IGM Financial Inc.: The Value Trap Continues

Description

Known by many as Investors Group, **IGM Financial Inc.** (TSX:IGM) may look like a fantastic investment to a retail investor. Stop! There is much more to it than that. Let's take a look.

The company, which operates in the advisor/client space through the Investors Group name, owns the mutual fund company Mackenzie Financial. Although the traditional business model of selling mutual funds through retail advisors has worked very well for many years, the marrying of these two businesses may not be as lucrative in the future as it was in the past.

Let's examine the first business. The advisors who "hit the pavement" to bring in new clientele are only paid if successful. These are the self-employed people. The second business (Mackenzie Financial) manufactures the product being sold by the advisors. These are the mutual funds.

What could be viewed as a marriage made in heaven during the 1990s and early 2000s has become problematic all around. As investors are more focused on what they are paying in fees, the popularity of mutual funds has declined. Additionally, the amount of mutual funds being sold on commission has also declined. Clearly, the taste of Canadian consumers is changing.

With an increased focus on ETF products, the company will have a very difficult time increasing the asset base and potentially growing the number of clients and assets under management. Should ETFs be offered to existing clients, it is important to note the thinner margins on these products.

Looking at company financials, total revenue has started to taper off, increasing by less than 1% between fiscal years 2015 and 2016. Looking at the bottom line, the company managed to report an increase of 2.5% in earnings per share (EPS).

What many investors do not realize, however, is the increase in EPS is actually not an increase in earnings at all. Earnings in fiscal 2015 and 2016 were almost identical. The increase in EPS was simply due to the fact that the company successfully repurchased shares in the amount of four million shares.

The value trap created by this company is that there is very little opportunity to drastically increase revenues or earnings per share (organically) in the future. The mutual fund business is in decline, while the ETF business (which is not more popular) brings with it lower margins for everyone involved.

The dividend-payout ratio has now been close to 71% for two consecutive years without any increase in the total amount paid. Investors who choose to purchase shares today will receive a comfortable yield of close to 5.75%, while not getting much more. Under the current circumstances, there is very little probability for growth.

For investors looking to make an investment in a dividend-paying security, it may be a good idea to evaluate the company as much as the dividend sustainability.

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ryangoldsman