EMPIRE LIFE CANOE GLOBAL EQUITY GIF

A core global equity solution with a growth focus

Transcript for the Empire Life investment webinar featuring Canoe Financial: Empire Life Canoe Global Equity GIF

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The Empire Life Canoe Global Equity GIF is a segregated fund available within the Empire Life GIF contract, which currently invests most of its assets in units of the Canoe Global Equity Fund mutual fund.

Matthew King

Hello, everyone. My name is Matthew King, VP of Product Strategy and Strategic Alliances at Canoe Financial. Today I'm joined by our partners at PineStone Asset Management to discuss the Empire Life Canoe Global Equity Fund.

Before we jump into a discussion on the strategy, I just want to highlight a couple of aspects of Canoe Financial. Our firm was founded in 2009, and is entirely independent and employee-owned organization.

Being invested in our business means that there's additional level of alignment with our investors. We like to say we eat our own cooking, so we share in the common goal and understand the absolute necessity of adding value for our investors. As active managers, a common way we evaluate our value add is really through the performance that we achieve. And I'm happy to say that over 73% of our investment mandates are currently ranked within their first quartile in their pure category on a ten-year basis

At Canoe Financial, we manage $14 billion on behalf of Canadian investors through our lineup of 20 actively managed investment solutions. Our solutions include everything from Canadian equity and Canadian energy to tax efficient fixed income solutions, and certainly global equity, as has been a strong part of our success.

By design, our organization combines both internal portfolio management and external sub advisory to establish a diversified passive management boutique where we feel that we don't hold the internal competitive advantage that's often where we'll look for external management to help offer exceptional strategy to retail clients. PineStone Asset Management is a prime example, and they currently manage about $60 billion on behalf of both our retail clients and our trust investors for some of the largest institutions in Canada. Their global equity track record dates all the way back to 2011, where it's achieved top decile results in its peer universe and has added more than 400 basis points of annualized out-performance over the common competitor.

The Canoe Global Equity Fund is a core active global equity offering suitable for investors looking for capital appreciation.

The team invests in 15 to 25 high conviction household names with a test of time approach, which leads to a long investment thesis and low stock turnover. The strategy invests in companies with both a quality focus, which traditionally has been a source of strong downside protection in turbulent market conditions, as well as growth which provides a strong runway for compounded revenue and earnings potential.

Here to talk about the PineStone approach, we have Sam Weiss, investment specialist over at PineStone Asset Management. Over to you, Sam.

Sam Weiss

Hey, Matt. It's a pleasure to be speaking with you all. So, I'm an investment specialist, as Matt mentions. So, sitting in on the investment team's weekly equity team meeting and working closely with a number of our clients and consultants.

During the next half an hour or so, I'll be going through PineStone Asset Management as an organization, as well as our investment team, our investment philosophy and process, and into all the aspects that go into the Canoe global equity strategy. First, starting with an overview on PineStone, as Matt had mentioned, we manage just shy of 60 billion Canadian dollars in assets under management, under four strategies, global, international and U.S. large cap equities, as well as global small cap equities.

All of these strategies are focused on a single investment philosophy and process, and that is a focus on exceptional high-quality companies that are held for the very long run. We are private employee owned and having separated from Fiera capital in 2021. And, similar to Canoe, we do pride ourselves in the alignment of interests that we do have with our clients.

So, this page goes through a bit of the timeline on PineStone Asset Management from the pre-Fiera days when Nadim Rizk, our founder, CEO and CIO, was first appointed to lead portfolio manager at a privately owned Canadian asset manager and first got his shot in managing global and U.S. equities. He shortly thereafter hired Andrew Chan as a research analyst.

And now Nadim and Andrew have been working together for nearly 20 years in total. The rest of the timeline does go through several milestones, including the team's launch in 2009 at Fiera capital as well as some of the strategies and investment team members that joined over the coming years, which will we'll be going through in a bit more detail. In terms of more recent years, PineStone Asset Management, having separated from Fiera Capital to create its own independent organization, it remains as the sub-advisor for Fiera Capital strategies as well as some strategies such as the Canoe Global strategy. More recently we have launched the global small cap strategy, and so, this strategy was launched on the belief that we could 1), add value to our clients; and 2), we have an edge in this space. So, we've found a number of ideas over the years that are attractive but don't necessarily have the liquidity or market cap characteristics to make it into the larger cap strategies. And I bring this up because we believe this launch does provide benefits to clients in the mainstream global equity strategy as we will be following some of these companies earlier in their life cycles. And if they are successful, they may graduate into the larger cap strategy.

