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# HOLD THE AI!

**By Gordon Pape, Editor and Publisher**

Some 5,000 scientists, academics, industrialists, and others have signed a petition calling for a six-month moratorium on the development of artificial intelligence (AI). Another 50,000 people are reportedly lined up to add their names.

The idea for the pause is to allow the world to formulate guidelines and rules for how AI is to be expanded and controlled in the years ahead. The proponents of the pause feel that without tight monitoring, we risk being overtaken and crushed by our own creation. A digital Frankenstein's Monster! Our only hope is to control it before it controls us.

It's a laudable idea. It's also totally impractical. Is China going to halt its AI programs? Is India? Is Israel?

Do we expect Microsoft to stand pat while Google forges ahead?

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And even if we could somehow persuade all these entities to sign on, how exactly would the moratorium work and what would be the end result? A United Nations resolution? The UN hasn't unanimously agreed on anything since it was created at the end of World War II.

Yes, we do need some controls on AI. But stopping development for six months will do nothing except give cheaters an edge. What will work? No one has found a realistic answer yet. Perhaps we should go back to the three laws of robotics that science fiction author Issac Asimov created in a 1942 short story. They are:

1. A robot may not injure a human being or, through inaction, allow a human being to come to harm.

2. A robot must obey orders given it by human beings except where such orders would conflict with the First Law.

3. A robot must protect its own existence as long as such protection does not conflict with the First or Second Law.

The problem is that these laws don't cover many of today's concerns. There is nothing to prevent AI from stealing human jobs. AI can be used to cheat your way through school without violating Asimov. It could be argued that AI is free to develop its own intelligence far beyond human capabilities. We're in uncharted territory.

While great minds try to solve this conundrum, the rest of us are left to consider how we can profit from this dizzying new branch of science. What better way to find out than to go right to the source. I asked the question to ChatGPT. Here's an edited version of its reply.

"Investors can profit from the development of AI by investing in companies that are at the forefront of the AI industry or are integrating AI into their products and services. Here are some examples:

"Technology companies: Technology companies that are involved in the development of AI can be excellent investment opportunities. Some examples of companies that are investing heavily in AI include Google, Microsoft, Amazon, IBM, and NVIDIA.

"Robotics companies: Robotics companies that are integrating AI into their robots can also be good investment opportunities. Companies such as ABB, Fanuc, and Kuka are examples.

"Healthcare companies: Healthcare companies that are using AI to improve patient outcomes, diagnose diseases, or streamline administrative tasks can be excellent investment opportunities. They include IBM Watson Health, Medtronic, and Pfizer.

"Startups: Early-stage startups that are focused on developing AI solutions can

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also be excellent investment opportunities, but they come with higher risks. Investors can look for opportunities through venture capital firms or online platforms that specialize in connecting investors with startups.

"ETFs and mutual funds: Investors can also consider investing in exchange-traded funds (ETFs) or mutual funds that focus on AI. Some examples include the Global X Robotics & Artificial Intelligence ETF (NDQ: BOTZ) and the ROBO Global Robotics and Automation Index ETF (NYSE: ROBO).

"Overall, investors should conduct thorough research and due diligence before investing in any AI-related companies or funds. The AI industry is still in its early stages and investing in AI-related companies can be highly speculative and subject to high volatility."

That's a reasonable and responsible look at the broad AI investment landscape, complete with warnings about risk and speculation. It was generated in less than a minute after the question was submitted. Impressive. Scary.

What about the quality of the advice? Google (Alphabet), Microsoft, Amazon, IBM, and Nvidia are all on our recommended list and all have been profitable. Alphabet announced last week that it plans to incorporate Chat AI into its Google search engine this year. Microsoft is already using ChatGPT in its Bing search engine. So much for a moratorium!

ABB, Pfizer, and Medtronic are also on our recommended list, although the latter is down from its recommended price. IBM Watson Health is not publicly traded.

Fanuc is a Japanese-based company that is the largest maker of industrial robots in the world. Besides Japan, it has operations in the US and Europe. The shares trade on the US over-the-counter market under the symbols FANUF and FANUY.

