Another Reason to Avoid IGM Financial Inc.

Description

Among financial services firms, fees are king. The ability of a firm to provide financial products and services to its clientele while maintaining higher margins than competitors is a great long-term advantage in this era of various, new low-cost funds and exchange-traded funds (ETFs). These low-cost alternatives to higher-cost actively managed funds (including mutual funds) have largely eaten into profits and forced many financial institutions and financial services firms to find other, creative ways of continuing to churn out quarterly earnings beats.

I'll look at **IGM Financial Inc.** (TSX:IGM) — specifically, its funds managed under the Mackenzie Funds and Investors Group banners.

Changing industry fundamentals a risk factor

Fool contributor Joey Frenette recently wrote of some of the key perils of investing in a financial services firm that provides high-fee services to a clientele that is largely becoming more sophisticated. Joe notes that Canadian mutual fund subscribers are currently paying some of the highest mutual fund fees in the world; I agree wholeheartedly that a changing level of sophistication among IGM's customer base in Canada as well as increased regulations for management expense ratios (MER) will result in continued downward pressure on asset management firms such as IGM and these companies' abilities to extract value from client bases via increasingly high fees.

More recently, Fool contributor Ryan Goldsman reiterated this sentiment, focusing on the fact that mutual funds and associated services are becoming a thing of the past. With newer investors leaning toward lower-fee alternatives to traditional mutual funds, IGM and other financial services firms intent on selling mutual funds are having to shift their mix of products to continue to meet demand moving forward.

M&A less likely in Canadian market

An analyst at **Canaccord Genuity** has suggested that one of the ways Canadian asset management firms could create value would be with increased M&A, citing recent deals completed in the U.S. that resulted in improved valuations and immediate increases in shareholder value.

This analyst has pointed to weak fundamentals and lower compounded annual growth rates among Canadian asset management firms such as IGM as the reason for the lack of M&A activity, noting that valuations have subsequently suffered, leading to relatively lower valuations compared to the broader index. IGM currently carries a dividend yield of 5.5% along with a price-to-earnings ratio of under 13 (the broader index trades above 15 times earnings), making IGM appear relatively cheap.

Bottom line

While IGM may appear to have value at first glance, it is clear that the changing economics of the asset management industry combined with a client base that is likely to continue to move its money toward lower-cost financial services is a recipe for long-term pain for IGM and other related businesses. The lack of accretive bolt-on acquisition options is just another reason long-term investors should stay away from IGM.

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