Why a Lack of Liquidity Sometimes Doesn’t Matter

Description

Investors purchasing shares in publicly traded companies often don’t stop to think about liquidity.

For shareholders, liquidity refers to the ability to sell out of shares, converting the investment back into cash at a fair price in a short time frame. When comparing the liquidity of securities to the liquidity of selling a home or a condo, we realize even the least-liquid securities are a better alternative to real estate.

The reason equity markets are preferred by many is due to the liquidity which accompanies it. Thinking about alternative investments such as real estate brings on the thoughts of lawyer fees, appraisals, financing, realtors, and, of course, finding a buyer or seller, which means a gap in time between the deal being struck and the exchange of funds.

Let’s not forget, shares of common stock settle in T+3, meaning after three days the buyer is the rightful owner of the stock. The availability of willing buyers and sellers can sometimes be an issue for certain real estate transactions.

While not all stocks trade millions of shares on a daily basis, the reality is, the higher volume or lower volume doesn’t always matter. Taking shares of **Morneau Shepell Inc** (TSX:MSI) as an example, the company has a total market capitalization north of $1 billion, yet the average volume is only approximately 56,000 shares per day — not very much.

For long-term investors looking for quality names to hold for the long term, liquidity (like when purchasing a home) is not the main concern. The only time one’s ability to buy or sell out of an investment enters the thought process is when it’s time to buy or sell.

As an investor seeking a fantastic business to add to the portfolio, Morneau Shepell is a good choice. It provides support to employers in the form of health, productivity, and retirement benefits solutions; it has a long runway for continued utility (from clients) and growth in the future.

Looking at the past five years, shares have increased steadily, offering solid returns while holding back on the excitement and/or euphoria. The dividend has remained steady at a rate of $0.065 per share, per month. Five years ago, the shares traded for less than $12, offering investors a yield in excess of 6.5%. At the current price close to $19 per share, the yield has fallen to a little over 4%. The good news is, the payout ratio as a percentage of cash from operations (CFO) has fallen drastically, potentially signaling that a dividend increase is on the way.

For fiscal 2012 and 2013, the dividend accounted for close to 100% of CFO, while the percentage fell to 76.5% in 2014 and 58.6% for 2015. Through the first three quarters of 2016, the percentage is close to 75%.

Although liquidity is important to investors who trade often, long-term investors need not be concerned with it. When you find a great business, it is possible to hold forever.

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