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- Andrew Johnson:** 00:41 Welcome back to the podcast. I hope everyone is enjoying the turn of the seasons as we, I guess, slowly step into spring. Joining me on the podcast today is [Mark Rutherford](#). Mark is an equity analyst on our research team, working on our Canadian Large Cap strategy.
- Andrew Johnson:** 00:56 Mark, you were on the podcast last fall. It's great to have you back today. How are you?
- Mark Rutherford:** 01:00 I'm good, doing well. Thanks again for having me, Andrew, it's nice to be back and share some of the things that have been going on in the market and with our [Canadian Equity Fund](#).
- Andrew Johnson:** 01:09 Absolutely. The last time that you were on we talked about way back kind of how you ended up at Mawer a few years ago, and we got a really good sense as to some of the earlier learnings that you had when you arrived here at the firm. I can only assume that this past 12-month period has provided an opportunity to learn even more and provided us with some great reminders of just how many things are out of our control and what we can do about it.
- Andrew Johnson:** 01:32 So, let's start there. What have you and the team been discussing when you reflect on what has unfolded over the last year?

- Mark Rutherford:** 01:37 Yeah, I think it's been a really big learning experience for everyone globally and our research team in particular. One of the things process-wise that we actually do as a research team is we get together at the end of the year, and everyone really thinks about some of the key learnings that they had. We share them as a broader research team and discuss so we can learn from other people and other funds as well. Within Mawer, for myself, and within the Canadian Equity Fund, I think 2020 was a really strong reminder that our process and the philosophy that's embedded with thinking about companies that we're investing in, and the wide range of outcomes that they can have based on different scenarios unfolding, is a really strong reminder of that in 2020.
- Mark Rutherford:** 02:25 Sometimes keeping that really broad perspective is difficult, especially in our industry. We're paid to have an opinion and find facts that maybe support evidence that supports the investment thesis or refutes the investment thesis. So, it's important on the other hand to stay balanced and say, "You know what? Facts have changed, macro environment has changed, we have a pandemic now, and maybe we need to re-evaluate whether this particular thesis is broken and we need to change course."
- Mark Rutherford:** 02:56 So, that was a really big reminder in 2020. I think thinking probabilistically was also another big thing that we really tried to focus on throughout the year. And we talked a lot about the initial economic data that was probably the worst anyone has seen in their careers. And very soon after that, we went from the worst data we'd ever seen to the biggest fiscal and monetary stimulus we'd ever seen. And later in the year eventually when the vaccine news came out, the probability has shifted even greater. And I think we tried to not make massive moves, but incrementally shift as those probabilities shifted from very dire to improving, and now more of a robust growth outlook at least in the near term.
- Andrew Johnson:** 03:44 Yeah, absolutely. You talked about shifting probabilities. I mean, you mentioned monetary response, the fiscal response, the vaccine news, that's all something that many of us are aware of and were pleasantly surprised with, I guess, the expedience of a lot of that stuff. What were some of the action items that came out of that for you and the team?

- Mark Rutherford:** 04:02 So, one of the things that we did in the fall, we were closely monitoring our financial exposure, particularly banks, but then also energy. And one of the things that everyone was really waiting for was kind of the initial vaccine news. And when we finally got that piece of information, I think it was November 11th, we added to energy, to financials immediately that day and continued over the last few months to incrementally add exposure as the probabilities really shifted towards governments and policy makers reopening the economy and people getting vaccinated, health concerns declining over the longer term.
- Mark Rutherford:** 04:45 So, that was really one of the big action items that we did. And on the same token, one of the things that we did not do that we could have done, because it looked pretty dire, was sell out of all of the banks and energy companies when the outlook looked really bad. We really, for the most part, held our core positions, [Suncor](#), [CNQ](#), and [Enbridge](#), and then just add it incrementally as some of the news got better.
- Andrew Johnson:** 05:10 Yeah, and I think that ties back to your earlier point about sticking to the process, falling back on our philosophy. These are all businesses that we've been very comfortable with holding for a longer period of time. And I don't think we took any new positions in these two spaces over the last six to 12 months. but again, falling back on the companies that we've held in the portfolio, very comfortable with, and to your point, not selling out, maybe just de-emphasizing them for the time period and then coming back to them when, as you mentioned, the probabilities have shifted massively.
- Mark Rutherford:** 05:42 And I think one thing that we watched really closely just as a very important kind of indicator for the financials, both insurance companies and the banks, and it particularly started to move post the vaccine news—was just longer term bond yields. And I know it's been a big topic of discussion on the broader markets, but that was one thing that we knew [IAG](#), [Manulife](#) and our bank holdings would really benefit from that steepening of the yield curve. So, that's really a key indicator in that space.
- Andrew Johnson:** 06:13 Now, I presume one of the other areas that we've spent a lot of time reflecting on over the last year has been the performance of management teams themselves with a lot of these companies. What has been your assessment or the team's assessment of the management teams within the portfolio that you've seen?