Kuka manufactures industrial robots in Germany but is 96% owned by the Chinese company Midea Group. It's listed on the OTC market as KUKAF but there is no active trading.

Neither BOTZ nor ROBO are on our recommended list. Both ETFs have similar patterns. They reached their all-time highs in 2021, then went into a deep slide. They've recovered this year, with BOTZ up about 19% year-to-date while ROBO has gained about 14%.

Both these ETFs look interesting in the current environment. Their prices aren't cheap, but ROBO has the lower p/e ratio at 27.4. BOTZ has a slightly better average annual return since inception. Either would be a good choice if you want an ETF in the AI sector, but my preference would be to buy shares in Microsoft, Alphabet, and/or Nvidia.

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# WHERE IS THE MARKET NOW?

***By Ryan Irvine, Contributing Editor***

As we move into the second quarter, let's look at current broader market valuations. One metric we like to focus on is the Shiller p/e. We consider it to be a more reasonable market valuation indicator than the regular p/e ratio because it eliminates fluctuation caused by the variation of profit margins during business cycles.

This chart shows the Shiller movements over the past 20 years.

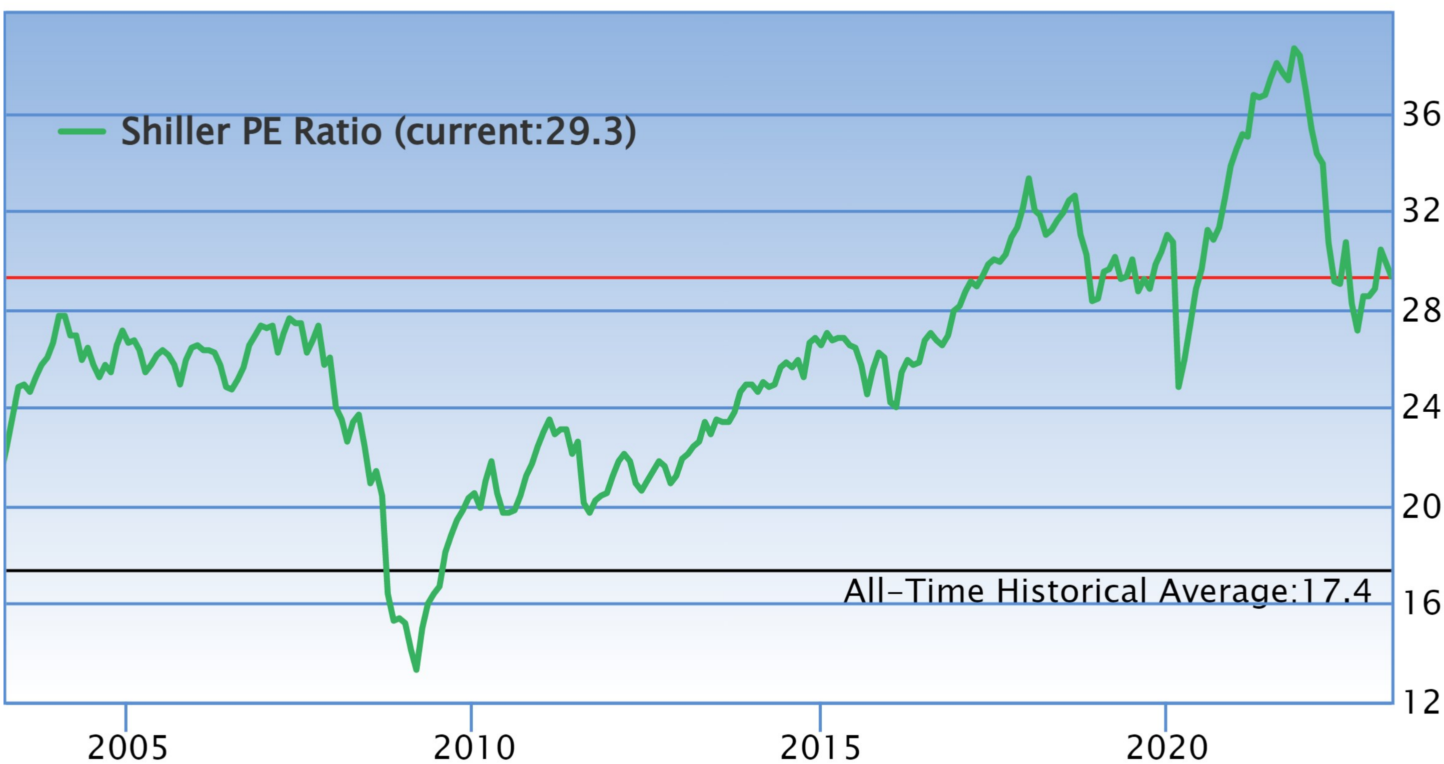
During the stimulus and low rate driven pandemic rally, the ratio reached its highest point in November 2021, in the range of 38.6. That was 48% above the average p/e of the last 20 years, which was 26.

