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StockHouse Q&A: Investing World According to GARP

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By Sean Mason

Fund manager offers Canadian small-cap selections

Jennifer Law is portfolio manager for the CIBC Canadian Small Companies Fund.

SH: What are your criteria when deciding whether to buy a stock?

JL: I'm a GARP (Growth at a Reasonable Price) manager. On my dream list would be an under-followed company, one that is early in its growth rate. Also, we look for great management that owns quite a bit of the stock. I'm buying growth, preferably at a lower P/E than the market. I find that in the Canadian market you have to be in a story early and you typically find that in under-followed companies before their growth rate is fully discounted into the market. So, you want to look for good management with a good business plan and you want to be in an industry that is growing, not necessarily spectacular but good fundamentals to the industry. Our investment horizon is two to three years, so over the next two to three quarters we want to see an inflection point of something - either introducing some new products or consolidating. That makes the earnings growth higher than the rest of the group or the rest of the market.

SH: How do you know when it's time to sell a stock?

JL: I'm more qualitative driven at the beginning - I want to know what the industry outlook is, what the competitive landscape is, and what the business model of the company is. Then I do the numbers, the quantitative part - how the company has performed during the last number of years. I find that a lot of small companies don't have a long history, so I'm not looking for a 10-year ROE track record. I look back typically two to three years and then I look forward three years ahead and that's a gauge as to what we should pay for this company. Our decision to sell, then, is driven by what we perceive as fair value for the company.

SH: Do you have a favourite sector currently?

JL: We have a fully-diversified portfolio. Capital preservation is a top priority, so we've been adding more stability to the portfolio. We've been adding on the utility side and consumer staples - very stable businesses with lots of earnings visibility. I still very much like the materials, especially metals and gold. I think we'll have another run in gold in September so I'm slowly accumulating my gold position. I think there's still a lot of value in the metals. A lot of my metal companies are still only trading at five to six times P/E, so I think they're attractive relative to other sectors. I think metals like zinc and copper have legs to it, room to move up. So, we're overweight in materials. Right now I'm underweighted in energy, partly because the local market for natural gas in the near term can be quite weak.

SH: What's your outlook for Canadian equities for the remainder of 2006?

JL: We want to be cautious. I'm more of a bottom-up type of portfolio manager. I really just look at my companies more so than trying to bet on a certain direction in the market.

SH: What stocks do you like at the moment?

JL: Global Railway Industries (TSX: T.GBI, **BullBoards**) - its stock had been falling but I believe things are moving back in the right direction. It's a turnaround story with new management coming in last year. They reported their first clean quarter last quarter and their margins were good and they restructured their balance sheet. They also have no debt and $1.6 million in cash. Their valuation is pretty attractive - this year it's probably trading 11 or 12 times (earnings) and next year probably 10 times.
Second, I want to talk about Vicwest Income Fund (TSX: T.VIC.UN, **BullBoards**), which is a trust. The company's involved in the non-residential construction market, which we feel is pretty healthy. It's very attractive on a yield basis - about 8.8%. It also has a payout ratio of about 70%. There's lots of room, therefore, for them to move distributions, so yields should improve.
We also like MediSystem Technologies (TSX: T.MDY, **BullBoards**). The company is a pharmacist for retirement homes, so it's a demographic we like. They get paid based on a formula - the government regulates how much pharmacists should charge - so I find the business model to be quite safe. The company is also very technology driven, so the way they transmit prescriptions to their dispensing office is quite innovative.
They've been gaining a lot of market share in Ontario and they've recent entered Alberta via an acquisition. So, it's a growing company with an attractive industry exposure and management owns about 10 million shares out of 23 million. They've been growing well on the top line, but the bottom line - because of the extra costs of introducing this new technology, ramping up in terms of staffing, and going to a new market in Alberta - has not been growing as fast as revenue.

SH: Thank you for your time

JL: Thank you