

# | The Value of Fundamental Research



At Greystone Managed Investments Inc. (“Greystone”), fundamental research is a vital part of our disciplined, bottom-up investment process. Our quantitative screening models pick up on positive market sentiment on a company and the job of the fundamental research team is to unravel what is driving that. It is the fundamental research that truly sets our concentrated active strategies apart from pure factor investing, due to the added insights uncovered by our dedicated group of global sector analysts.

Creating positive business momentum can be very different for each company and may derive from any growth driver that is improving the intrinsic value of the business over the longer term. Some examples of growth drivers include sales momentum, market share gains, return on equity, EBIT or cash flow improvements and increasing pricing power. Our fundamental research analysts thoroughly evaluate every security on our research list to cut through the noise and validate the future growth prospects of the company, which we believe are often not fully recognized in the market price of the security. Identifying and understanding the sustainability of a company’s growth drivers is key to successful alpha generation over a full market cycle.

Our research first evaluates the attractiveness of the industry in which the company operates from various perspectives, such as Porter’s Five Forces.\* We are looking

to assess the medium to long-term growth rate of the industry and secular themes taking place within it, such as technology changes, income growth, demographics, or changing consumer preferences. To achieve this we focus on the competitive business position of the company — including branding, technology, and cost structures — while placing a high level of emphasis on the business acumen of the management team by examining their ability to build the business, navigate changes in the environment and, arguably the most important, the capital allocation decisions they make. Lastly, we exercise valuation discipline, ensuring that we do not overpay for the securities that meet our focused investment criteria.

The end result of our investment process is not only a company with positive business momentum at present, but more importantly a company where this momentum is sustainable due to a competitive business franchise, strong balance sheet, excellent company management, within an industry that may be benefitting from secular growth themes.

A good way to illustrate the importance of our fundamental research is to highlight an example. Ashtead Group (“Ashtead”) is an equipment rental company based in the U.K. Most of its revenues are derived in U.S. dollars through its holding in Sunbelt Rentals. We

\* Porter’s Five Forces are named after Michael E. Porter. The five forces are: competition in the industry; potential of new entrants into the industry; power of suppliers; power of customers; and threat of substitute products.

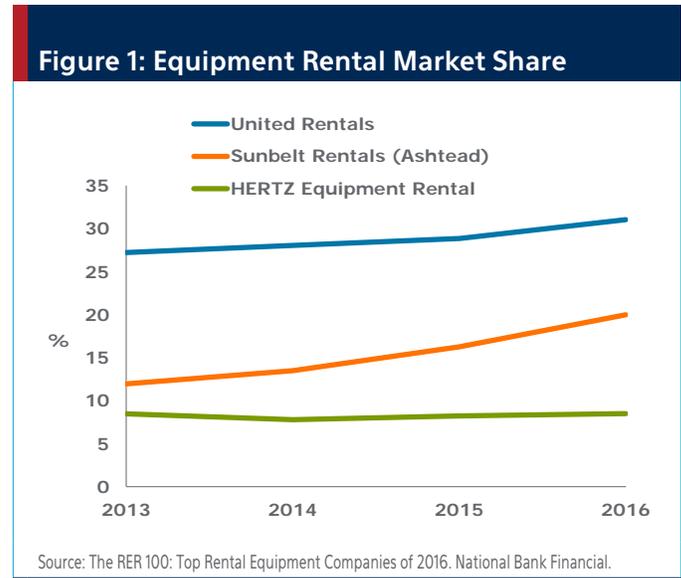
originally reviewed Ashtead in 2013 after it ranked well in our quantitative screening models. After conducting our fundamental research, we purchased Ashtead and it has been a strong contributor to performance, with the stock price more than doubling since.

In terms of industry competition, the equipment rental business in the U.S. is fragmented. The barriers to entry by new competitors come in the form of managing utilization, maintaining capital discipline, brand strength and the customer’s route to market. The key profitability measure used in the industry is dollar utilization – or the amount of rental revenue brought per year divided by the cost of purchasing the piece of equipment.

