In Search of Growth: Beyond The Headlines

Reading the headlines of the business section in national newspapers, you would think that Canadian stocks are limited to resource and financial companies. Admittedly, many investors are currently intrigued about issues such as over-extended home prices and their effect on Canadian banks or the effect of currently low oil prices on energy stocks and the Canadian economy.

Beyond The Big Three Sectors

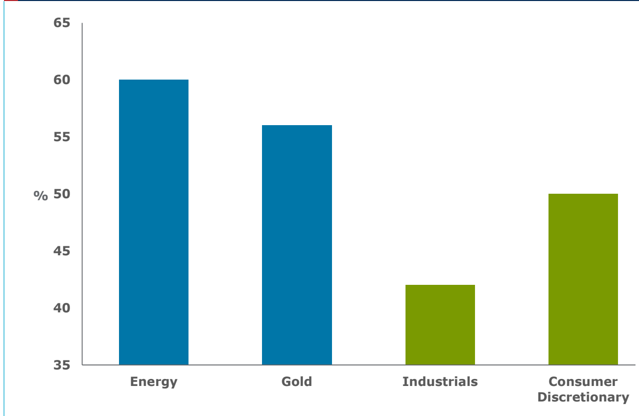
Currently, 146 of the 240 stocks in the S&P/TSX Composite come from the Financials, Energy and Materials sectors (the "Big Three"). For growth investors like Greystone, the Big Three sectors have been a good hunting ground over the years. However, we have also uncovered positive growth stories beyond these sectors.

While the other sectors make up a smaller piece of the pie, that still leaves 94 companies which represent a reasonable universe to choose from when building a large cap Canadian equity portfolio.

Diversification is the obvious reason to include stocks beyond the Big Three sectors. However, there are other reasons why stocks outside these sectors may be attractive propositions:

1. **NON-HOMOGENEOUS THEMES:**
   Given that commodity prices are a large determinant for resource company earnings (or interest rates for many financials), stocks in these sectors can be said to be homogeneous - "a rising tide lifts all boats." However, non-resource stocks are more likely to move to the beat of their own drum. Figure 1 shows the average correlation of stocks to their overall sector performance.

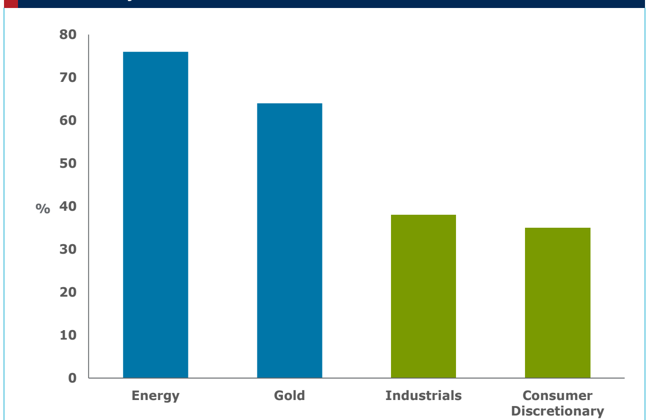
Figure 1: Resource Stocks More Correlated to Sector Returns (Sector average of a stock's correlation to sector return)



Source: Greystone, TD Securities. S&P/TSX Composite stocks only.

2. **LESS COVERAGE:**
   Sell-side research is focused on the Big Three sectors. Figure 2 below shows how there is less coverage for non-resource sectors versus resource sectors. We see this as an opportunity: there is greater opportunity for higher returns when the story is less well known.

Figure 2: Less Analyst Coverage for Non-Resource Stocks (% of stocks within sector that are covered by 10 or more analysts)



Source: Morningstar CPMS. As at August 2016. S&P/TSX Composite stocks only.

GREYSTONE
MANAGED INVESTMENTS INC

3. **SECULAR GROWTH VS. CYCLICAL GROWTH:** Many stocks exhibit cyclical growth where peaks and troughs in the economic cycle provide an opportunity for economic gain. However, there are "secular growth" companies that have above-market levels of growth over more than one economic cycle.

Flying Under The Radar

By way of example, here are two less well-known Canadian stocks with growth profiles that exhibit these characteristics:

NEW FLYER INDUSTRIES (NFI)

NFI is the largest North American manufacturer of heavy-duty transit buses supplying authorities in Canada and the U.S. They also manufacture motor coach buses. Given their leading market share in manufacturing as well as aftermarkets, they are able to take advantage of improving transit bus fundamentals such as higher demand due to rising U.S. state/municipal tax revenues, growing ridership numbers and increased focus on public transit as a green option. Their recent acquisition of Motor Coach Industries (November 2015) also provides a growth opportunity through improving profit margins. While NFI guided for C$10 million in synergy savings from the acquisition, our Industrials Portfolio Manager, Heather Greenman, expected they would do better after visiting with management in Winnipeg.

At the time of writing, cost savings from the acquisition are already at $5 million, after just two quarters, with further gains expected. NFI is a great example of a stock that is less dependent on macro themes to drive earnings growth and which is currently only covered by six sell-side analysts.

WASTE CONNECTIONS (WCN)

WCN provides waste collection, transfer, disposal and recycling services in North America. They are also a leading provider of non-hazardous oilfield waste treatment, recovery, and disposal services. By recently (June 2016) completing a reverse takeover of Canadian-based Progressive Waste Solutions, WCN is now listed on both Toronto and New York stock exchanges. The deal also makes the new entity an industry leader in waste solutions that should immediately start to benefit from cost savings. Going forward, management believes that the fragmented US$67 billion waste market will open up further opportunities for growth through tuck-in acquisitions. This is a company that is able to generate a considerable amount of free cash flow. When we met with management in May 2016, they indicated that 20% would be used to grow the dividend and 30% for acquisitions, which leaves a further 50% for potential share buybacks or increased levels of M&A. This company is only covered by five sell-side analysts.

Benefits of Bottom-Up Approach

The examples above highlight stocks that rarely make the headlines. They continue to go about their business often generating greater returns for shareholders compared to resource or financial stocks. Greystone's equity philosophy is centred on building portfolios with a bottom-up, stock selection approach. This approach ensures that we are able to uncover companies doing great things regardless of the sector they may be in.

"At Greystone, we believe earnings growth drives stock prices. At the stock level that means finding companies that are growing regardless of their sector. At the portfolio level it means finding as many different sources of growth as possible."

James Baldwin, Senior Vice-President of Canadian Equity

FOR MORE INFORMATION

Simon Segall, MA, ASA
Vice-President, Institutional Relationships
416-309-2595
simon.segall@greystone.ca

Chirag Patel, CFA
Vice-President, Canadian Equity
416-309-2187
chirag.patel@greystone.ca

Greystone.ca