- Mark Rutherford:** 06:29 Yeah, I think the management teams that we have throughout the year, we're very happy overall with how management teams performed. I think the nice thing that gave [Vijay](#) and myself a lot of comfort throughout the year was that companies like [CCL Industries](#), [Couche-Tard](#) and [Boyd](#), which was added to the portfolio in 2020, those companies were really looking to opportunistically take advantage of some of the distress in the market and make acquisitions to grow their business at favorable prices. I think one of the common themes is those companies tend to be CCL and Couche-Tard in particular, very decentralized in nature, and that really seemed to help. And also just in terms of the amount of leverage that those companies have on their balance sheets, they could operate with significantly more leverage, but they don't. And so, they really treat their companies like owners over the long-term.
- Mark Rutherford:** 07:26 And CCL had a tough year in certain parts of the market. They make labels that could go on apparel or goods, such as labels for beer or beverages. And because of tourism being down so much, they were hit really hard in certain pockets of their business. But looking at the end of the year, they made some acquisitions, margins improved, and they ended up growing earnings per share by 10% in 2020. So, that's maybe one example that I'd highlight.
- Mark Rutherford:** 07:55 One company that maybe had a little bit more what we regard as very high quality on the management side is [Saputo](#). Large owners of the business that they run, run it very successfully for a long period of time—but maybe because they were so lean and efficient in certain parts of their business, as demand shifted for dairy goods from restaurant and industrial and markets to really grocery focused—some of their production had a little bit of a harder time adjusting to that. So, that was one learning as well for 2020 is it's good to be efficient, but companies can have issues if they get too efficient and too stringent with their inventory management and how their production is set up.
- Andrew Johnson:** 08:39 Yeah, that's interesting. That's going to be probably something important to reflect on, I guess, in the future when you're assessing other companies in this space and taking those learnings and trying to apply it to any new holdings that we're looking at. We've just talked a little bit about the importance of sticking to the process when faced with uncertainty and how important that is. What has that meant even more specifically for you and the team? Have there been any improvements or new approaches that have come from that?

- Mark Rutherford:** 09:02 So, one of the things we've been tinkering with in our risk management process internally, we're always encouraged to tinker as a team. One of the things we've been discussing lately has really been situational awareness. And so, you can think about a deer that's in the forest. Deer are kind of constantly scanning what's going on in their surroundings. And similar to that, we are scanning the market, and whether that be news flow or price movements, interest rate movements, whatever it may be. And there's all those traditional metrics that we think about as risk parameters, but we also want to think about the other side and that's managing ourselves and our own kind of the human element.
- Mark Rutherford:** 09:45 So, one thing we've been practicing is emotional awareness. And so, Vijay or myself will actively share with others if there's something going on that is maybe bothering us—or maybe our mind is somewhere else, we're dealing with a family member at the hospital, whatever it may be, "I only got two hours sleep last night because something happened," and really there we can work better together I think as a team to say, "Okay, let's have this discussion maybe tomorrow when we're not in maybe a state that's not really conducive to clear long-term thinking." And so, that's just one element that we're just tinkering with and just want to be aware of our teammates and really try to manage our emotions so that we can make the best decisions long-term and be as objective as possible.
- Andrew Johnson:** 10:34 It's an interesting topic to talk about with situational awareness, especially in your role. And you mentioned how important it is to manage your emotions as a part of that, to kind of keep things at bay and keep a clear mind. I have to imagine that if you're that deer out in the woods and you're constantly taking in inputs and information and trying to reconcile that with your experience and what that may mean, a lot of that has to be noise. So, as an individual, as an analyst, how do you try to filter that out? How do you, I guess, try to brush off that noise and get to what actually matters?
- Mark Rutherford:** 11:07 So, one of the challenges that internally we could have a million different risk indicators that we're checking every day and you've just created, [Jim Hall](#) would call it, a giant noise machine. And that may not be really beneficial to your process. So, I think limiting kind of the number of things; we're not going to be checking every risk indicator possible but flagging certain things that we think stand out to teammates. That's one thing that we do. And on the other hand, all signal also starts as noise. So, to get to the signal at the end of the day, you do have to work through a bunch of the data that may not be important and really think about, "Okay, what really are the key factors that we want to weight when making the decision?"

