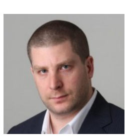
Put these small caps on your stock picking list

Despite his cautious view on North American equity markets, David MacNicol sees plenty of opportunity in several Canadian small caps

Michelle Siu for National Post



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Manager: David MacNicol, MacNicol & Associates Asset Management
Portfolios: Individual client portfolios for approximately 150 families
Description: Combination of equity, fixed-income and alternative-asset strategies
AUM: $150-million

David MacNicol sees plenty of opportunity in several Canadian small caps despite a cautious view on North American equity markets.

The president and portfolio manager of Toronto-based MacNicol & Associates Asset Management said the current environment is one that suits stock picking, rather than relying on broader gains from equity indexes.

“The market is being driven by unnatural forces rather than true economic factors,” he said, referring to quantitative easing by central banks around the world. “It takes a lot of jawboning to get stocks to continue moving higher.”

MacNicol also noted increased liquidity makes it easier for people to run for the exits.

“Targeting special situations allows us to be in parts of the market that will be safer if unemployment numbers disappoint, for example,” he said. “If poor economic news comes out, the overall market will obviously be affected, but it doesn’t mean everything will go down.”

Whereas valuations, economic growth and controlled stimulus are the typical forces that drove markets in the past, the manager sees too many variables impacting equities these days.

“Sooner or later, inflation will come into the system — that’s what all these governments are betting on,” he said. “But we don’t see it for a while.”

MacNicol has recently been moving down the scale in terms of market cap as that is where many of the opportunities outside traditional sectors can be found.

In addition to offering clients exposure to global equity and bond markets, MacNicol & Associates also provides access to alternative assets such as a real estate fund, private equity fund and several third-party hedge funds.

The manager also continues to target companies that pay substantial dividend yields. One such name is Alaris Royalty Corp., which has partnered with 12 privately-held family businesses to provide owners alternative financing while allowing them to maintain control.

“These are businesses that would never come up for sale because they are such great cash-flow generators and, in many cases, have supported several generations,” MacNicol said.

BUY

Sylogist Ltd. (SYZ/TSX-V)

The position: Long-term holding; adding with new client money

Why do you like it? This Calgary-based software logistics company provides things such as accounting solutions for municipalities and school boards in western Canada, as well as fuel and meeting management solutions. Sylogist recently acquired Epic Data, which deals with the top defence contractors in the U.S. and many Fortune 500 companies.
“I liken CEO James Wilson to a younger Warren Buffett in terms of how he isolates other software companies and makes investments. I’ve got a lot of faith in this company,” MacNicol said, noting Sylogist’s internal rate of return has been 40% for the past 10 years.

Biggest risk: Government spending cuts.

Loyalist Group Inc. (LOY/TSX-V)

The position: Recent purchase

Why do you like it? Loyalist Group is a consolidator of companies that provide English as a second language and professional development trainers. "CEO Andrew Ryu is concentrating on Vancouver and Toronto, which accounts for more than 80% of the market and where most of the business is still being run by mom and pop," MacNicol said. "Many of these operators are in their 60s and 70s and really don't have an exit strategy."
By paying the operators in Loyalist stock, the former owners have an opportunity to stay involved, while capitalizing on the company's growth and success.

Biggest risk: Potential competition from U.S. players.

Amaya Gaming Group Inc. (AYA/TSX-V)

The position: Recent purchase

Why do you like it? Despite the backlash against online gaming in recent years, MacNicol noted various governments in desperate need of tax revenues are now welcoming companies such as Amaya, which stands to benefit as a provider of online, mobile and land-based products and services such as casino, poker, sportsbook, lotteries and slot machines.

Biggest risk: A slow down in approval regulations as Amaya only does business in regulated markets.

SELL

Petrominerales Ltd. (PMG/TSX)

The position: Recently reduced

Why don't you like it? Petrominerales has been an underperformer, but MacNicol is also shifting away from oil producers and into service providers. "In some cases, the capex budgets of producers have doubled or tripled," he said. "As a result, a lot of money is going to flow down into service companies."

Potential positives: The company contains labour costs, boosts volumes.

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