, which are trading on reasonable valuations. The majority of CGI's portfolio is invested in Canadian equities, but up to 20% may be invested in US companies to gain exposure to business areas that are unavailable for investment in Canada. The manager seeks companies with strong franchises, preferably firms with market-leading positions or a unique product offering. Some higher-yielding positions are held, which help towards the payment of CGI's dividends, such as Bank of Montreal and Royal Bank of Canada, which both have a dividend yield of c 3.5%. CGI has a bias to mid- and large-cap stocks; the median market cap is C\$5bn and more than 90% of the portfolio has a market cap above C\$1bn.

Current portfolio positioning

At end-March 2017, CGI's top 10 holdings represented 33.9% of the portfolio, which was broadly in line with 33.8% at end-March 2016; seven positions were common to both periods. CGI currently has 53 holdings, which is at the lower end of the typical range of 50 to 65, as the manager has consolidated a number of holdings in recent months. Average annual portfolio turnover is 16-17%, but was higher than 20% in 2016, as the manager repositioned his exposure to some sectors during the year, such as adding to the energy sector. As shown in Exhibit 3, over the last 12 months

the largest increases in exposure on a sector basis were technology (6.1pp) and energy (3.7pp), with the largest decreases in financials (including real estate, -4.6pp) and consumer discretionary (-3.8pp). The active weights are similar to those in [our last report](#) (published in September 2016).

At end-March, 15.9% of CGI's portfolio was invested in US equities; the manager comments that the holding in Amazon, which has seen significant share price appreciation (c 50% over the last 12 months), is likely to be held for a long time given the strength of its Amazon Web Service (AWS) cloud computing operation. There is increased competition in this area from companies such as Alphabet (the parent of Google) and Microsoft, but the manager suggests that AWS continues to have a strong leadership position.

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

	Portfolio end-March 2017	Portfolio end-March 2016	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/index weight (x)
Materials	19.2	16.3	2.9	12.1	7.1	1.6
Energy	17.5	13.8	3.7	21.4	(3.9)	0.8
Consumer discretionary	16.3	20.1	(3.8)	5.1	11.2	3.2
Financials	13.6	20.8	(7.2)	34.5	(20.9)	0.4
Information technology	12.4	6.3	6.1	2.9	9.5	4.3
Industrials	11.3	12.8	(1.5)	9.0	2.3	1.3
Telecommunication services	3.2	3.5	(0.3)	4.8	(1.6)	0.7
Real estate*	2.6	N/A	N/A	3.0	(0.4)	0.9
Consumer staples	1.9	2.2	(0.3)	3.8	(1.9)	0.5
Utilities	1.0	1.1	(0.1)	3.0	(2.0)	0.3
Healthcare	0.0	0.8	(0.8)	0.6	(0.6)	0.0
Cash & cash equivalents	1.0	2.3	(1.3)	0.0	1.0	N/A
	100.0	100.0		100.0		

Source: Canadian General Investments, Edison Investment Research. Note: Numbers subject to rounding.*In March 2016, real estate was part of the financials sector.

CGI participated in the March 2017 Canada Goose IPO; the issue was priced above the indicated range and was heavily oversubscribed by potential investors. As a result, CGI was not allocated a full position and has subsequently been buying shares in the open market. Founded in 1957 under the name of Metro Sportswear, Canada Goose is a manufacturer of high-end outerwear, with a strong brand name. It began as a family-run business and the grandson of the founder is leading the expansion of the company into new channels. Historically a wholesale business, Canada Goose is now expanding its retail and e-commerce operations. Over the last three years, annual revenue growth has averaged c 40% and gross margins have increased from 38.6% to 50.1%. Its largest markets are the US (35% of revenue) and Canada (33%), with near-term expansion plans focused on Germany, Italy and Scandinavia. In the past, Canada Goose has had private equity investment from Bain Capital (which has also backed CGI's number one holding Dollarama); proceeds from its IPO will be used for debt reduction.