The next slide goes through are our four strategies: global, U.S., international and global small cap. The global, U.S. and international strategies are managed by Nadim Rizk, our founder, CEO and CIO, and all of these strategies are concentrated portfolios with a focus on, again, strictly exceptional, high-quality companies that go through a rigorous, fundamental analysis and in the variety of steps which will be reviewing in the following slides. The global small cap strategy is managed by Thomas Horvath, who was previously a lead analyst covering the consumer sector with PineStone Asset Management.

In terms of where we're different from a number of other investment managers, especially in the long only global equity space, it really comes down to these three key things.

Number one, alignment of interests.

So, as I had mentioned earlier, a variety of employees at PineStone, primarily members of the investment team, are equity owners in PineStone Asset Management. Additionally, the investment team is all compensated on the long-term portfolio performance. So, what I mean by that is the five-year value add above the benchmark is the key variable in determining the investment team's variable based compensation. Additionally, the entire investment team is invested in the same strategies that you and many of our other clients are invested in.

Next, the research component.

Both Nadim and Andrew began their careers as research analysts and over the years, as well as bringing in individuals who have been together and worked very closely over the years they've developed a very rigorous structure and repeatable process to doing fundamental research. This includes the T.I.M.E. score (**T**rack Record, **I**ndustry Attractiveness, **M**anagement Quality, **E**conomic Moat), which is an investment criteria score that that looks to assess the quality of different businesses and allow you as an investor to compare, a company in the consumer sector versus one in financials. Additionally, the models, the templates, etc., many of these areas have been developed and refined and are constantly evolving as the team has been working together all these years. Many of these aspects are led and overseen by Andrew Chan, our Head of Research.

Number three, in terms of where we're different, it really comes down to mindset.

There are a few investors who are as buy and hold or as low turnover as we are at PineStone. What I mean by that is we are more inclined to hold companies through soft patches as we find timing the entry and exit points of certain stocks is extremely difficult, but rather we want to identify these high-quality companies where the thesis is for the long run. And so, what I mean by the long run, is five, ten, 20 plus years. Just one proof statement on this point is nearly 70% of the portfolio has been held since inception of the strategy. And so we do look to remain committed to our investment approach of finding these high-quality companies and not necessarily be lured by market darlings, highflying growth, stocks that do risk potential derating.

Next, I'll go through the investment team in a bit more detail. I've spoken about a couple of these individuals, but just to note, it's a very eclectic team. In total, the team speaks nearly 15 languages, each divided by sector. So sector expertise across the entire investment team with, importantly, primary sector coverage as well as back-up sector coverage.

This team does get together on a weekly basis in the weekly equity team meeting. And this is a meeting that goes anywhere from 3 to 5 or 6 hours where they’re generally discussing one name or one topic in great detail. During this meeting, the backup sector analysts, so take for example, a financials name that’s been discussed by Nick Cileli, Dominic Tremblay, would be assigned the devil’s advocate.

Dominic would be working to poke holes in the investment thesis, challenge some of the model assumptions, challenges the T.I.M.E. score as well as highlight any key risks to the investment thesis of the name or topic that is being discussed. Additionally, the entire investment team again is compensated on total portfolio performance, so everyone is equally incentivized to be extremely active in this meeting.

Nadim and Andrew have really cultivated a culture where everyone is empowered to speak up, everyone is empowered to state their opinions on the stocks that are being discussed and it leads to very constructive discourse where the team is assessing all possible ideas and constantly assessing alternatives. So, alternative names that may be on the wish list or in the portfolio or competitors, etc.

I'll also note this entire investment team has seen virtually no turnover whatsoever since their inception in 2009. And in terms of how the team likes to hire, we do like to hire folks young. We like to hire folks young generally straight out of school in order to indoctrinate them into our investment process, in our style of investing, because we are buy and hold, so long duration in terms of the tenure of holding these companies, it takes a different mindset as I had mentioned previously so we are less inclined to bring in somebody from the outside or for a hedge fund who is used to having their ideas implemented rather quickly. But rather the research analyst who spends quite a bit of time on existing holdings in the portfolio so that maintenance work. So, the work really just starts when we initiate a position and then it requires quite a bit of maintenance throughout the tenure of the holding period.