This has been eclipsed literally once since its been tracked (over 100 years). That was during the dot-com madness in 1999, when it was at roughly 44.

## Where is the Shiller p/e today?

As I write, the Shiller p/e is 29.3 or 12.2% higher than the recent 20-year average of 26.1. This is far better than the range of 38 hit in November 2021. However, it is instructive to point out that the Shiller p/e is still 68% above its all-time average of 17.4, indicating valuations are not anywhere near cheap by historic standards.

Using this metric as a guide, while the current valuations are superior to most periods in the last four years (outside of the Pandemic Flash Crash), risk remains elevated. Keep this in mind when making investment decisions in the coming months.



# RYAN IRVINE'S UPDATES

**Recommendations are colour-coded:**
**Green indicates Buy**
**Yellow indicates Hold**
**Red indicates Sell**

## Hammond Power Solutions TSX: HPS.A

**HOLD**

*Originally recommended on Jan. 28/13 (#21304) at $8.60. Closed Thursday at $35.68.*

**Background:** With a history that dates back 100 years, Hammond Power is a leader in the design and manufacture of custom electrical engineered magnetics, standard electrical dry type, cast resin, and liquid-filled transformers. The company offers autotransformers, buck-boost transformers, control transformers, distribution transformers, drive isolation transformers, encapsulated transformers, furnace transformers, multi-pulse transformers, pad-mounted transformers, regulating transformers, and medium voltage distribution transformers. It also produces reactors, active harmonic filters, dV/dT filters, and unitized substations.

The company serves the oil and gas, mining, steel, waste & water treatment, commercial construction, data centers, EV charging, energy storage, solar, and wind power generation industries. Hammond Power has manufacturing plants in Canada, the United States, Mexico, and India.

**Performance**: The stock has moved steadily higher this year and at one point came within a few cents of $40 before retreating a little. The share price gains were driven by record 2022 financial results. We have a gain of 315% since the stock was first recommended.

**Recent developments:** As expected, 2022 was a record year on all fronts for Hammond Power, including revenues, EPS, gross margins, cash generation. and balance sheet improvement.

The company introduced long-term revenue targets. These included reiterating its three-year target of $750 million in revenues by 2026 and a target of $1 billion in revenues by the end of the current decade.

In 2022, revenues increased 46.9% to $558.5 million from $380.2 million in 2021. Earnings from operations jumped 156.8%, finishing at $59.4 million in 2022, compared to earnings of $23.2 million in 2021. The increase in earnings from operations is due to higher sales and additional gross margin dollars, offset by

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***Hammond Power—continued from page 5...***

higher selling, distribution, general and administrative expenses.

Net earnings from operations for 2022 jumped 195.4% to $44.8 million compared to $15.2 million in 2021. The main contributors to the higher current-year net earnings were higher sales and additional gross margin dollars. EBITDA from operations was $69.8 million, an increase of 131.6%. Basic earnings per share for the year was $3.79 versus $1.29 in 2021.

Hammond Power saw a significant order backlog increase, posting a 117.1% year-over-year gain compared to Dec. 31, 2021. The backlog increased 13.3% from the third quarter of 2022. The combination of price increases and strong demand in the third and fourth quarters contributed to the record-high backlog.