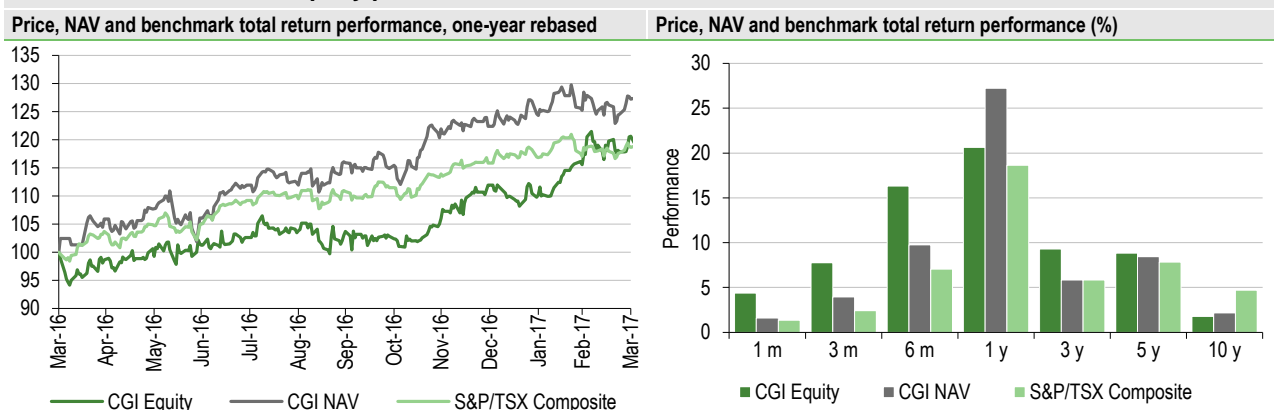
Another relatively new addition to CGI's portfolio is Shopify, which has generated the highest year to date performance for the fund. Shopify provides an easy-to-use, cloud-based, multi-channel commerce platform, which is designed for small and medium-sized businesses. The manager suggests that the company is in the early stages of its growth cycle – over the last four years, revenues have compounded at an average annual rate of 117%, although the company is yet to generate a profit.

The manager highlights top 10 holding CCL, commenting that the company's share price continues to perform well. CCL is the largest global label manufacturer, with the highest margins in the industry. It supplements its organic growth with mergers and acquisitions – in December 2016, CCL announced the acquisition of Innovia, owned by a UK-based private equity company. Innovia is a manufacturer of speciality films, and is the world's largest producer of polymer banknotes, with a greater than 90% market share. The deal is expected to be accretive to CCL's earnings.

Performance: Strong 12-month performance

Absolute returns are shown in Exhibit 4; over the last 12 months to the end of March 2017, CGI's C\$ NAV and share price total returns of 27.2% and 20.6% respectively are comfortably ahead of the benchmark total return of 18.6%.

Exhibit 4: Investment company performance in C\$ to 31 March 2017



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

CGI's NAV total return has outperformed the benchmark over one and five years, is in line over three years, while trailing over 10 years. The 10-year record is affected by a period of underperformance between mid-2007 and mid-2009; this was primarily due to the effects of gearing in an extreme market downturn and an overweight position to smaller-cap stocks.

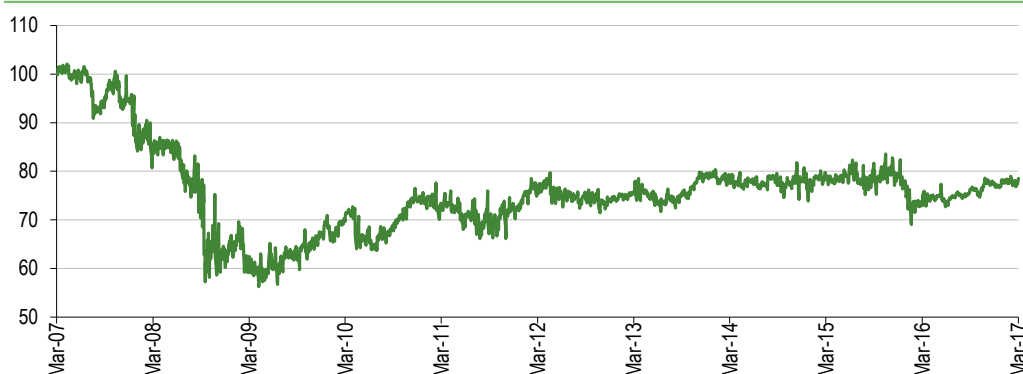
During 2016, CGI lagged the benchmark by 2.9pp. Canadian equities rallied strongly, but market leadership was narrow, led by resource stocks – the materials and energy sectors both had total returns of more than 35%. In such an environment, CGI's broad portfolio tends to trail the benchmark. Gold stocks in particular rallied sharply and CGI had underweight exposure to this area. The manager comments that relative performance improved towards the end of 2016 as the stock market leadership broadened.

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	3.0	5.2	8.6	1.7	10.2	4.8	(24.8)
NAV relative to S&P/TSX Composite	0.2	1.5	2.5	7.2	0.0	2.8	(21.8)
Price relative to MSCI Canada	3.1	5.5	7.9	1.2	9.2	3.6	(24.5)
NAV relative to MSCI Canada	0.4	1.8	1.8	6.8	(0.8)	1.7	(21.5)
Price relative to FTSE World	2.4	1.4	5.5	1.2	(8.8)	(26.7)	(35.2)
NAV relative to FTSE World	(0.3)	(2.2)	(0.5)	6.7	(17.1)	(28.1)	(32.7)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-March 2017, in C\$ terms. Geometric calculation.

