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Caroline Montminy, CFA
Moderator
Vice President,
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BREAKOUT SESSION:

FINDING A NEEDLE IN A HAYSTACK

Caroline Montminy (CM): Good afternoon. I am Caroline Montminy, an Investment Counsellor in Burgundy's Montreal office. Thank you for being with us today for an interactive discussion about Burgundy small-cap strategies. For investors like Burgundy who thrive on research, small companies are very attractive. We began investing in small caps in 1995 when Allan MacDonald launched our Canadian small-cap strategy. Then two years later, he launched our U.S. small-cap strategy. Allan has since chosen Andrew Iu and Steve Boutin as the successors to manage both mandates. Andrew was previously an Analyst on Burgundy's Canadian small-cap strategy since he joined the firm in 2013. And Steve was Portfolio Manager of our U.S. small/mid-cap strategy since he joined in 2012. More recently, Andrew Choi, who's covered both Asian and European large companies for Burgundy since he joined us in 2010, has found a unique opportunity to exploit in European small caps.

Steve, thank you for joining us today. So, you began investing in stocks when you were still in high school, and you dedicated your entire career of more than three decades to small-cap investing. **Given your experience, can you please tell us how the process has evolved over the years?**

Steve Boutin (SB): Yeah, sure. Hi, Caroline. Nice to see you. Yeah, you mentioned that I started to invest when I was in high school. And before we get into the subject, I want to mention also our own industry has been disturbed over the years. And when I was in high school, one thing I used to do was to write to companies, asking for their annual reports. And then, sending them by mail – not email, the old way, mail – and waiting a few weeks, and then I would get the annual reports, read them, and try to find good investments this way. So just fast forward to today, the same high school students can do the exact same thing in two minutes and have access to all the publicly traded companies in North America and the world. So, as you can imagine, with the information so readily available and fast to get, the markets are quite efficient today.

And what it means is to find a great business, and it's cheap at the same time and the stock will remain cheap for a while, it's very, very rare. So, you have to be opportunistic. And I think at Burgundy we're good at it because we study a lot of companies even if they're too expensive, because we like them, we like management. And sometimes if they miss a quarter but we feel the business is still a great business long term, then you can be very proactive, and buy when those inefficiencies happen. So, I thought it was important to mention that disruption happens everywhere.

CM: So you mentioned earlier that information is more accessible today, but the fact is that small-cap companies do disclose less information. So I'd like to ask Andrew Iu, **how do you fill this gap in your research?**

Andrew Iu (AI): Yeah. Thanks, Caroline. Well, I'll start off by saying I certainly echo some of the things Steve said. Certain kinds of information have never been easier to get. It's very easy to get filings. It's extremely easy to get financial data. There's tons of financial databases out there. So that kind of information is easy to get, and that makes it all the more important to get proprietary information. It makes it all the more important to get out of that basic set of information and find information that other investors don't have to give you an advantage and give you an edge. And I think that's what makes small-cap investing fun. If you work hard, you can find that information and it actually does make a difference to your investment thesis. And you find things that are ultimately mispriced.

To give a few examples, I'll use a company case study. It's a company we bought last year called Tecsys. It's a supply chain software company. The main industry they serve is healthcare. Healthcare networks, hospitals. Think of all the supplies that are used in a hospital. The back end of that is powered by software, and they provide that software. And I'll just use it to bring to life a few ways we try to get that proprietary information. The first one is management and access to management. Steve alluded to the importance of management. And I think we're blessed at Burgundy to have a very good reputation, to be long-term oriented investors. And so, I don't want to say it's easy, but if we contact a CEO or a CFO of a small-cap company, it's very likely they're going to take our meeting and they're going to spend time with us.

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AI: In the case of Tecsys, founded by an entrepreneur who is still the CEO. He owns a big chunk of stock. You can sense his passion for the business when you meet with him. I've probably met him ten times over the course of my career at Burgundy. And to Steve's point earlier, a lot of what we do is finding quality and waiting until it's on sale. So, that's the first part. I'll just use this Tecsys example to bring to life how valuable management access can be in one of those moments where a company is on sale. We bought Tecsys in

March of last year. And just to give you quick context, it was crazy. The Canadian small-cap market declined 46% in six weeks. It felt like the sky was falling. And I reached out to the CEO at the time and I was able to get an hour of his time in the middle of March when the economy was just going into shutdown mode.