**Plant expansion:** During 2022, Hammond Power increased its investment in new equipment to expand capacities at existing plants in all four countries over the course of 2022. Despite this expansion of existing facilities, management foresees the strong momentum in its market continuing through the current decade. As a result, in December it announced a capital investment program designed to take advantage of this long-term demand.

Specifically, on Dec. 20, 2022, the company announced its intention to increase its planned capital program by approximately $40 million over two years. These planned capital investments are expected to be made over the course of 2023 and 2024 and, when complete, are expected to increase Hammond Power's overall sales capacity by approximately $180 million.

The expenditures will be focused on areas targeted to increase capacity and reduce lead times for low voltage, power quality, and induction heating products. These investments are also expected to support Hammond Power's supply chain resilience initiatives. The company intends to focus the capital program primarily in Mexico and the United States. In Mexico, Hammond Power is planning to set up an approximately 80,000 square foot small products facility, while also adding equipment to existing facilities there. The company also expects to expand its manufacturing capacity at the Mesta location in Pennsylvania, as well as its facility in Guelph, Ontario.

Staff and equipment upgrades will begin contributing by the current quarter. Benefits from the additional two plant expansions (US and Mexico) will not begin contributing until 2024.

**Balance sheet:** Hammond Power's cash position and balance sheet continued to strengthen over 2022, providing a solid foundation to grow organically and through acquisition in 2023 and beyond.

**Outlook:** Visibility for growth in 2023 is strong for the first half, then limited in the second half but the backlog remains solid. Growth will moderate through

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***Hammond Power—continued from page 6...***

2023, however 5-10% growth is the long-term target. Based on a conservative EPS multiple of 10, fair value is in the range of $42.

**Conclusion:** Last year was fraught with challenges in terms of supply chains, rising costs, and a tight labour market. Faced with these challenges, the company impressively delivered the strongest financial performance in its 22 years as a separate public entity. All business units performed well on sales and profitability metrics. Revenues increased by 47% to an all-time record, driven primarily by price increases over the past two years, but also supported by strong organic growth, which management estimated to be in the 10-11% range.

Customer, product and geographic diversity increased during the year with sales growth in Mexico and within the company's power quality products. Management was particularly pleased with the growth of the Mesta business (a tuck-in acquisition which the company originally expected to generate sales of $5 million in 2021). In its first full year of operations within Hammond Power, Mesta sales increased to $14.5 million.

Gross margins were strong throughout the year and ended 2022 at 29.6%. The primary drivers of the increase were higher throughput in the company's factories and a favourable product mix during the year. Volatile material and freight costs were less of a concern in the latter half of the year as compared to previous quarters and margins in the fourth quarter were exceptionally strong due to some inventory adjustments and product mix.

We do caution that on a normalized basis, gross margin percentage should fall in the range of 27.5-29.5%. Hammond Power's fourth quarter gross margin was well above the target range, and we would expect this to normalize in 2023.

The company's backlog has increased to record levels. Industry demand has continued to be strong, as shown by the backlog, but the pace of growth is slowing. Nevertheless, the growth remains strong and extends into the first half of 2023 and with some projects into 2024.

Strength was seen across all channels in the fourth quarter, but most notably in the US distributor and original equipment manufacturer (OEM) channels.

We have been very pleased with the company's execution over the past 24 months and the leap in the share price has driven significant gains for readers. While we expect Hammond's first quarter to show strong profit growth year over-year, margins will normalize and price increases will lap comparables, lowering growth rates in 2023 as the year progresses.

Trading at around nine times earnings, the stock is not expensive given that peers trade in the range of 15-16 times earnings and the market trades at 18-20 times earnings. However, Hammond

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# Envela Corp. NYSE: ELA

*Originally recommended on Dec. 5/02 (#22243) at $5.32. Closed Thursday at $6.80. (All figures in US dollars.)*

**BUY**

**Background:** Envela is a "re-commerce" business that is based on the recycling or reselling of products. Envela has two segments: DGSE, which is business to consumer, and ECHG, which is business to business. DGSE encompasses Envela's gold, silver, bullion, jewelry, watch, and luxury item purchasing, reselling, and refurbishing business. The segment experiences seasonality during Christmas, Valentine's Day, and Mother's Day, as jewelry sales are generally higher. Envela has three current companies operating under the DGSE segment: Dallas Gold & Silver Exchange, Charleston Golden & Diamond Exchange, and Bullion Express. Two more are planned: ShoplyCo and Oxhead. The subsidiaries have physical retail locations in Texas and South Carolina. Additionally, the segment has wholesale transactions.

