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CANADA TIP SHEET

Mavrix Likes The Micro-Cap Horizon

By BRIAN TRUSCOTT

VANCOUVER—Mavrix Fund Management Inc.'s Small Companies Fund hunts for micro-sized companies offering interesting stories and high compound growth rates, plain and simple.

"We probably have one of the smallest average market (capitalizations) of any mutual fund in Canada," said Roger Dent, a Mavrix vice-president and the fund's associate portfolio manager. "We are firm believers that the micro-cap area is able to offer some of the best returns in the marketplace."

He said these companies, by virtue of being small, are able to grow at higher compound growth rates than larger companies. More importantly, this part of the market is often seen as too risky or inconsequential by many investors.

"We face little competition to buy stocks. As a result, we are able to get businesses at much more attractive valuations than we could get in the larger-cap area," he said. "We try to buy small companies that have interesting stories that aren't known by the market but that have an aspect of the story that we think will attract broader attention in a relatively short time-frame."

Easier said than done, but Dent said the fund is usually on the lookout for companies sitting on upcoming events or sitting on some sort of catalyst that will garner attention.

"The biggest upside is when you can find something off the beaten track that's going to move onto the beaten track; we try to find companies that have something sufficiently exciting which will get institutional investors, retail investors and research analysts on the bandwagon," he said.

Having said that, Dent said the fund isn't really looking for high-risk, high-growth companies.

"We're looking for companies that don't have a lot of downside, meaning the market doesn't have a lot of expectations (priced in)," he said. "We're trying to avoid significant losses, have the occasional large winner, but have the majority of companies be solid above-market performers."

In other words, the fund isn't stuffed full of highly leveraged, high-momentum type stocks. Instead, this C\$30 million-plus fund looks for those companies that the market doesn't appear to focus on, which means valuations are usually low and attractive.

"The reality is that in this type of market, we would be investing C\$1 million or less in most of these companies, so for a C\$100 million fund, it becomes difficult to justify," he said.

The issue is further complicated by the fact that few people have extensive experience in covering this segment of the market and that research, if any, is hard to come by.

Still, Mavrix's efforts appear to be paying off. Dent's small companies fund, which was launched in September 2004, is up more than 36% over the past two years.

Few People Try To Understand Micro-Cap Market

"We diversify significantly, so our fund might have 75 companies in it, typically," he said. "At the same time, we try to insinuate ourselves in the thick of the information flow in the micro-cap sector."

He said few people try to be well-informed in this sector. "A lot of people buy things based on recommendations that don't have a firm basis," he said.

Interestingly enough, the fund isn't focused on resources—a hallmark of most small-cap funds in Canada these days.

"We do have exposure, but we are skewed outside of resources," he said. "We search around the micro-cap areas in technology, industrial products and healthcare—where it's easier to find things off the beaten track than in resources."

One of the fund's larger holdings is Grey Island Systems International Inc. (GIS.V), which provides global-positioning-system-related services to fleet operators, primarily in the transit business. For example, those signs at bus stops which tell you the time that the next bus will arrive are done via GPS.

"The company has been winning numerous mandates across North America...and the company, in its most recent

quarter, just became profitable," he said. "We think the stock is trading at well under 10 times earnings for the upcoming year, which in the technology space is extremely reasonable and far lower than where other GPS-related companies trade."

Another holding, called Hammond Power Solutions Inc. (HPS.A.T), is an established company that makes electrical transformers, primarily for large industrial uses.

"They're the North American leader in custom transformers, and the stock is trading well below 10 times earnings," he said, adding that earnings in 2007 should be north of the 65 Canadian cents a share it generated this year. "There's no research and there is virtually no institutional following, but we think the company is growing to a size where it's going to get attention."

A third company is Nautilus Minerals Inc. (NUS.V), a company which plans to mine the sea bed in Australasia. Dent's fund bought in when the company went public earlier this year, even though there was a lot of skepticism about what this company could achieve or if undersea mining was even possible. Back then, the shares changed hands for \$2 each. Thursday, the stock is trading at C\$5.50.

And that's exactly what Dent's fund looks for—a company flying under the investment radar, but one that's set to grab attention. No surprise, then, that Teck Cominco Ltd. (TCK), Anglo American PLC (AAUK) and Barrick Gold Corp. (ABX) have all bought into the undersea story and have sizable stakes in the company.



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