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Three small-cap stock picks from a $7-billion outperforming fund manager

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Scotiabank portfolio manager Vishal Patel sees several advantages to managing both small- and large-capitalization companies for his clients. There's often a connection between the different-sized companies, either in their business models or sector, he says, and having both adds depth to the broader investment due-diligence process.

"Being a large-cap manager makes me a better small-cap manager and vice versa – and the reason is you can do a lot of channel checks," says Mr. Patel, vice-president and portfolio manager at Scotiabank's 1832 Asset Management, who oversees about $7-billion in assets across 16 Canadian and U.S. equity mandates.

Another benefit of doing both is that he can watch the smaller companies grow up and reap the financial rewards for his investors.

"One of the things that you want to do in the small-cap space is to be early: You want to see things early; you want to invest in companies early; you want to identify management teams early," says Mr. Patel, who manages the Scotia Canadian Small Cap Fund, which won two Lipper Awards this year in the Canadian small/mid-cap equity category. Mr. Patel manages a very similar Dynamic Power Small Cap Fund as well. (Mr. Patel also won four more awards for different funds in other categories.)

The Scotia Canadian Small Cap Fund has returned 48 per cent over the past year, as of Oct. 31, and an annualized rate of 31 per cent over the past three years and 16 per cent over the past five years, after fees of 1.32 per cent for the Series F class.

To find those early-stage companies with growth potential, Mr. Patel looks for alignment of capital, including companies with strong entrepreneurs, that are founder-led and with managers who have a meaningful ownership stake.

There are more of these companies to choose from in Canada today, across sectors such as technology, health care and financial services, Mr. Patel adds, which has contributed to a "robust outlook" for the small-cap sector.

"I am excited by some of the newer companies and newer business formations," he says, and believes small caps can be a "great portfolio diversifier" for investors.

Here are three small-cap picks:

Andlauer Healthcare Group Inc. (AND-T)

The Toronto-based trucking company, which specializes in logistics and delivery solutions for the health care sector, is run by chief executive officer Michael Andlauer, whom Mr. Patel calls "a phenomenal Canadian entrepreneur."

Mr. Andlauer also owns more than 50 per cent of the company through his management firm, which Mr. Patel likes because it means he has a vested interest in the company's success.

"If you can co-invest with him, you want to co-invest with him," he says.

Mr. Patel bought the stock when it went public in late 2019 at $15 a share. It's now trading around $48.

"We continue to own it and like it," he says, in part because the company has also been using its excess cash flow to make acquisitions in the U.S.

A risk for the stock would be any sudden departure of Mr. Andlauer, Mr. Patel says, but adds it's a risk with any company where the owner has strong ties to the brand.

Trisura Group Ltd. (TSU-T)

Toronto-based Trisura is a property and casualty (P&C) insurance provider with operations worldwide.

"We like P&C insurance as an investment category," says Mr. Patel, who also owns large-cap P&C insurer Intact Financial Corp. "It's a simple business to understand."

Mr. Patel is a fan of Trisura CEO David Clare and his ability to continuously grow the business.

"I believe in him. I've studied him. He has that winning mindset," Mr. Patel says. "I believe he's got a long runway in the next 10 years to continue and execute, and deliver on that strategy, and has the capital to do it."

He says there's a similar management risk with Mr. Clare, as well as "elevated valuations" amid competition for acquisitions in the P&C insurance industry.

"But this is why you need somebody in the seat that's very strong … like David Clare," he says.

He bought the stock in early 2019 at around $8. Trisura is currently trading around $44.

“I’m committed to owning the business, longer-term,” Mr. Patel says.

Kinaxis Inc. (KXS-T)

Kinaxis is a rapidly expanding Ottawa-based cloud software-as-a-service (SaaS) platform, which serves supply chain operations across North America, Europe and Asia.

“We’d like the reoccurring nature of its business model,” Mr. Patel says, and believes the company has a lot of room to expand worldwide.

“It has a huge TAM – total addressable market,” Mr. Patel says. “There are so many supply chain companies globally; automotive manufacturers need their help; grocery companies need their help … I like the idea of software and I like the idea of supply chain.”

Kinaxis has been experiencing some growing pains over the past year, Mr. Patel says, with rising costs as it expands its sales force to bring on more customers, which has also put pressure on its margins.

“It’s really short-term pain for long-term gain,” he says. “I believe it will set them up for a bigger and better business longer-term. And this goes back to being a long-term investor because the outlook for the products and services that they sell is great and the demand is great, but it takes time to close these [customer] deals.”

He says the risk with Kinaxis is the same with any technology company, which is providing software that stays ahead of the competition.

Mr. Patel bought the stock at $85 in early 2019. Kinaxis shares are currently trading around $220.

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