

Laketon Canadian Growth Equity

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John: Hello and thank you, our listeners, for joining us for this month's audio commentary. My name is John Slattery, and as president of Laketon Investment Management it is my pleasure to welcome back Susan Spence, Vice President and Portfolio Manager of the Laketon Canadian Equity Fund.

Susan, the topic of today's audio recording is the Industrials Sector, which is comprised of quite a diverse group of companies. Can you tell us what areas within the sector the Laketon Growth Equity Team is currently focused upon?

Susan: John, right now we are really focused on two areas within the Industrials: the railway stocks and infrastructure-related companies.

John: So Susan, what is it about the railway stocks that you currently like?

Susan: Well to begin with, the rails are a significant component of the Industrials sector. The two railway stocks in the S&P/TSX Composite Index are Canadian National Railway Co. (CN) and Canadian Pacific Railway Ltd. (CP). At approximately 2.8%, their index weights combined account for almost half of the overall Industrials weight, which is roughly 6%. An important part of our investment process as Laketon's Growth Equity Team is managing risk in the portfolio, including benchmark risk at the sub-industry level. Therefore, we pay close attention to the larger components of the index.

At this point in time we do view the rail industry as an attractive area, so we think it makes sense to be overweight the rails. The structure of the railroad industry means that competition is limited, and in a generally high oil price environment rails are gaining share from alternate forms of transportation, specifically trucking. The rail companies proved to be quite defensive plays within the Industrials sector during the economic downturn, and yet are also positioned well to benefit in the economic recovery.

John: Susan, can you elaborate a bit more on the opportunity for the rails going forward?

Susan: Of course, but I'll start off by pointing out that during the downturn, both CN and CP made substantial inroads in reducing their cost structures and improving the efficiency of their rail systems. Along with their US peers, both companies saw significant volume declines in the past year, but pricing has held up well in the industry and the previously-mentioned cost cutting helped the companies to limit the impact to the bottom line.

So going forward, as volumes improve, CN and CP will benefit from the leverage their new lower cost bases will provide. Weekly data is available for North American rail volumes, and it shows that volumes have bottomed out and have begun to recover sequentially. We expect the year-over-year comparables to turn positive in December, and expectations are for a gradual recovery as the economy slowly gains momentum through 2010. Despite the most recent upward leg in the rail stocks, they continue to trade below typical early cycle multiples (which bodes well for multiple expansion). And the combination of an improving top-line and margin expansion should lead to solid double-digit earnings growth in 2010 and for the next several years.

As an aside, the latest upward move in the stocks was triggered by the announcement in early November that Warren Buffett's Berkshire Hathaway Inc. company was buying the 77% of Burlington

Northern Santa Fe Corp. shares that it did not previously own at a significant premium. This was a move intended not only as a bet on the rails and Burlington Northern specifically, but also on the broader US economy.

Our rail exposure in the portfolio is through CN. We believe CN is a superior investment to CP given the strength of the management team, the breadth and composition of its rail network, its business mix and its consistent position as the lowest cost operator of the major North American railways. Specifically addressing the cost structure, we have greater confidence in CN's ability to retain more of the efficiency gains it achieved through the downturn as volumes pick up than we do in CP's ability.

John: Susan, I would now like to shift from companies that move things to those that make things. What opportunities do you see with respect to infrastructure?

Susan: Companies with exposure to infrastructure projects, as well as engineering & construction companies in general, will also benefit from the expected gradual pick-up in economic activity, both in North America and globally. Although there has been a lot of excitement around targeted infrastructure stimulus spending by federal governments, in the US in particular, we have yet to see much evidence of these specific projects emerging. However, overall activity is starting to pick up, both in terms of general infrastructure spending and other engineering & construction projects. After a period of decline, we are starting to see growth in engineering & construction companies' backlogs resume. Although these new projects won't impact companies' revenue lines for some time, the stocks tend to react sooner, cuing off the backlogs.

One company in this area that we like is SNC-Lavalin Group Inc. (SNC). SNC is Canada's largest engineering & construction company, with solid management, a strong global network and a well-diversified base of business. We like SNC for its global exposure, as we think there are greater near-term opportunities for growth outside of North America than within it. SNC also has greater exposure to infrastructure spending than most other publically-traded Canadian engineering & construction companies, and we believe that growing demand for infrastructure projects globally is a trend that will provide a tailwind for the industry for many years.

John: Susan, I've notice that you haven't mentioned the aerospace industry. As you know, Bombardier and CAE are of two the other larger weights in the industrial sector. Do you have any exposure to these names?

Susan: At this point in time we do not have any aerospace exposure in our flagship Premium Growth mandate. Although we consider both Bombardier and CAE to be companies we would invest in (and in fact have owned in the past), given the strength of their market positions in the businesses they operate in and the strength of their management teams, we believe there is near-term risk of further negative earnings revisions for these names -- a key factor that the Laketon Growth Equity Team focuses on. Although both companies have parts of their businesses that are more stable (transportation for Bombardier and the military side of CAE's business), the current downturn in the aircraft market has not yet run its course, particularly on the commercial side, and we feel there will be more bad news to come for these stocks before things start to pick up again.

John: Thank you Susan for your comments and discussion today and we certainly look forward to hearing from you in future audio commentaries. I would also like to remind our listeners that the Laketon website is a source of varied and useful information. In addition to the audio files you can gain access to our quarterly fund commentaries for all of the Laketon funds. If you can't find what you need, I encourage you to contact us and let us know how we can help you. Goodbye and thank you for tuning in today.