In terms of how we define quality, which I've mentioned a couple of times now at this point, it really comes down to these five key factors.

Number one, we look for companies that generate high return on invested capital. This is generally due to their competitive position, say, economies of scale, brands, equity, technology advantage to name a few. And additionally, these companies do generally grow at a potential whereas they have excess capital that they can redeploy into these high returning projects.

Additionally, these are companies that generally generate strong and predictable free cash flow and compound shareholder wealth over the long term. The final point is an important one and again, kind of goes back to the maintenance work that goes into assessing all of these companies as well as the rigorous fundamental research process. So, the team does have an obsession with capital preservation. So, we aren't necessarily looking to hit a bunch of home runs, but rather a lot of singles and doubles in terms of companies that can compound shareholder value in excess of the market over the long term.

Going back to the investment team's mindset, this page does display the holding period analysis, that I had mentioned earlier. Nearly 70% of the names in the portfolio have been held for over ten years and nearly 90% for over five years.

This next slide goes through our investment process, something that is taken very seriously and has evolved over time. However, in general, it has remained very consistent in terms of the key four steps. So, first, starting with idea generation, ideas are generated from a variety of places. We do some proprietary screens, so screening companies for certain financial metrics such as return on invested capital, margins, free cash flow generation, and additionally valuation.

We also get ideas from existing holdings. So, looking up and down the value chain, looking at competitors, suppliers, customers of the companies that we own, and oftentimes we even get ideas from meeting with management. So, we do take engagement with our companies quite seriously. And so oftentimes through speaking with management, we'll discover new ideas. One example would be, Sherwin-Williams, where the paint manufacturer and distributor where we got that idea through Graco, which is a paint application equipment producer. Additionally, we also get ideas through general discussions, conferences, etc.

Next comes the fundamental research process, which generally begins with an initial view. So that is a condensed version of the PineStone research report. Say a 4 to 8-page document that really reviews the key thesis as well, as the key attributes of the company that is being discussed. And, so, this is intentionally a shorter version because the initial view is then discussed with Andrew or Nadim to decide whether or not to do the go ahead on doing the full PineStone research report. Because this research report, which is all done in-house, requires looking through company filings, proxy circulars, reading through earnings transcripts, meeting with management, reviewing financials very closely, as well as producing the team's own proprietary intrinsic value model – all of these factors and activities take quite a bit of time. They take anywhere from 6 to 8 weeks to create just one report. And so, we do believe this is an important aspect of our investment process as it allows us to assess very thoroughly the investment thesis as well as the key risks.

Then you also see the mention of the T.I.M.E score (**T**rack Record, **I**ndustry Attractiveness, **M**anagement Quality, **E**conomic Moat), which we'll discuss later on in this presentation just with a couple examples to help bring it to life.

Next comes the portfolio construction in process where diversification is a key aspect. So, diversification importantly by end market. Sectors we find often can be somewhat misleading. Looking at where these end market revenue drivers are coming from and ensuring that we don't have a portfolio that is exposed to one primary risk factors such as U.S. housing, so making sure we have exposure to a variety of factors overall.

Additionally, when it comes to new positions, we generally like to start those new positions relatively small because we are not going to know a company that we just initiated a position on regardless of how rigorous our research is on, as well as those that we've owned for ten, to 20 years, those companies that we've gone through multiple management teams, multiple board members, multiple market cycles, etc.

Then, finally, the risk management aspect.

This is primarily done at the security level, so understanding all possible risks. And, again, going back to the team's obsession with capital preservation. Additionally, from a portfolio level perspective, there is some scenario analysis that is done. And, again, going back to my prior comment just around diversification and ensuring that all these high-quality companies do derive their revenues from different drivers overall.