Exhibit 6: NAV total return performance relative to benchmark over 10 years



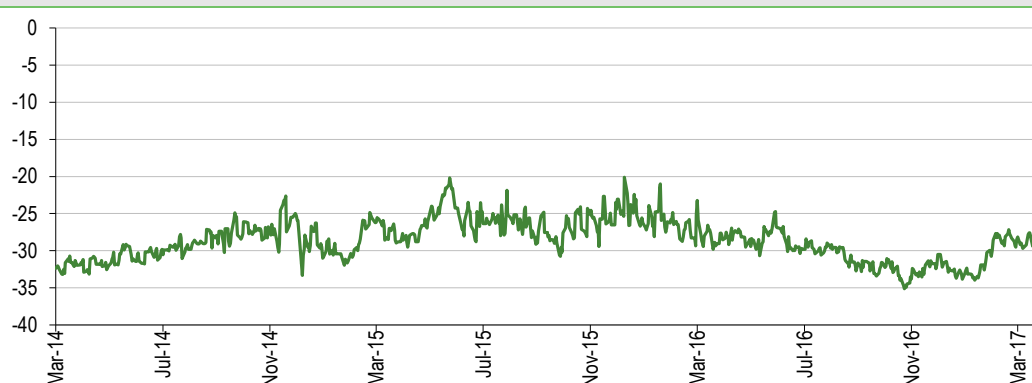
Source: Thomson Datastream, Edison Investment Research

Discount: In the middle of the three-year range

CGI's shares are currently trading at a discount of 29.2%; this is around the middle of the three-year range of 23.2% to 35.1%. The one year average of 30.2% is wider than the averages of the last three, five and 10 years (range of 24.5% to 28.9%). The wide discount may be due to the relatively high level of gearing or the large controlling shareholders, which could have an impact on investor perceptions and liquidity.

There is no discount control mechanism in place – as CGI is a Canadian investment corporation, its tax benefits would be lost if it repurchased any of its shares. If CGI's relative investment performance continues to improve or there is increased demand for Canadian equities, there is scope for the discount to narrow.

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. It has 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. The new debt has an interest rate of 2.28%, which lowers CGI's average cost of debt from 3.825% to 3.015%, saving C\$1.215m in annual costs. At end-March 2017, gross gearing was 20.1%.

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 2016, the annualised management expense ratio was 2.66% including leverage costs (2.63% in 2015) and 1.65% excluding leverage costs (1.57% in 2015). The management expense ratio excluding leverage costs is more comparable with the ongoing charge figure used in the UK.

Dividend policy and record

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. The manager suggests that 2017 could be the last year that a special dividend is paid, and he is hopeful that the annual dividend will rise over time. In 2016, the total annual dividend of C\$0.76 (C\$0.64 quarterly and C\$0.12 special) was in line with the 2015 dividend (C\$0.56 quarterly and C\$0.20 special). CGI's current dividend yield (including the special dividend) is 3.6%.

Peer group comparison

In Exhibit 8 we show the two funds in the AIC North America sector with significant exposure to Canada, although it should be noted that they follow different mandates; CGI has the better performance over one and three years, while lagging over five and 10 years. As noted in the Performance section, the trust's 10-year performance record was affected by being geared in a significant market downturn during the global financial crisis in 2007-09, and having an overweight exposure to smaller stocks. CGI's ongoing charge and level of gearing is higher and it has a lower dividend yield.

Exhibit 8: Selected peer group at 25 April 2017 (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	434.7	21.6	17.5	54.6	19.9	(28.7)	1.7	No	119	3.6
Middlefield Canadian Income	199.0	18.9	13.3	64.7	85.6	(5.9)	1.0	No	118	4.7
Simple average	316.9	20.2	15.4	59.7	52.7	(17.3)	1.3		119	4.2
Trust rank in sector	1	1	1	2	2	2	1		1	2

Source: Morningstar, Edison Investment Research. Note: TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

CGI has seven board members, four of whom are independent of the investment manager. Chairman Vanessa Morgan was appointed in 1997; she is president and CEO of MMA. Appointed in 2001, Jonathan Morgan is president and CEO of CGI and executive vice president of MMA. Michael Smedley was appointed in 1989; he is executive vice president and CIO of MMA. The independent directors and their dates of appointment are Neil Raymond (2002), Richard Whittall (2004), James Billett (2005) and Michelle Lally (2015).

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