And he spent an hour with me during that time. He sort of said: The top of our sales funnel has actually never been better because this pandemic has exposed the vulnerabilities in supply chains. It made every hospital executive realize this is not an area we can continue to under-invest in. And it's a small anecdote, but things like that give you the conviction to act when it feels like everything is sort of falling apart. And so we were able to buy the company then, shortly after that meeting. Second one is experts. We're very fortunate that Burgundy is a big firm. We have a big research budget, and we can spend that in various ways. And our largest research expenditure is actually expert advice. Our team does 700 expert calls a year, ex-executives, ex-salespeople, competitors, suppliers, people who really understand the industry and the ecosystem that a company operates in.

> "…[In] the small-cap world, oftentimes if you can find unbiased information that gives you confidence in the quality of the product, that really moves the needle for the thesis and your overall appraisal of the quality of the business."

In the case of Tecsys, I've spoken to their customers, hospital CIOs. I can tell you this software is extremely difficult to replace once you put it in. So things like that give us conviction and give us sort of information that other investors don't have. And then, the final thing that I think is somewhat unique to small caps is that most small caps they often have just one or maybe two products. And this is nothing to take away from my large-cap colleagues, but many large caps are actually conglomerates, right? They have dozens of business units. So in the small-cap world, oftentimes if you can find unbiased information that gives you confidence in the quality of the product, that really moves the needle for the thesis and your overall appraisal of the quality of the business.

CM: Yeah. Thank you, Andrew. I'd like to keep on this topic of the simplicity in the business model. Andrew Choi, **do you want to expand on that a little bit?**

Andrew Choi (AC): Sure, Caroline. That point that Andrew made regarding simplicity, I think is a really important one because understanding the company's value proposition is a key focus for us. So, to that end, I think seeing a product in action can actually be very helpful and it can make up for hours of reading about something. So one example of this in action: We own a company called Ten Lifestyle. The company provides something called lifestyle concierge services. And what this is if you look on the back of your credit card, there will usually be a toll-free number that you can call in case of emergency. Ten Lifestyle provides this type of service through private banks and high-end credit cards, but with focus on travel, dining, and entertainment. And so, this is a very niche product. Not many people know about it. I certainly have never used it or even knew it existed.

And Ten Life is one of the only publicly traded company that provides this service, so I was struggling through the research process a little bit. And I'm reading about how their members love the service, but I wasn't quite getting it. And lo and behold, during the research process, my car breaks down – not once, but twice in one month. And so, I pulled out one of my cards and looked at the back and there was a number, and I called. And I got to say, it was the best banking experience I've ever had in my life. And now, this card is one of the last ones I'm cancelling. So to make it clear, this is just an anecdote, and you always confirm your experience using data. And in this case, Ten Lifestyle has an industry-leading Net Promoter Score. And they've been winning contracts from their competitors, which shows that their service actually is being valued. But it really shows just how powerful it is to see something in action versus just reading about it. I think primary research is very useful.

CM: I think it's fair to say that growth stocks have been very popular for a few years now, and they've had a large impact in your respective markets. In many cases, these are not stocks that we own because we know that there are short-term fads that can tumble as quickly as they have risen. So, we are being contrarian here. And Steve, maybe, **do you want to talk about how being a contrarian can add value in the long term?**

SB: Sure, Caroline. Well, to me, the definition of a contrarian is someone who has a different view than the consensus, but also has to be right. Because if you're not right, at the end you won't make any money. So, that's probably the way I approach being a contrarian. And, well, you mentioned those high-growth companies not making any money. If you look today at the Russell 2000, which is the small-cap index in the U.S., and 2000 means 2000 companies, over 40% of them today are not profitable. And since at Burgundy, we only invest in profitable companies. Just by doing this, I must say right now I feel like kind of a contrarian.

