



## Warning: Power Financial Corp (TSX:PWF) Might Be a Massive Value Trap

### Description

Many value investors have been attracted to **Power Financial Corp** (TSX:PWF), which is one of Canada's largest financial services stocks.

Power Financial has two main things going for it today. The company trades at a discount to the sum of its parts, which include big stakes in publicly-traded entities like **Great-West Financial**, **IGM Financial**, and **Pargesa**, a European holding company. This discount has historically been about 25% versus the sum of the parts.

Additionally, Power Financial trades at an attractive price-to-earnings ratio. Thanks to a recent sell-off, shares currently trade hands for just 9.3 times trailing earnings.

Finally, we have the dividend. Power Financial has long been a favourite of dividend investors, and with a current yield of 6.7% it's easy to see why an income investor would be excited today. And remember, the company has raised its dividend each year since 2014.

But once we delve a little deeper, there's a reason why the company looks so attractive on the surface. Power Financial has multiple flaws — defects I think will keep the stock cheap for a very long time. Here's why.

### Conglomerate discount

The uncomfortable truth about conglomerate discounts is they never seem to go away.

It's easy to be attracted to the gap between the true worth of Power Financial's assets and the current market price. It would seem the gap should go away at some point. After all, it's so obvious.

But it doesn't seem to work that way. Let's face it; if you liked the underlying holdings so much, why bother with Power Financial? You'd just buy whichever piece appealed to you the most while ignoring the other parts.

An investment in an undervalued conglomerate is wholly dependent on the underlying assets

performing. Say Power's subsidiaries grow earnings by 10% a year. Power Financial would therefore also grow earnings at approximately 10% a year. But that's the whole upside. It's unlikely the conglomerate discount will go away.

That's a satisfactory result, but not a stellar one. And it would be no better than buying the underlying parts.

### **Weak underlying businesses**

The majority of Power Financial's assets are invested in Great-West Lifeco. Power's stake in the life insurance giant is worth \$18.8 billion versus Power's full market cap of \$21.5 billion. The company's fortunes are tied to Great-West Life's.

Great-West Life has traded at a cheap valuation for years now. Shares are just 10.5 times trailing earnings and trade at 0.6 times sales. Both of these metrics are cheaper than the competition's stocks.

There's two ways we can look at this. A value investor might consider this a reason to be bullish on Great-West Life. A pessimist would argue there's a reason the company's shares trade at a discount. I'd put myself in the latter camp.

The Great-West exposure doesn't concern me nearly as much as Power Financial's IGM Financial stake. IGM, the parent of Investors Group, is in the middle of a transformation.

The ETF business is steadily eating into IGM's main profit driver, that of overpriced mutual funds. The company is adapting by pivoting to a heavier emphasis on financial planning. Whether the new strategy will pay off remains to be seen, but many investors aren't optimistic.

IGM will also get hit by a declining market, which will both decrease assets under management and perhaps lead investors to try a different approach. Many investors will use a crummy year as an excuse to try some of these ETFs they've been hearing so much about.

### **The bottom line**

Despite underlying metrics that make the stock appear to be a good value, I'd avoid Power Financial Corp. Investors will likely outperform going forward by buying the good part of the underlying business — Great-West Life — while avoiding IGM Financial.

But even the good parts of Power Financial don't look particularly good. I'm avoiding the stock today, albeit I like the looks of that 6.7% yield.

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**Date**

2025/08/17

**Date Created**

2019/01/04

**Author**

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