ECHG re-commercializes consumer electronics and IT equipment, as well as provides end-of-life recycling services for products. Envela has four companies operating under the ECHG segment: Echo Environmental, ITAD USA, Teladvance, and Avail Recovery Solutions.

Additionally, the company offers IT equipment for businesses looking to upgrade their software, hardware, and networking capabilities. During upgrades, the company provides the disposition of previous equipment, which is then used for its re- commerce operations.

**Performance**: The shares reached the $8 level in March before retreating.

**Recent developments:** Revenues in 2022 grew 29.6% to $182.7 million from $141 million in 2021. However, growth slowed in the fourth quarter to 7.6% as sales slowed by 12.8% to $12.9 million. Operating income in the quarter rose by a healthy 21.2% to $3.4 million, although ECHG moved higher at a slower 3.2% to $1.5 million.

For the year, net income per diluted share increased by $0.21, or 57%. The increase is due primarily from the revenue increase of approximately $41.7 million from fiscal 2021 to fiscal 2022, the removal of the reserve against the notes receivable of $838,647 during fiscal 2022, and the valuation allowance reduction of $1.5 million against the deferred tax benefit during fiscal 2022. On a normalized basis, 2022 EPS was about $0.52, up 41% from $0.37 in 2021 and besting analysts' estimates of $0.49.

**Conclusion:** From a valuation perspective, Envela trades with a fully taxed trailing p/e in the range of 15.7, an EV/EBITDA of 11.35, and a price-to-FFO of 10.61.

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***Envela Corp.—continued from page 8...***

Envela is a unique business which has created a significant turnaround over the past five years by focusing on its core competencies and operating almost exclusively within the more profitable and less risky segments of its markets. Impressively, management has taken EPS from $0.02 in 2018 to $0.52 in 2022.

The company's tax losses have been run through to start 2023 (tax rate expected to be 23%). This will make for tough reported earnings comparables through 2023 (against untaxed earnings in 2022) and could lead to long-term buying opportunities. But if management continues to execute, we expect revenue and operating earnings growth in the range of 12-20% in this year. Normalized EPS could be flat to down in the first half of 2023 but growing in the second half. Moving into 2024, reported earnings should accelerate meaningfully once again.

Given the fact the company is trading with a rather modest multiple of just over 10 times trailing funds from operations (FFO), 2023 should be a good time to accumulate shares on pullbacks. While the business is not without risk, it holds a higher-than-average degree of recession resistance, which is a bonus in the current environment.

**Action now**: Buy with a 2-4 year outlook but expect near-term volatility.

## Calian Group Ltd. TSX: CGY

**BUY**

*Originally recommended on March 1/21 (#22109) at $63.25. Closed Thursday at $63.*

**Background:** Calian is a diverse company that offers business services and solutions to both industry and government customers in the areas of Advanced Technologies, Health, Learning, and IT and cyber solutions.

Advanced Technologies provides innovative products, technologies, and manufacturing services and solutions for the space, communications, defence, nuclear, government, and agriculture sectors. Health manages a network of more than 2,400 healthcare professionals delivering primary care and occupational health services to public and private sector clients across Canada.

Learning is a provider of emergency management, consulting and specialized training services and solutions for the Canadian Armed Forces and clients in the defence, health, energy, and other sectors.

IT and cyber solutions supports public and private companies through a wide range of products and solutions that solve complex enterprise problems with technology.

**Performance**: The stock has been choppy so far this year and is currently trading at close to its recommended price.

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***Calian Group—continued from page 9...***

**Recent developments:** Revenues increased 14% in the first quarter of the new fiscal year, from $130 million to $148 million, driven by strong performances in Information Technology & Cyber Solutions (ITCS) and Learning segments.