- Andrew Johnson:** 11:54 You just mentioned, I'll pick up on, the fact that signal really starts as noise. And I think a part of determining what is signal from the noise is not just limiting bias, but also having competency and knowledge around certain areas. So, I know offline you and I've talked about how you've involved some other individuals in your management calls with some of our holdings or some new holdings that we're looking at. So, maybe you can tell our listeners a little bit about what you're doing there?
- Mark Rutherford:** 12:21 One of the other things process-wise that we've worked on in combination with our lab group internally, that's integrated with the research team...and just a reminder for listeners as to what the lab is. That's really a group of team members internally at Mawer that are working to provide tools that we can better utilize to improve the research process so that's maybe custom reporting that we're using to measure our portfolios and gather data from different sources. And so, Alex Lam, Darren, and a few other members, [Justin Anderson](#), on the research team spends a lot of time with that group. And they're helping us develop these tools to help improve our process over time. And then also now we're looping them into the investment process a little bit to help on the due diligence—so, finding that very helpful.
- Mark Rutherford:** 13:15 We're really trying to incorporate that into the research process. So, now when we look at a company that's a software company or a technology heavy company, we've started to say, "Okay, let's have a management interview and get to understand company strategy, the competitive landscape, how they think about capital allocation, how well they're executing." But then there's another skill set that we can really harness internally with the lab, and that's having a separate meeting to meet with some of the product managers and the technical software developers at some of these technology companies to really get a better understanding of how the company is built from the ground up. And is the company designed from an aspect of a modern architecture that can scale well over the long-term? Or is it a situation where, "No, this company is a little bit more older technology, but they still might have good prospects." But we just need to understand what we're dealing with in each scenario.
- Mark Rutherford:** 14:17 So, that integration with the lab and having additional due diligence calls, I think is just helping improve the diligence process. Because sometimes tech can all get lumped together, and really what we see when we look a little bit deeper is there are some very big contrasts comparing one company to another.

- Andrew Johnson:** 14:37 Let's talk a little bit more about the strategy itself and what's going on inside the portfolio. I know one area that many of our listeners are probably curious on is the major, I guess, [potential deal](#) that was announced between [CP Rail](#) here in Canada and Kansas City Southern in the United States. Just take us through the context of that deal, what it means for the North American rail industry, and then finally, I guess, as CP shareholders, what's our take on their strategy there?
- Mark Rutherford:** 15:03 Yeah, so that was one of the big items of news in the first quarter of this year, and that's CP coming out and announcing the \$25 billion acquisition of Kansas City Southern. And Kansas City Southern really connects with CP's rail network in the U.S. and really goes down through the Gulf into Mexico. And so, this acquisition and merger relief that the companies have announced—it's a friendly merger—so both companies agree that they think coming together would provide a lot of value on both sides. It would really create a powerful network. So, when you merge Kansas City Southern's network as well as CP, you create a network that spans both West Coast, East Coast of Canada, down through the Midwest into the Gulf and then down into Mexico. And so, that would connect six of the seven largest Metro areas in North America on a single line.
- Mark Rutherford:** 16:06 And for shippers that can really lower cost because it saves time of interchange that can be costly between different operators. And CP really views this as a big growth opportunity for the company longer-term. And I think both myself and Vijay think it makes a lot of strategic sense. You just create a much more powerful network that can make you more competitive against other rails that you're competing against.
- Mark Rutherford:** 16:33 So far the reaction has been quite positive from shippers. So, they've received support from hundreds of shippers across the globe that value this. I think they view it as bringing increased competitiveness and a very efficient option to them. And really, going forward, I think an important part of this and what time will tell—it's uncertain as to how it will play out—is there's regulatory approvals that need to happen over the coming year. And that's one thing that I know CP and KSU have worked hard to kind of structure in a way that they think is highly likely to get approved. And so, longer term, I think if it goes through it would be very positive for CP shareholders.
- Andrew Johnson:** 17:22 When I think about large deals of this size, the first thing that always comes to mind is how slow is the regulatory review going to be? How much anti-competitive eyes are going to be on it? But it sounds as if there's actually some positives that are coming from the industry on this, which could influence—and I won't assume anything—but probably reduce the anti-competitive risk that is associated with deals like this.

