What Growth Means to Greystone

What's your Investment Style?

"What's your investment style?" – it's a common question that is asked of institutional investment managers. It's an important question, especially for those institutional investors that hire managers with different styles as an "offset" to each other. The typical response to this question is "growth" or "value" or "income" or "small cap" or a whole host of other terms that essentially group investment managers into different categories. In fact, Morningstar created their Style Box in 1992, which pegs a manager into one of nine squares on a grid to determine where a manager's style fits with regards to size and style (as measured by where they fit along the value-growth continuum).

At Greystone, our approach to equity investing is biased towards a growth style. We believe that identifying companies with sustainable growth drivers for their businesses translates into higher future earnings, which in turn leads to higher stock prices. How does our growth style manifest into the types of companies we prefer to invest in?

Business Momentum

In our equity research, we focus on a company's business momentum. To us, *business momentum* is more than just looking at earnings growth or revenue growth: it is about understanding what that growth is operationally driven by and how sustainable it is. One method we employ to start thinking about these drivers is to apply Porter's Five Forces model of industry competition, which looks at the threat of new entrants and substitutes, the bargaining power of customers and suppliers, and the type of competition within the industry. Indicators of sustainable growth often times appear at the company level before they impact stock prices. Many investors tend to underestimate the increase in value that occurs when structural improvements in the business occur. Structural improvements happen all the time, but do not always coincide with earnings per share growth. Over time though, an improved profit profile will result, which leads to an increase in the intrinsic value of the company. Equally important is having a sense of how long that momentum can last – as business momentum matures, a company's ability to generate excess cash flows at a high level of return on invested capital is increasingly important.

Our aim is to assemble a portfolio of such companies whose business momentum comes from a diversity of factors. Some examples would include robust organic growth, increasing market share, execution of a disciplined M&A strategy, clearly identifiable advantages versus peers or a strong presence in a disruptive industry. The more diversified our portfolios' business momentum drivers are, the more resilient the portfolios will be in the face of changes to business and investment environments.

By no means do we have a copyright on the term business momentum! However, it's a term that best describes the type of stocks we like to own in our clients' portfolios. We think Celgene (U.S. healthcare company currently owned in our U.S. Equity portfolio) CEO Mark Alles summed it up nicely when commenting on his company's Q1-2017 results:

> "*Our significant first quarter operational, financial and strategic progress strengthen our confidence and outlook for 2017. Our business momentum is increasing as we continue to generate meaningful catalysts and long-term value drivers.*"

Let's take a look at a couple of examples that at the time of writing are also held in Greystone equity portfolios on behalf of our clients.

ALIMENTATION COUCHE-TARD (ATD): SUCCESSFUL M&A STRATEGY

Alimentation Couche-Tard (ATD) is a Canadian success story, starting out from their Quebec roots and growing (and still growing!) into a global leader in the convenience store business. Their business momentum story has been the successful execution of acquisitions achieved over the last few years (see Figure 1). Acquisitions are most effective when there is a clear vision of how the acquired company will operate under the new ownership. Recently, ATD has been acquiring gas stations and using their expertise in the convenience store business to drive profit margins higher by running the gas stations' stores more efficiently.

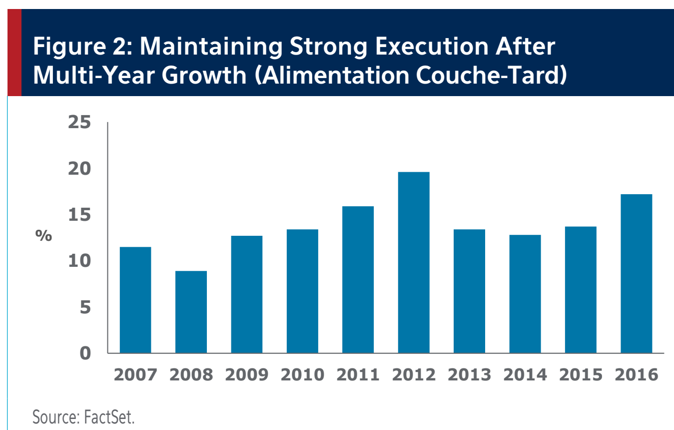
Figure 1: Notable Acquisitions (Alimentation Couche Tard)

