Are Better Days Ahead for Canada’s Mutual Fund Industry?

Description

Over the past five years, Canada’s mutual fund industry has gone through a very difficult period for a number of reasons.

Let’s begin with the rise of exchange-traded funds (ETFs).

Many investors have started to take notice of the difference in fees between mutual funds and the more passively managed product. The challenge for the mutual fund industry has been that returns have not been significantly higher than the overall market. Although measures, such as the Sharpe ratio, which measures the return for a given level of risk, may be helpful, most retail investors do not understand these measures. This means that many are not taking the lower amount of volatility into consideration.

Given the higher fees charged by mutual funds, many mutual fund companies have attempted to increase the bottom line by cutting costs. Although the total assets administered by the company have increased, the revenues generated by many of the independent competitors have not followed suit.

For long-term investors of **AGF Management Limited** (TSX:AGF.B), the market has not been kind. After cutting the dividend in early 2015, shares fell to a low near the $4 mark in early 2016. For those who have invested in shares of the company, the risk taken at a price of $4 may just have paid off. Currently trading near $7, the dividend currently offers a yield of slightly more than 4.5%.

For investors considering the income statement, there could still be a lot of apprehension before they pull the trigger. Top-line revenues have fallen from $452 million in fiscal 2014 to $415 million in fiscal 2016. Bottom-line earnings have also decreased over the same period from $61.2 million to $42.4 million. As shares currently pay a dividend of $0.53 per share, the earnings per share, which have declined from $0.68 in 2014 to currently $0.53, may not be enough to sustain the current dividend over the next few years.

Halfway through fiscal 2017, the company has made a total of $0.27 per share while paying out $0.16 in dividends. Things may be turning the corner, but let’s not forget how equity markets have performed over the past few years. Given the increase in the financial markets both north and south of the border, total assets under administration have increased organically. With more money to manage, the company should have been able to generate a higher amount of revenues.

Investors looking to purchase shares of an undervalued company may need to consider AGF Management Limited very carefully. As the company may just be at the crossroad of either taking off in the right direction, or if things turn negative, investors will once again see their income payments cut and a share decline would follow.

Given the changing landscape in the Canadian financial industry, it will be critical for mutual fund companies to either accept thinner margins and lower profits or risk being bought out by a bigger competitor.

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Date
2025/07/21
Date Created
2017/07/20
Author
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