Next, I'll just give a brief preview of the T.I.M.E. score. So, this is essentially a report card for a company and what it goes through each of these categories have has a variety of subcategories which are rated by the research analysts. It is then discussed with the backup sector analyst or the devil's advocate in addition to Nadeem and Andrew. So, there are a variety of checkpoints and checks and balances where it helps avoid any analyst bias when it comes to rating these certain categories. But you may notice the relatively large wait for economic moat and industry attractiveness, and this is intentional as regardless of how good a company is, regardless how good the management team is, how good their recent growth profile is, if it is in a dying industry, like the printing press made years ago, chances are, regardless of how good that company is, it can't outrun its industry. That is why understanding the industry and the economic moat around the business is extremely important.

You'll also notice the negative factors bottom right. So, these initially start as governance red flags as we find that companies with good governance generally have good financials, good ethics, good morals, good business practices in terms of the communities and areas they operate in, good practices when it comes to dealing with their customers, suppliers, etc. So, these negative factors do detract from the overall weighted average T.I.M.E. score.

This enables the investment team to compare ideas and really standardize the research process across different industries, different sectors. So again, comparing companies in the consumer sector to those in financials, for example.

Next in terms of portfolio construction, there are some guidelines in place that help ensure that the portfolio is adequately diversified.

As you see, a very concentrated portfolio of 15 to 25 names and very low turnover. So, turnover generally below 10% annualized name turnover per year. And then additionally a couple minimum exposure to certain GIC sectors as well as sector weights as well as emerging markets. We don't typically invest a lot in emerging markets, however, we do have a few names in emerging markets such as Taiwan Semiconductor, the world's largest chip foundry mostly because it's domiciled in Taiwan, however, we find that it derives most of its revenues from developed markets, for example.

When it comes to sell discipline, again, we are very low turnover. However, we will exit a position if we find we've made a mistake or if we find the investment thesis is no longer valid. So, in those cases we are comfortable exiting the position and exiting it rather quickly. But more often than not, a full position exit, is motivated by a better opportunity elsewhere in the funds or perhaps on the wish list. Those are the two key reasons for us exiting a certain position.

Now we'll go through a couple individual company examples to help really bring this investment process and philosophy to life.

First, starting with AutoZone, the leading retailer of aftermarket automotive parts, primarily in North America. AutoZone is a great example of the types of businesses that we look for. This is a position that was initiated in, I believe, 2014. If you think about the auto industry in total, there are, say, 20 different car manufacturers, 20 different makes from each manufacturer and then say 20 different years they are actively in the car fleet in the world. That leads to a lot of complexity in auto parts.

So, hundreds of thousands of SKUs are required in order to properly service autos. And given the necessity of having your car working, having your car maintained, having it fixed when things go wrong is extremely important and AutoZone has really established itself as a leader in this part due to, number one, their inventory position, so holding those hundreds of thousands of SKUs, that very important inventory database. Additionally, their high-quality service. And then their scale and their stores. As you see on the page bottom left, that map that goes through the roughly 6,000 stores in the U.S. that are available for customers to drive in.

And what AutoZone does in addition to their very qualified service is oftentimes they'll do things such as rent you a part to help you install that new part into your car. Or, they'll let you leave your car there to have it repaired on the spot. So, all of these factors, all of these competitive advantages, do enable AutoZone to command very high margins, especially with their private label brands such as the Duralast batteries, additionally high return on invested capital.

They do have very strong capital allocation discipline, having used that for most of their profits to reinvest in their business, either through store openings, share buybacks, just to list a few areas.

As you see, this is just an example of a T.I.M.E score. Generally, when it comes to a T.I.M.E score, we are looking for companies with above a 70 to 80% T.I.M.E score. And as you see, AutoZone does have a fairly strong T.I.M.E score overall, and it also trades at a reasonable valuation.

Each of these categories, as you see on the page, are rated in quintiles, so zero through four being the highest possible mark. So, while AutoZone does have great pricing power in terms of their parts, it doesn't necessarily get a four on pricing power because of potential alternatives with some of their competitors, but a very strong pricing power overall.

In terms of cyclicality, you may notice that AutoZone does have a four in cyclicality. AutoZone has been able to demonstrate strong growth even during economic downturns. Given the importance of cars and folks being perhaps in the soft patch of the economy, being less inclined to purchase a new car, but rather repair or maintain their existing car, AutoZone has been viewed very much as a counter-cyclical company.

So, this is exactly the type of companies that we are looking for. Those that do not require a lot of capital in their business, are not very cyclical and have a strong moat around their business overall.

