DIXON MITCHELL
INVESTMENT COUNSEL

DM MONTHLY REPORT
September 2022

PORTFOLIO ACTIVITY

During the summer, we trimmed several outperforming positions (including Thermo-Fisher and Apple) and allocated this capital to names which we believed offered better value at the time. We also cut our weight in software developer OpenText (see below).

FEATURE STOCK
OpenText (OTEX)

OTEX is a Waterloo, Ont. based maker of information management software and solutions, including cyber-security, data analytics, and cloud applications. In late August, the company announced its intention to acquire British info-tech business, Micro Focus, for $6bn in cash and assumed debt. Though the deal would nearly double OTEX's size from a revenue perspective, we had misgivings about the purchase for a number of reasons. First, the recurring portion of Micro Focus's revenue stream is significantly lower than that of OTEX, which we believe will materially increase business risk. Second, the announced strategic goals of the purchase are more focused on cost cutting and revenue stabilization than on growth. And, finally, the acquisition will add significant debt to OTEX's balance sheet, which could become difficult to eliminate if management's stabilization plan underperforms. Despite the company's track record for value creation through acquisitions, the perceived risk associated with this transaction led us to materially cut our allocation to OTEX.

BUYBACKS JUMP AS OTHER LIQUIDITY SOURCES WANE

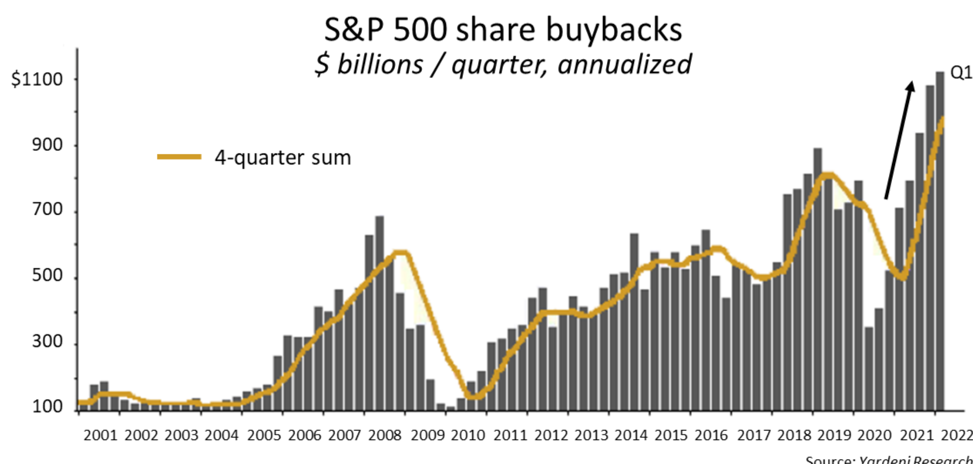
As we exit the covid economy, one of the concerns weighing on stocks relates to the pending reversal of the fiscal and monetary measures implemented to help us through this extraordinary period. While this source of liquidity will almost certainly taper in the months ahead, corporate share repurchases could fill part of the void. As per the chart below, announced and executed buybacks surged to an all time high in the first part of 2022, as companies collectively decided that retiring their own stock was as good a use of excess capital as any. When we analyze buyback activity in DM portfolios, we broadly categorize it in three ways:

Consistent Return of Excess Capital – these companies tend to operate in less cyclical industries, allowing for a more steady flow of disposable funds. In the US, Visa has been a steady repurchaser, with the company retiring 20% of its outstanding stock over the past decade. In Canada, Gildan Activewear has taken half as much time to reduce its share count by the same amount, including a 4.5% repurchase in the first half of 2022.

Opportunistic Repurchases – these buybacks are lumpier, but can nonetheless have a big impact on outstanding equity. Canadian trucking and logistics operator TFI International, for example, has primarily used excess cash to consolidate a fragmented industry; in between acquisitions, however, it has been an aggressive buyer of its own stock, retiring 5% of shares in the past 8 months alone. South of the border, Texas Instruments emphasizes organic growth with available capital, but has also used buybacks to boost value, cancelling 47% of its stock over the past decade.

Cyclical Return of Capital – commodity producers and other cyclicals often produce massive amounts of free cash when conditions swing their way, with disciplined firms returning some of this wealth to shareholders. In the first seven months of this year, for example, Canadian Natural Resources has repurchased $7bn (or 5%) of its outstanding equity.

Not all share buybacks are effective, especially if they're offset by overly generous employee options programs, but when management teams take a disciplined approach to repurchases, they can provide an effective boost to the value of remaining equity.



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