Tap in to Canada’s Private Equity Markets With ONEX Corporation

Description

Over the past 20 years, shares of **ONEX Corporation** (TSX:OCX) have returned an astounding 18% annually. During the past decade shares have returned three times that of the TSX overall.

These market beating results have been the direct result of ONEX’s sizable $4.3 billion private equity portfolio. While the private equity markets have done incredibly well in previous years, the market is currently flooded with capital, valuations are high, and competition for deals is higher than ever.

Can investors hope that ONEX will replicate its fantastic historical results moving forward?

Diversifying revenue streams

Previously, shares in ONEX primarily represented an investment in the company’s private equity portfolio. Therefore, the stock would typically fluctuate based on the perceived value of its major holdings. Its competitor **Celestica Inc.** still runs this model.

ONEX has since evolved into a company with far more predictable earnings by entering the private equity market as an outside manager. **Brookfield Asset Management Inc.** has also adopted this model, and the share price has responded well. Since the switch, ONEX has amassed a managed portfolio of $15.9 billion. Management anticipates growing its funding base by 10% annually. In the past five years the company managed to outpace this target, growing at an average of 12% a year.

The company’s client base appears very long-term oriented, hopefully meaning that the company can rely on this portfolio to generate fees in good times and bad. Almost 75% of the capital is from pension funds, bank or insurance companies, and endowments.

Could ONEX actually benefit from an overheated private equity market?

While an overvalued private equity market seems like a major risk, there are ways that ONEX is capitalizing.

Number one, its managed portfolio continues to attract massive amounts of capital. In the past two years alone the company's funding base has grown by over 50%. This has helped management fees grow from $9 million in 2010 to an expected $34 million in 2015. Overall, global private equity fundraising has returned to pre-financial crisis levels. While redemptions can always reduce the funding base, ONEX's long-term-oriented clients and excellent historical results should mitigate some of this effect. In the interim the company can continue growing its very profitable portfolio management business at record pace.

Number two, private equity funds are increasingly cashing out previous investments at record multiples. Last year, the global value of buyout-backed exits hit all-time highs. ONEX has an opportunity to sell its own holdings at very attractive valuations while growing its managed portfolio that carries less direct risk.

Shares have responded to the potential of managed portfolios

From 2008 to 2012 shares traded at a discount to the company's Net Asset Value (NAV) for a majority of the time. Only in 2012 did shares start to trade at parity with the NAV. Since then, the stock has traded at a premium of anywhere between 5% and 10%. This premium helped push shares to an all-time high a few months ago.

ONEX as a manager is the new driver

ONEX's holdings are worth roughly $61 a share according to the company. While it still needs time to mature, the company believes its management business is worth anywhere from $17 to $21. If this is correct, shares look to be almost 20% undervalued. Despite a higher than average valuation, shares look to be undervaluing ONEX's ability to become a profitable asset manager.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:ONEX (Onex Corporation)

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