Next, I'll go through LVMH, the luxury giant based in France. So LVMH is a very diversified business at this point and really benefits from extremely high barriers to entry, just given their brands are generally 100 plus year-old brands. So, virtually no alternatives, no replacement to the brands that they offer, such as their luxury leather handbags for example. So, very strong pricing power just given the desirability of their products and then additionally attractive growth, given that the high-end customer benefits from the wealth compounding effects, so their wealth growing in excess of GDP. There are also a variety of other tailwinds such as younger generations, brand awareness, really driven by social media and in cultural preferences in Asia, namely in China.

We do believe that LVMH is one of those companies that does benefit from all these areas. And, as you see, extremely high margins, especially compared to other consumer companies, relatively low debt to EBITDA. So, as I had mentioned earlier, clean balance sheet is another important aspect that we look for in our companies.

So, I'll perhaps go fast forward to the T.I.M.E. score. Just to note here, LVMH does have an extremely high positive times score 87% roughly, but it does get deducted slightly due to several of those governance red flags that you see on the far right side of the page, that all those four flags or five flags in total, those detracts 3% from the overall T.I.M.E. score. And then additionally, the key person risk with Bernard Arnault. That said, these are not flags that necessarily they are assessed, they are discussed in great depth, but if there is something that we are comfortable with, with the upside/downside, then it is something that is factored in, but extremely important in the overall thesis.

So next is Moody's. In the interest of time, I'll try and be rather brief here but Moody's is the ratings agency operating essentially in a duopoly with S&P Global. Moody's really benefits from incredible pricing power given the value of having a Moody's rated bonds can be anywhere from 60 to 120 basis points and spread compression, whereas Moody's is only charging their customers, say, three, four, five, six basis points to rate that bonds.

So, the IRR or the return on capital for those debt issuers is extremely high overall. So that really enables Moody's to command high margins, high return on invested capital. Moody's is a great example of one of the higher T.I.M.E. scores in the overall portfolio. As you see, 92% overall.

In the interest of time, I'll just wrap up by going through this shows the Morningstar rating as well as the new global equity funds growth since inception relative to the peer group, average.

And finally, these are the portfolio characteristics. So, these figures should not come as a surprise to many of you, as they're very consistent with our investment philosophy and process. So, I'll point you to the bottom factor, extremely high margins in excess of the benchmark, high return on invested capital, as well as return on equity, and growth fairly in line with the benchmark as we are not necessarily looking for fast growers, but really companies that can defend their competitive position and command their high margins and reinvest in their business to take market share over the long term.

You'll also notice valuation is a bit higher than the benchmarks. So, this is because generally high-quality companies do trade at a premium to the market. When it comes to valuation, we think about it like a gas gauge. If a company is cheap, then we are inclined to initiate a position. If it's fair, we're inclined to initiate a position. But if it's expensive, it may be a situation where we will simply add the company to our wish list and revisit their story at a later date when it's looking a bit more attractive. But valuation is not a multiple re-rating, is generally not a key factor in terms of the portfolio's long term returns instead is really the compounding of shareholder value and earnings growth over the long term.

Matthew King

Perfect. Sam, thank you so much for the overview of the process. I'm going to go actually back to the performance slide because I think it's fantastic. First off, I just want to say I'm excited about the partnership with Empire Life, the launch of the Empire Life Canoe Equity strategy. As mentioned, the strategy has a history of strong compounded annualized returns, and that compounding can obviously add to significant capital in any investment account.

If you look at the table on the top left, you take $10,000 and you allocate that to us back in 2011, that $10,000 would be more than $46,000 today. That's more than $18,000 over the peer group average. Again, you started with $10,000, but you're getting an extra $18,000 by allocating in our top-notch strategy. Consistency is certainly a key and a trademark, I would say, of the PineStone approach. The strategy has outperformed the pure average in ten of the last 11 calendar years. Again, I think that's achieved through that time tested and disciplined investment approach, deep fundamental bottom-up research that Sam walked us through, and the utmost importance placed on identifying those really high-quality companies that can compound for the long run.

So that being said, we thank you for listening in on the global equity session and look forward to earning your support. Thank you very much.

Sam Weiss

Thank you.

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