Gross margin was above 30% for the third consecutive quarter. Adjusted EBITDA rose 2% to $14 million while operating free cash flow grew 24% to $12 million. EPS rose 3% to $0.39 from $0.38 in the same period a year ago. Cash on hand was $58 million and net liquidity was $131 million. New contract signings in quarter were $126 million. Management also reiterated 2023 guidance.

**Acquisition:** On March 9, Calian announced an agreement to acquire the assets of Hawaii Pacific Teleport (HPT) for up to $62 million, inclusive of earnouts. The deal is expected to close by the third quarter.

HPT is a commercial teleport servicing the greater Pacific region through operations across the Hawaiian Islands and Guam. The company's strategic location in the mid-point of the Pacific enables it to provide secure, contiguous connectivity between the Americas and nearly all of Asia from a single source location. Through its satellite gateways, data centre, media management centre, and terrestrial networks, HPT offers a range of satellite communications services to a deep roster of global satellite operators. The company has operated as an independent teleport for over 20 years and will be integrated into the Space division of Calian's Advanced Technologies segment. HPT is expected to contribute $18 million in annual recurring revenue. Estimates are Calian is paying about 6.5x trailing twelve months EBITDA, based on an approximate 40% margin rate.

**Conclusion:** Calian's fiscal Q1 2023 numbers came in largely as expected. All -in, we are now forecasting 14% revenue growth and 12% adjusted EBITDA growth in the current fiscal year, with performance expected to be back-half weighted.

**Action now**: With the company trading at just over 10 times EV/EBITDA, and management continuing to target higher margins via internal improvements and accretive margin improving acquisitions, we see Calian offering solid long-term value over the next 2-3 years. Buy.

***Hammond Power—continued from page 7...***

Power's business has historically held a significant level of volatility in terms of profitability and, as such, risk-averse readers could certainly consider taking some profits in the 25% range of their initial positions. At present, we continue to see strong growth for Hammond Power in the first quarter and view it as slightly under fair value near term.

**Action now**: Take part profits. We are shifting our rating near-term to Hold given the strong run-up in the company's share price.

# GAVIN GRAHAM'S UPDATES

**Recommendations are colour-coded:**
**Green indicates Buy**
**Yellow indicates Hold**
**Red indicates Sell**

## TD Bank TSX, NYSE: TD

**BUY**

*Originally recommended by Tom Slee on Feb. 12/07 (#2706) at C$34.98, US$29.80. Closed Thursday at C$79.65, US$59.07.*

**Background:** TD is Canada's second largest bank and one of the top fifteen in the US, where it has more branches in the eastern and south-eastern states than in all of Canada. It has particular strengths in corporate and retail lending and a large asset management arm. This includes a minority stake in US discount broker Charles Schwab, obtained from merging its TDAmeritrade division three years ago.

**Performance**: The shares are down $4.12 from our last update in March, when they were trading at $83.77.

**Recent developments**: TD's share price has been sliding over the last month, down almost 11%. Fears over its US exposure and the proposed US$13.4 billion takeover of First Horizon Bank (NYSE: FHN) has led short sellers to focus their attentions on Canada's second largest bank.

As noted in last month's update, TD is now selling at its cheapest valuation for at least a decade, with a price/earnings ratio of less than 10 times 2022-23 earnings and a dividend yield of 4.8%. The collapse of Silicon Valley Bank (SVB) and Signature Bank in the US has seen a flight of deposits from small and medium sized banks to large banks. These are regarded as "systemically important" under the Dodd/Frank legislation passed after the Great Financial Crisis of 2008-09.

TD emphatically qualifies as such a bank, both in Canada, where there has not been a major bank failure for over forty years, and in the US where it has more branches than in Canada, and where the First Horizon deal will make it the sixth largest bank in the country.

Right now, First Horizon is selling well below the US$25 a share that TD offered. It closed Friday at US$17.71, having fallen below US$15 immediately after the SVB collapse. TD is now well positioned to renegotiate the deal and acquire First Horizon at a lower price, as the authorities will be anxious to ensure the deal closes to help restore confidence in the banking system.

