Income Investors: Can You Count on IGM Financial Inc. and its 6.1% Yield?

Description

Today's low interest rate environment is tough on folks who need to generate consistent income from their investments.

The days of GICs and other zero-risk investments yielding 5% are over. So, investors are left with a few choices. They can either invest in dividend-growth names that provide a smaller current yield but have growth potential, or they can invest in stocks with higher yields and limited growth.

Many of these higher-yielding stocks pay out a large percentage of their earnings in dividends. This makes the yield that much more risky. If a company that pays out 80% of earnings as dividends stumbles a bit, a dividend cut could be very likely.

But there are higher dividends that are safe. One that's popular with investors is **IGM Financial Inc.** (TSX:IGM). Can income investors count on the wealth manager to maintain its generous 6.1% dividend?

The business

IGM Financial isn't your typical wealth manager.

It's the owner of Investors Group, one of Canada's leaders in the sector. Nearly 5,000 Investors Group financial advisors provide millions of customers with mutual funds, life insurance, and mortgages. The company has approximately $75 billion under management.

The company also owns Mackenzie Financial, one of Canada's largest mutual fund families. Mackenzie funds are primarily sold by Investors Group advisors, but they're also marketed by some 25,000 other fund salespeople.

The big advantage it has compared with a company like **AGF Management Limited** is the in-house sales staff. It has Investors Group agents that are instructed to push company funds. AGF and other competitors are stuck trying to convince advisors working with other companies to push their funds.

Having its own fleet of advisors helps IGM in another way, too. It can offer things like ultra-low mortgage rates as a loss-leader to help entice customers. If somebody shows up for a mortgage, an Investors Group agent has the opportunity to sell them on other wealth management products. It's hard to cross-sell as a competitor when all you offer is funds.

The issues

This has traditionally been a good business. Mutual fund fees of 2.5% and up ensured the company some handsome profits.

But these days, IGM is having to deal with some serious headwinds. The first issue is the popularity of exchange-traded funds. Investors are starting to figure out just how much fees drag total returns. If someone buys a mutual fund that returns 8% annually, that falls to just 5.5% after paying a 2.5% management fee. That's more than 30% of total returns.

The other big issue that's upcoming is new rules coming out in 2016 that require advisors to disclose any management fees in dollars, rather than in percentage points. This means that on a portfolio worth $100,000, a 2.5% management fee suddenly turns into $2,500 worth of fees. Once they're presented with actual dollar figures, many customers might start to look for cheaper options.

Will this affect the dividend?

Investors have already figured this change will affect earnings going forward. Shares of the company have fallen more than 15% over the last year, as investors are nervous about the future of the business. I was one of them; I sold my shares back at the $45 level in late 2014.

At first glance, the dividend sure looks sustainable. Earnings over the last 12 months came in at $3.05 per share, while the company paid out $2.25 per share in dividends. That's a payout ratio of 73%, which isn't bad for a stock yielding more than 6%.

The issue is what earnings will end up doing in the future. Shares trade at just 12.2 times earnings, which is a significant discount to the market as a whole. But compared with many of its competitors–like Canada's banks–that's actually a bit expensive.

The other issue is the balance sheet. The company has increased debt by nearly 60% since the end of 2011, as total borrowing has gone from $5.1 billion to $8.1 billion today. More debt isn't necessarily bad, but earnings have stayed flat during the time. I'm not sure the money was borrowed wisely.

At this point, IGM's big dividend looks to be secure. However, investors need to keep an eye on results and make sure earnings don't take a hit next year with the new rules.

CATEGORY

1. Dividend Stocks
2. Investing

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1. TSX:IGM (IGM Financial Inc.)

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