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Seriously, I... And I think the only thing I want to say about being a contrarian, it's not about next quarter. We're not trying to figure out if this company is going to beat expectations or be below expectations next quarter. It's really about the next three to five years. And you try to find something that the market doesn't fully understand or appreciate about a business. And, again, if you're right, you should make a good profit. And at Burgundy, we have an advantage. Our clients understand this. And we have probably more long-term capital than other money managers because our clients are patient. And if you can invest for the next three, five, seven years and be patient, you can do very well by being a contrarian.

CM: Yeah. That's true. Andrew Choi, **you have a reputation for covering a very large number of companies. Is it because you're a contrarian?**

AC: Well, the link might not be I guess immediately obvious, but I guess it is linked in a way. And I think that's because I think being contrarian is important. But I think it's just as important in having the contrarianism come as a by-product of independent thinking. And especially in this small-cap end of the market, where you don't really have a great visibility into the rest of the market and you don't really know what the buyers and sellers are really thinking, I think this becomes really important.

And so to that end, our objective is to get as wide of a footprint over our universe as possible and come to as many independent conclusions on those companies as possible. And then, you can try to find companies that are mispriced within that set. And I think in addition to this, part of being contrarian sometimes is being contrarian to yourself. So, we want to uncover opportunities that other investors are missing out on or ignoring. And sometimes that group includes myself. So, I think that has me looking at a lot of companies that I might not be naturally attracted to in the beginning.

CM: That's very interesting. Andrew Iu, in your case, maybe being a contrarian was simply not owning gold mining stocks in the past year. These have been really popular. Can you talk a little bit about your approach in Canada?

AI: Yeah, for sure. I mean the gold miners were the place to be in 2020. And mining overall is still a popular place to be. I guess maybe one thing I'll say around that, which echoes what Andrew Choi was just saying, is the way we approach investing at its core is independent. We are trying to find wealth-creating businesses and we're trying to find them at reasonable prices. That's what we're trying to do. And because of that, at the outset, we end up being very different than everyone else, and we end up being independent thinkers. And I think perhaps the best evidence for that is just what our portfolios look like compared to the benchmarks, right? In my universe, almost a third of the market is mining companies. I don't own a single one. Many investment managers, they start with the index and they use that to guide their investment thinking. But we do the opposite because of that independent mindset.

> I think it's really important that our clients understand that we're independent thinkers. We think with the starting point of buying good businesses and not from the starting point of: What's in the index and what do other people own?

And it's for a simple reason: Mining companies over long periods of time tend to destroy shareholder value. They're very popular right now, but they don't have competitive advantage and they produce a commodity. And I think every Portfolio Manager at Burgundy sort of has to deal with this from time to time. Steve, I think that's probably biotech for you right now, where it's the biggest part of the Russell, and almost none of them make any money, and it's a very speculative area, but it's very popular. And so to Steve's point, I think it's really important that our clients understand that – that we're independent thinkers. We think with the starting point of buying good businesses and not from the starting point of: What's in the index and what do other people own?

As an example of contrarianism in Canada, I agree with Steve. I think being contrarian means you're doing something that's unpopular. And so one way to do that is to potentially look at a whole sector which is unpopular and find companies within it, where, to Steve's point, the consensus opinion on it is wrong. So, one place we did that last year in Canada was in real estate. It was the second-worst performing sector after energy last year. Everybody thought all real estate meant enclosed malls and office buildings. That was the consensus view. And that's just not the case. There is a lot of that. And there are certainly landmines in real estate. And we're not sure where those sectors are going to go. But some real estate actually had a lot of good things going for it.

We bought one company, which is called Summit, which is a warehousing real estate business. E-commerce demand is creating huge demand for this kind of real estate. And yet the consensus view was that this is a piece of real estate like all others, which is going to have a challenged outlook.

CM: Well, thanks, Andrew Iu. And thank you, Andrew Choi and Steve for being with us today. It's been fascinating to discover how dynamic the small-cap universe is and how it's affected by disruptions, capital markets, and more recently, speculation. What really stood out to me is how you've been able to be creative and adapt to these new elements, but always sticking to Burgundy's core philosophy of quality-value investing. ■