TD's 10%+ stake in leading discount

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# GORDON PAPE'S UPDATES

**Recommendations are colour-coded:**
**Green indicates Buy**
**Yellow indicates Hold**
**Red indicates Sell**

## Norfolk Southern Corp. NYSE: NSC

**HOLD**

*Originally recommended by Tom Slee on Nov. 13/09 (#2944) at $52.22. Closed Thursday at $205.41. (All currency figures in US dollars.)*

**Background:** Norfolk Southern operates almost 20,000 miles of railway in 22 states and the District of Columbia. It serves every major container port in the eastern United States, operates the most extensive intermodal network in the East, and is a major transporter of coal, automotive, and industrial products. The company has been in business since 1827.

**Performance**: Everything was going well for Norfolk Southern. Then came the Feb. 3 derailment in East Palestine, Ohio, when all 38 cars of a freight train left the track. Many were carrying hazardous materials and the subsequent fire sent plumes of toxic smoke into the atmosphere. Investors rightly viewed the accident as a huge liability and the share price plunged.

**Recent developments**: Two weeks after the derailment, the company announced the creation of a $1 million charitable fund to assist the community. As well, NSC said it would distribute more than $1.2 million to help families and businesses cover costs related to the evacuation that was ordered after the wreck.

"We are committed to East Palestine today and in the future," said Norfolk Southern CEO Alan Shaw. "We will be judged by our actions. We are cleaning up the site in an environmentally responsible way, reimbursing residents affected by the derailment, and working with members of the community to identify what is needed to help East Palestine recover and thrive.

"This fund allows Norfolk Southern to move quickly to meet their immediate needs. We anticipate making further charitable contributions in East Palestine as conversations continue with local leaders and members of the community."

However, none of this satisfied many local residents and in late March the US Department of Justice filed a suit against the railway which could lead to heavy fines.

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***Norfolk Southern—continued from page 12...***

According to The Washington Post, the government wants Norfolk Southern be “held accountable” for polluting waterways and forced to pay penalties under the Clean Water Act in addition to the cost of the cleanup. The Environmental Protection Agency took control of the cleanup on Feb. 21.

The Justice Department is asking for penalties of $64,618 a day for every violation of the Clean Water Act as well as civil penalties of $55,808 a day or $2,232 per barrel of oil or hazardous substance. Costs could mount as each part of the train crash could invoke separate penalties.

The company did not issue a comment on the lawsuit.

**Financials**: A few days before the derailment, the company reported fourth quarter and year-end results. The results were impressive.

Fourth quarter railway operating revenue was a record $3.2 billion, up 13%, or $385 million, compared with fourth quarter of 2021.

Railway operating expenses were $2.1 billion, an increase of 19% compared with the same period last year due to higher fuel prices, increased claims costs, and higher compensation and benefits.

Income was a fourth quarter record of $1.2 billion, up 5%, or $52 million, year-over-year. Diluted earnings per share were $3.42, up 10%, or $0.30 compared with the same period in 2021.

For the full year, railway operating revenues were a record $12.7 billion, up $1.6 billion (14%) from 2021. Operating expenses were $7.9 billion, an increase of 19% compared with the same period last year, driven by higher fuel prices, inflation, network congestion, and higher compensation and benefits.

Earnings from railway operations were a record $4.8 billion, up $362 million (8%) year-over-year. Diluted earnings per share were $13.88, up $1.77 (15%) from 2021.

**Dividend**: The board of directors approved a 9% increase in the company’s quarterly dividend. It is now $1.35 a share ($5.40 a year), up from $1.24 a share ($4.96 annually).

**Outlook**: Everything seemed to be going well until the accident. Now the future is clouded with the aftermath from the derailment and more legal actions against the company are likely. These could result in heavy costs over the next few years, but nothing can be assumed at this point.

**Action now**: Hold.

***TD Bank—continued from page 11...***

broker Charles Schwab (NYSE: SCHW), which also caused concern as its share price fell by one third after the SVB collapse, should also recover as concerns over its solvency recede.

**Action now**: TD remains a Buy for its strengths in corporate and retail lending and its large asset management division, as well as its strong position in the eastern US.