Key positives for the company identified through our fundamental research analysis included: Ashtead had strong earnings momentum into the economic recovery; was making mix improvements including enhancing the quality of its fleet and technical capability; and had strong company management, as evidenced by the fact the company had grown its fleet, revenue and profitability in difficult markets, while deleveraging their balance sheet through difficult market conditions following the last recession.

Our fundamental research also showed that non-residential construction was accelerating in the U.S. Ashtead was steadily gaining market share through M&A and strengthening their position relative to competitors. In addition, the company was benefitting from the secular trend of companies renting equipment, rather than owning

it. We believe there is room for the propensity of companies to rent equipment in the U.S. to grow from 50% closer to the 75% achieved in the U.K. Our rationale includes the fact that this allows companies to keep up with new technologies, enabling them to comply with environmental regulations and the latest health and safety practices. In addition, renting provides the company flexibility – freeing up investment capital and moving to monthly contracts. We continue to hold Ashtead in the portfolio, as these drivers of growth remain intact at the time of writing.



As part of our disciplined investment process, we recognize that not every investment thesis by our fundamental research team works out and it is extremely important

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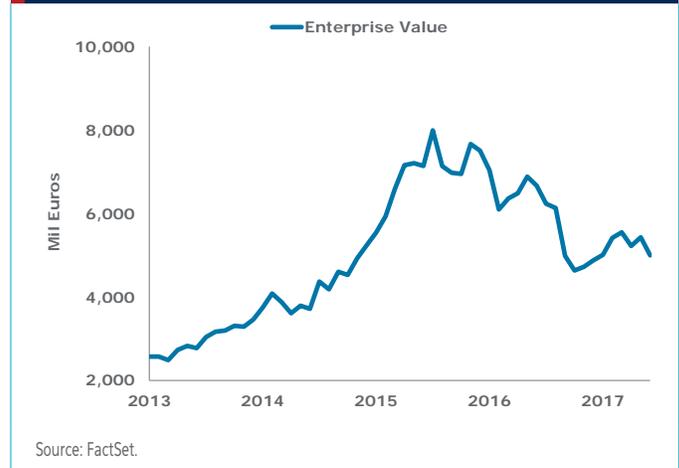


to know when to sell a security. We conduct routine post mortems on stock decisions that did not work out to review and learn from them. An example is Ingenico Group S.A. (“Ingenico”), a leading payment terminal manufacturer, which is based in France. We purchased Ingenico early in 2015 and sold it out of the portfolio by the end of the following year.

The growth drivers we identified through our fundamental research included the shift towards online transactions and a proposed change in regulation in the U.S. requiring merchants to upgrade their payment terminals. We also expected a shift in Ingenico’s business mix away from slower growing payment terminals to payment services through strategic acquisitions to support growth.

After several months, it was evident that our investment thesis was not playing out as we expected (see Figure 2). The favourable regulation change in the U.S. was delayed and concerns were raised that the benefit of the payment terminal upgrade cycle might be smaller than we originally anticipated. In addition, company management was inconsistent in communicating its business prospects and operating environment, and lost credibility after issuing a negative profit warning in September 2016. Though the company had been redeploying cash into higher growing business lines, it did not seem to be gaining synergies out of the deals, either from an operating or cost basis. We decided to sell the security and replace it with companies where we had higher conviction in the sustainability of future growth. Our post mortem analysis identified that

**Figure 2: Ingenico is Losing Business Momentum**



we underestimated the regulatory risk of the terminal upgrade cycle in the U.S. and its impact on the company. We also did not fully appreciate the quality of the company management and their ability to redeploy capital and structure deals beneficially. We documented these lessons and they inform all our subsequent investment research.

Managing a concentrated, high conviction public equity portfolio is a dynamic activity. Our fundamental research team plays a crucial role in generating alpha for clients by finding companies around the world that are experiencing positive business momentum. Their work in identifying and understanding the sustainability of the various growth drivers of a company’s business momentum distinguishes our strategy from a pure factor-based approach.



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## Greystone Managed Investments Inc.

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We are a private company, majority-owned by our employees – over 95% of eligible employees are shareholders.\*

Greystone has in-house expertise in the following areas:

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- Canadian Small Cap

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- Balanced
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- Alternative Suite



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\*An eligible employee is defined as contributing one or more years of service to Greystone.