- Mark Rutherford:** 17:44 I think the big concern from shippers would be that you reduce competition. There was also a concern probably from regulators or politicians that any large deal like this would result in reduced service level or result in a lot of job losses across the industry. And this is really a growth driven transaction from what the companies are saying. So, that appears to be a positive indication that there would be less concerns on that front. And then the way the networks are connected, they wouldn't be removing big service areas to save costs or create cost synergies. It's more looking at additional customers they think they could serve longer-term by combining.
- Mark Rutherford:** 18:30 So, they'll go through the regulatory process and we'll have to wait and see how that checks out. But I think they're really leaning on the expertise of management and they're making a calculated assessment. The other one small thing I'd mentioned is that they are the two smallest class one rails. So, coming together, I think they can argue that they are really enhancing the competitiveness within the major rails. So, that may be a supportive factor for it going through.
- Andrew Johnson:** 19:00 That's a great point. Another deal that hit Canadian markets this year was the [IPO of TELUS International](#). So, this is the customer experience and digital solutions company. I think most people are familiar with the parent company, [TELUS](#), I guess, the broader telecom company here in Canada and presumably, Mark, we knew about this business that they were incubating and growing. So, "tell us" more about TELUS and [TELUS International](#)?
- Mark Rutherford:** 19:25 Very good, I like that, it was a great intro. TELUS International is a company that has been inside of TELUS for a number of years. It really started, I think going back to 2008, when TELUS was really working on their own customer service, how to get better. And really, they said, "You know what? We need our own group internally focused on how to optimize customer service." Low churn is a really important factor for any telecom operator. So they started really growing this business from the early 2000s. They've made a number of acquisitions along the way to really enhance their service offerings. And they got good enough at it that they said, "You know what? Why don't we also do this for other companies? We think it's a core expertise and we think it has potential to be a big business longer-term." So, that is a little bit of the history.

- Mark Rutherford:** 20:24 Looking at TELUS International's what they do and what they provide for customers, they really provide three things: outsourced customer service, content moderation, as well as data annotation services. Data annotation has become something that I recently learned more about. And really, if you think about all of the algorithms that companies are using and developing now for consumer products, it could be identifying: having a computer or a camera identify what an object is, it could be for autonomous driving helping a vehicle identify what certain objects are. All of those algorithms that are being developed, they really require data annotation. That is, humans at the end of the day labeling different types of data, and that could be labeling what a colour is, what type of sound is being made, identifying an object with a word. And so, that's just an example of what they do on the data annotation side.
- Mark Rutherford:** 21:23 And combined, the company's very profitable, generating 21% EBITDA margins. I think they're looking to get mid 20s kind of adjusted EBITDA margins going forward, generating reasonable mid-teens return on invested capital. A lot of their customers are under three to five-year contracts. So, that does create a very nice recurring revenue profile that we like. And then as I mentioned, a lot of their customers happen to be in technology and markets which have a lot of embedded organic growth—which is just a nice tailwind for the company to have.
- Andrew Johnson:** 21:59 Mark, how does that reflect on the management team of TELUS, the parent company?
- Mark Rutherford:** 22:03 I think it's part of the culture that TELUS really is focused on over the years. They've always been a big proponent talking about how important culture is to them. And I think giving people autonomy internally to go improve the current offering, and them being able to really nurture and incubate this business as it's grown and become a leader in the industry to also offer it to other companies. I think that is just evidence that management is very good at seeing an opportunity and capitalizing on it. Even though it's maybe not their core competency of the telecom business. One thing that we do like too longer-term with TELUS International is that TELUS will remain on the board as well as have a large stake in the business. So, we think we have a very aligned kind of long-term owner that benefits TELUS International.
- Andrew Johnson:** 22:56 All right, Mark, well, you've been very generous with your time today. I greatly appreciate that. So, thank you, and I look forward to talking with you down the road.
- Mark Rutherford:** 23:05 Great, thanks so much for having me, Andrew, I really appreciate it.

