Avoid IGM Financial Inc. in Spite of its Stellar Dividend

Description

At a current yield exceeding 5.5%, many retail investors will want to warm up to shares of **IGM Financial Inc.** (TSX:IGM). Even better than its yield is the current price-to-earnings ratio of approximately 13.5 times. What could be viewed as a retail investor's dream come true may actually turn out to be a nightmare. Let me explain.

IGM controls both Investors Group and Mackenzie Investments. For those not in the know, Investors Group is a company which employs commission-based financial advisors who hunt for new clientele with assets to invest. Once the client signs up, the advisor can sell a number of mutual funds, including those offered by the mutual fund company Mackenzie Investments.

If everything goes well, IGM makes money on both the manufacturing side (through Mackenzie Investments) and again through the sales side (Investors Group). Again, for an investor, it may seem like a dream come true, but when you look deeper, there are a number of serious issues to consider.

As many readers of the Motley Fool are aware, mutual funds have lost a lot of their lustre in the past several years. More investors are concerned about fees and are asking for exchange-traded funds or, better yet, are taking complete control of their investment portfolios.

IGM is in a position where a significant amount of its clientele holding their products asking for something better. The problem is, anything else offered except mutual funds will reduce the company's profitability over the long term. Basically, no other investment product has fatter margins than mutual funds.

Over the past several years, the financial services industry has witnessed increased consolidation, cost cutting, and independent mutual fund companies have witnessed net redemptions year after year. In this particular case, investors are only getting a yield which is barely sustainable. Over the long term, it will be almost impossible to experience capital appreciation for investors buying at current levels.

Although the dividend-payout ratio as a percentage of earnings was 72.4% in 2012, 71.2% in 2013, 72.8% in 2014, 72.3% in 2015, and 75.3% through the first three quarters of 2016, this ratio doesn't show investors the entire picture. Looking at the dividends paid as a percentage of cash from operation

(CFO), available on the cash flow statement, we realize the dividends paid account for a much greater percentage of the available cash flow generated from the business.

Dividends paid as a percentage of CFO was 78.6% in 2012, 77% in 2013, 74.4% in 2014, 91.5% in 2015, and 79.6% through the first three quarters of 2016. Although the payout ratios are high on the CFO side, it is going to be very difficult to sustain the total dividends paid given the leveling off of revenues and earnings.

Remember, for new clients of Investors Group, mutual funds are not the top priority. Existing clients are demanding lower expenses or they'll take their business to a competitor. For retail investors chasing yield, this is not the place to go. As often happens, juicy yields from businesses in decline will inevitably have to be cut.

Don't get seduced by this juicy yielder!

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