COVID-19: THE CHANGE CATALYST

The global pandemic has imposed significant near-term challenges on people, governments, and businesses across the globe. Looking beyond the immediate future, we outline our views on how COVID-19 may act as a longer lasting change catalyst across several industries, and how some of the companies held in our Small Cap portfolio are well positioned to benefit.

THE CHANGES

- Containment measures used to combat the pandemic have accelerated the shift towards e-commerce for consumer purchases due to “shelter in place” requirements.
- Companies have had to rapidly deploy work from home (WFH) capability to protect their employees and continue to service their customers.
- The healthcare industry has had an enormous burden placed on it, with limitations in capacity becoming quickly apparent.
- Environmental, Social and Governance (ESG) issues will continue to rise higher on investor’s and societies’ minds as we navigate through the current crisis.

THE IMPACTS

HEALTHCARE spending is expected to accelerate in certain areas, as the industry ramps up capacity in ICUs/urgent care to an adequate level to deal with future outbreaks. As a result, we expect to see an increase in research funding and diagnostic and testing equipment along with less political scrutiny on drug price inflation. Telemedicine and home care are also expected to play a greater role.

- Jamieson Wellness and Andlauer Healthcare are two holdings benefitting from increased consumer demand for medicine, vitamins, minerals, and supplements, particularly as economies open and people resume social activities.

FREIGHT TRANSPORT/DELIVERY companies should see a benefit from e-commerce parcel delivery services via air and ground, particularly since airline passenger capacity will likely remain subdued for an extended period which represents a meaningful portion of freight-hauling capacity.

- Cargojet, which has ~90% of the overnight airfreight (“middle mile”) market in Canada, is seeing huge demand tailwinds from the acceleration of e-commerce, particularly as it continues to grow its strategic relationship with Amazon.
- Intertape, is well positioned to benefit from increased e-commerce activity with its leadership in water-activated tape (i.e. package-closing adhesive that allows for graphics/branding like “Prime”) and protective packaging systems (bubble mailers, air pillows, etc.).

COMMUNICATION infrastructure is in focus due to increased demand for greater bandwidth to facilitate working from home, and greater streaming of home entertainment (video, gaming). An acceleration in 5G deployment by wireless carriers will enable greater usage of wireless services, which should also benefit wireless equipment suppliers.

- Recently added, Calian Group, is positioned to benefit in a number of areas coming out of the pandemic, including its Advanced Technology segment benefiting from maintenance on existing telecommunication infrastructure and installation of new ground communication systems, and its cyber security consulting practice as remote work arrangements proliferate.

ENERGY demand is expected to be impacted by lower than previously expected transportation requirements, which should result in a reduced break-even price for oil production. Future growth in gasoline demand could be impacted should WFH trends accelerate, and jet fuel could suffer from a communication technology led reduction in business travel needs. From a Canadian perspective, access to storage and egress will be paramount to minimize production disruptions and take advantage of best pricing.

- Gibson Energy has an irreplaceable asset with its Hardisty, Alberta storage hub and should see steady demand for increased tankage under long-term take-or-pay contracts as producers, shippers, refiners and traders look to maximize profits in a volatile crude environment.

REAL ESTATE companies have come under increased investor scrutiny in a post-COVID-19 world. Most negatively impacted are the Retail REIT's where social distancing, behavior changes and permanent closures of certain tenants will all impact demand. Office space may also face demand pressure as more people work from home, while the need for less density in office buildings to accommodate social distancing may be a slight offset. Industrial real estate should benefit from an increase in demand for more warehouse and data center space.

- Both small-cap real estate holdings are positioned to perform well in the new environment. Storage Vault, Canada's largest self-storage player is seeing increased near-term demand from life changes (job loss, student moves, deaths, divorce, etc.) and set up to benefit longer-term given the defensive nature of the asset class (very low percentage of someone's income) and changing business landscape (more remote work, commerce driving off-site storage demand).
- Minto Apartment REIT, is focused on the most defensive real estate asset class given individuals prioritization of spending on shelter (rent paid first before other expenditures) and greater relative affordability during periods of economic stress (home owners trading down to apartment).

ESG issues are expected to become more important as pictures of bright blue skies or wildlife roaming the streets provide a glimpse of a world with a lighter human influence. Furthermore, companies that look out for their employees, customers, and communities can see benefits over the medium-term through improved employee and customer retention and brand equity. Lastly, executive compensation practices will come under greater scrutiny given the hardships faced by many during these challenging times. A significant proportion of our holdings are well positioned here.

- Pure-play, independent power producer Boralex, is a direct beneficiary of the continued environmental push to reduce carbon emissions and continues to see strong growth opportunities for wind power development in both North America and its largest market France.

MACROECONOMIC IMPACTS

On the macroeconomic front, with the significant amount of jobs lost to the pandemic thus far, governments have had to borrow substantial amounts to support the healthcare system and the broader economy. However, this level of spending is intended to bridge a gap and cannot be sustained longer-term. Eventually the economy will be on stronger footing, and governments will then shift towards deficit reduction. With inflation and interest rates expected to remain lower for longer, governments should be able to successfully navigate their budget situation by reducing their spending and increasing taxes.

Navigating the current investment environment has become particularly challenging for investors. Our bottom up, individual stock picking is increasingly focused on the "new emerging environment", that has been catalyzed by COVID-19. By remaining disciplined on our investment process, we look to take advantage of opportunities to invest in quality small-cap companies that are trading at reasonable valuations and are expected to come out stronger from the current downturn.