Details	Year	Deal Size ($B)
Acquired fuel retail business from Statoil (Sweden)	2012	US$2.8B
Acquired fuel and convenience retailer The Pantry (U.S.)	2014	US$1.7B
Acquired 450 gas stations in Ireland	2015	Undisclosed
Bid for fuel and convenience retailer CST Brands* (U.S.)	2016	US$4.4B
Acquired 280 gas stations from Esso (Ontario & Quebec)	2016	C$1.6B

Source: Company News Releases. * Deal expected to close in early 2017.

For ATD, knowing exactly what snacks to have at the checkout counter or what type of baked goods are in the display case is a science! They utilize "big data" to make informed decisions and are able to squeeze out every extra dollar of revenue they possibly can. This momentum has played out over the last few years and as it becomes more difficult to execute at the same level, it is encouraging to see their Return on Invested Capital (Figure 2) has been sustained at a very healthy level.

Figure 2: Maintaining Strong Execution After Multi-Year Growth (Alimentation Couche-Tard)

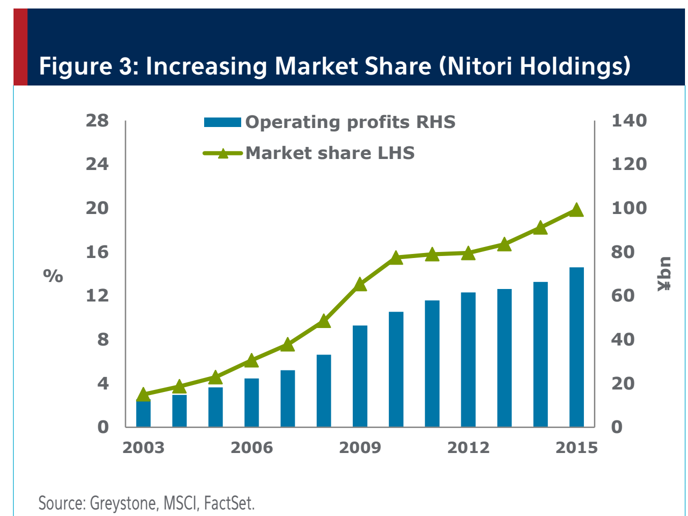


Source: FactSet.

NITORI HOLDINGS: MARKET INSIGHTS DRIVING GREATER MARKET SHARE

Nitori Holdings (Nitori), listed on the Tokyo Stock Exchange, is a profitable retailer of furniture and home fashion goods mainly in Japan. Business momentum for Nitori has been driven by their continued ability to successfully execute cost reductions while restructuring operations to allow them to gain market share in Japan (see Figure 3). It has an integrated business model of manufacturing and direct purchase relationships, which gives the company cost and market insight advantages that competitors do not have. Benefits of its integrated business model include better management of inventory, more frequent product launches, and lower production costs. These competitive advantages will continue to help the company's business momentum and sustain profitability in the longer term. Its 5-year average return on invested capital of 16.6% is higher than its domestic peers as well as the broader Japanese and world equity markets, which are all in the single-digits.

Figure 3: Increasing Market Share (Nitori Holdings)



Source: Greystone, MSCI, FactSet.

Conclusion

From a portfolio management perspective, building a portfolio of companies with different growth drivers is important as we know the market will not reward them all at the same time.

We believe having this diversity in the portfolios helps provides resilience to our longer term results. At Greystone, our Public Equities team is structured to benefit from strong quantitative identifiers, such as return on invested capital, coupled with a global approach to fundamental analysis where our sector analysts are always asking "*What is this company's business momentum and how does it compare to its global peers?*".

For More Information: Toll Free: 1.800.213.4286 | Email: inquiries@greystone.ca | Greystone.ca

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