Income Investors Beware: This Canadian Company Is “Diworsifying” Itself to the Max

Description

Power Corporation of Canada (TSX:POW) is a massive holding company owns full and partial stakes of various businesses with a primary emphasis on the financial services industry. The company is considered “well diversified” by many, but I think it’s actually “diworsified” with so many stakes such that the risk/reward trade-off is negatively impacted by the vast number of subsidiary firms under the Power Corp. umbrella.

Unless you’ve got a management team that’s on steroids, it’s difficult to monitor the progress of every single partial stake. The company’s non-financial holdings include the likes of Pargesa Holding SA, Square Victoria Communications Group, and Power Energy with subsidiary businesses whose industries span from alternative energy, wines and spirits, construction materials, and media.

Talk about being a jack of all trades, and the master of none!

While management’s specialty is financial services, the glut of additional investments hasn’t exactly been a boon for investors, as demonstrated by the lack of returns over the past decade.

While some holding components may seem somewhat promising, there are a few rotten eggs in the basket, including **IGM Financial Inc.**, a wealth management company whose top and bottom line is heavily reliant on the sale of actively managed mutual funds with exorbitantly high fees. Such financial products, I believe, will remain in secular decline as lower-cost alternatives continue to pick up traction.

Graeme Roustan, an activist investor who owns less than 1% of outstanding shares, urged Power Corp.’s chairman to offload interest, including Pargesa Holdings, China AMC, and Power Energy, to name a few.

Roustan stated that Power Corp. is invested across too many unrelated sectors and that its portfolio holdings increased overall risk instead of mitigating it.

I couldn’t agree more. Power Corp. is a classic case of a diworsified business that’s grown to become too much to handle for management. Add the fact that the company’s wealth management business will likely be hit by the rise of FinTech, and Power Corp. is starting to look like a train wreck in the works.

While management has taken a stake in robo-advisor Wealthsimple, I believe the move is an insignificant hedge that will ultimately accelerate the cannibalization of its traditional wealth management business, if anything.

Foolish takeaway

In its current state, Power Corp. looks like a **Fairfax Financial Holdings Ltd.** that's gone wrong.

Power Corp.'s portfolio is in dire need of some spring cleaning, and until management can overhaul its portfolio, I'd avoid its shares because the company's hierarchy of mediocre holdings has "diseconomies of scale" written all over it. And without a Prem Watsa to pull off spectacular bargain takeovers, I think there's no chance that Power Corp. will ever become as successful as Fairfax.

The 5.15% dividend yield may seem appealing, but I think the potential for capital losses is just too large, especially if management further diworsifies its portfolio.

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