This Stock's Buyback Actually Makes Sense

Description

CI Financial Corp. (TSX:CIX) released its second-quarter results August 9. Included in the earnings news was the announcement that it was cutting its annual dividend payout from $1.41 a share to $0.72 a share to increase its capital allocation flexibility.

The markets didn't like the news, although it will use some of the savings from dividend payments to buy back its stock, which hasn't traded this low since 2012.

I think the move is a good one for a couple of reasons.

CI stock is too cheap to ignore

CI stock is cheap for a reason: it sells plenty of mutual funds in an age of ETFs. Seemingly out of step with the future, investors couldn't care less that it continues to generate solid profits despite the industry headwinds it faces.

"These are strong results, showing that we have been able to increase CI's profitability and maintain the efficiency of our operations in the face of industry headwinds and redemptions," said Chief Executive Officer Peter W. Anderson. "CI continues to generate a high level of free cash flow, which reached $330 million for the first six months of the year, a record for the company."

The fact is, CI is generating approximately $650 million in free cash flow annually for an FCF yield of 10.2% (market cap of $5.75 billion plus $897 million in debt less $185 million in cash), thereby easily eclipsing the 8% FCF yield most consider the floor for making value investments. By comparison, **BlackRock, Inc.** (NYSE:BLK), the world's leading asset manager, has an FCF yield of 4.8% or less than half of that.

Now, I'm not suggesting CI is in the same league as the company that owns iShares, but its business is hardly ready for the scrap heap either.

I would suggest that a more appropriate FCF yield for CI stock would be halfway between the two around 7.5%, which translates to an enterprise value of $8.8 billion (100 divided by 7.5 equals 13.3 times $660 million in free cash flow), 36% higher than its current valuation.

Buybacks are best done when trading at historical lows

As I said earlier, CI stock hasn't traded at these levels since 2012, making share repurchases the best capital allocation lever it can pull at this point in the game.

Over the past 12 months through June 30, CI has repurchased $559 million of its stock. In the first six months of 2018, it repurchased 11.4 million of its shares at an average price of $27.03. During the first six months of the year, CI stock's hit a high of $30.23 in January and a low of $23.36 in June; thus, it paid around the midpoint of its share price over those six months, a decent if not spectacular showing.

Now trading slightly lower than its low in the first half of 2018, the $1 billion the company has set aside for purchases over the next 12-18 months should start now and continue at a rapid pace, taking into account the terms of its normal course issuer bid, until its 50-day moving average climbs above its 200-day moving average.

Chairman Bill Holland explains the company's rationale for cutting the dividend and repurchasing its shares.

"CI is in a very strong position financially, with robust free cash flow of approximately $650 million a year," Mr. Anderson said. "Today, we strongly believe that the best use of free cash flow is to aggressively buy back CI shares because they offer such compelling value. Each share bought back is accretive to earnings."

The bottom line on CI Financial stock

In mid-July, Fool contributor Ambrose O'Callaghan noted that the company's stock was trading at a six-year low, something I've alluded to as well. He went on to suggest its 5.9% dividend yield is very compelling.

Well, CI's decision to cut the dividend has dropped the yield to 3.3%. If you're a value investor, that shouldn't bother you in the slightest.

In late June, I suggested that Vanguard's move into actively managed mutual funds in this country could do permanent damage to companies like CI because that would put even more pressure on it to reduce fees. By cutting its annual dividend it can afford to use the $180 million or so in dividend savings to absorb future fee cuts.

If you're a dividend investor, you might not like the move. However, from where I sit it makes total sense.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:BLK (BlackRock, Inc.)
2. TSX:CIX (CI Financial)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Investing

Date
2025/08/18
Date Created
2018/08/15
Author
washworth