

Big gains in small caps

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Canadian small-cap specialists Martin Dufresne and Patrick Potvin, portfolio managers at Montreal-based Fiera YMG Capital Inc., have been steadily boosting their weightings in the technology sector.

"We are finding select stocks that trade at modest valuations relative to the companies' growth prospects," Dufresne says. These companies, he says, are enjoying particularly strong demand for their products/services.

Overall, says Potvin, "our strategy is to sell off low growth or disappointing companies and put the proceeds into those companies that we consider have a more promising growth profile."

In keeping with their small-cap mandate, the two managers have also been reducing holdings of companies that have become large cap and parlaying the proceeds into smaller caps that "generally tend to have higher growth prospects," Potvin says.

Fiera YMG has roughly \$21-billion under management of which about \$6-billion is in Canadian equities. Dufresne and Potvin manage a number of small-cap Canadian portfolios including the Millennia III North American Small Company fund. This is part of the segregated family of funds managed by Fiera YMG for Desjardins Financial Security.

The Millennia III North American Small Company fund has almost 50% in the U.S. equity market via futures contracts linked to the Russell 2000 Index. The rest is invested in Canadian small caps and is actively managed by Dufresne and Potvin. The two managers target firms with a market capitalization of \$100-million to \$1-billion at the time of purchase. This portfolio has 64 names.

In terms of sectors, the portfolio is underweight materials at 22% versus 35% of the benchmark BMO small-cap equity weighted index. It has 13% in the energy sector versus 22% in the benchmark index. The portfolio is significantly overweight industrial and consumer discretionary stocks and is modestly overweight technology.

In the technology sector, Dufresne and Potvin have sold their holding in Mediagrif Interactive Technologies Inc. This Quebec-based company develops and operates various vertical business-to-business based networks including The Broker Forum and Power Source On-Line.

"We were patient with this stock, but have been disappointed in its earnings growth, which has been flat for a number of years and is expected to continue to be lacklustre," Dufresne says.



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Martin Dufresne, left, and Patrick Potvin of YMG Capital have found small Canadian technology companies that trade at reasonable valuations.

In this sector, they have bought what they describe as an "earlier stage" tech company which they consider has excellent growth potential, though it is not yet profitable: Absolute Software Corp. This Vancouver-based company provides software for tracking and enhancing the security of personal and mobile computers.

"Its software can both locate the computer and protect confidential data on it."

Product lines include ComputraceComplete and Absolute-Track. The company has a market capitalization of \$590-million. "Absolute Software's offering is cutting edge," Potvin says, "as the software is embedded in the computer."

The company, he says, has been spending money on developing its products and building its client base. It is currently generating cash flow, but has yet to turn a profit, he says.

It is expected to report cash flow of 63¢ per share and a loss of 20¢ for its fiscal year to June 2007. For the fiscal year to June 2008, the consensus is for cash flow of 97¢ per share and a loss of 12¢ per share.

For the fiscal year to June, 2009, the company is expected to report cash flow per share of \$1.15 and EPS of 8¢.

"Thus the company is expected to turn a profit in its fiscal year to June, 2009," Potvin says.

An emerging technology stock that they like is Zao Corp. This Calgary-based company has a database of digital photographs and property values on residential real estate in the United States. The company is early stage with a market capitalization of \$160-million.

Zao's database is a resource for a wide range of users -- realtors, appraisers, city assessment departments and financial institutions. Zao plans to launch a Canadian project this fall.

Zao, says Dufresne, is expected to report a loss of 2¢ a share in 2007, but turn a profit of 50¢ a share in 2008.

In the gold sector, the two managers profitably sold their holding in Yamana Gold Inc., which currently has a market capitalization of \$4.4-billion.

Dufresne and Potvin noted in the Buy & Sell column, May 3, 2006, that they received shares in Yamana when it took over Desert Sun Mining Corp., a holding in their portfolio. At the time, Yamana shares traded at \$12.25 and subsequently had a good run, but the stock has recently retreated.

They have invested in junior gold mining company Minefinders Corp. Ltd. This Vancouver-based company has a market capitalization of \$640-million. Minefinders is developing its Dolores gold/silver project in Mexico, "which is a relatively stable country to conduct mining operations in," Potvin says.

This mine is expected to be in production by yearend.

"Now is our sweet spot to buy this stock", says Dufresne, "as the market will likely increase the valuation on this stock when the mine goes into production."

The consensus is calling for Minefinders to produce EPS of \$1.39 in 2008 and \$1.57 in 2009.

-Fiera YMG Capital Inc. may hold positions in the securities mentioned.

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