



This 2.75% Dividend Stock Is a Direct Bet on Canadian Wealth

Description

There are 3,233 stocks listed on the Toronto Stock Exchange and the Toronto Venture Exchange combined. Last year, 147 new companies joined this expanding group of publicly listed firms. There's also a countless number of derivatives, exchange-traded funds, real estate investment trusts, special purpose vehicles, and fixed-income securities floating around.

Now imagine getting a tiny piece of every single transaction of those countless financial instruments traded every single day. That's the basic business model of the **TMX Group** ([TSX:X](#)).

Created in 2008 and based in Toronto (of course), the TMX Group is best known for owning and operating North America's third-largest stock exchange by market capitalization. However, the group also owns other exchanges such as the TSX Venture Exchange, the Montréal Exchange, the TSX Alpha Exchange, Shorcan Brokers, and the Canadian Depository for Securities.

Across the world, companies that own their national stock exchange are in a unique position. There can only ever be one dominant capital market in each country or region, so the competition is generally limited to international peers, while the barriers to entry are extraordinarily high.

This makes TMX's business remarkably stable and lucrative; 50% of revenue is recurring every year, the free cash flow yield is 6.3%, and the dividend yield is 2.75%.

However, TMX has gone [one step further to ensure growth](#). It's been expanding to foreign markets in recent years and already derives 33% of revenue from outside Canada. The group has also been leveraging its vast pool of data to diversify the business and create new avenues of income.

At the end of 2018, more than a third of the company's revenue was derived from what it calls "global solutions, insights, and analytics." This department offers indexes, data subscriptions for traders, co-location services, and a data platform for European wholesale energy markets (Trayport).

The data services segment of the business is growing the fastest (55% year on year in 2018) and has the highest gross margin (60%). The company's management expects this segment to grow at high single-digit percentages every year for the foreseeable future.

Meanwhile, other segments of the business such as equity trading and capital formation will grow at single or less-than-single digits every year. The overall combination of high- and low-growth segments should enable TMX to meet its target of double-digit compounded annual growth in earnings per share over the medium term.

Management has set itself a target dividend-payout ratio of 40-50%, which means investors should be able to extract handsome dividends from this rock-solid growth strategy.

Applying the dividend discount method, assuming dividend growth of 3% and required rate of 6%, leads to an intrinsic value of \$80 per share. The stock currently trades 5.8% higher, at \$84.67, so I think accumulation would be a clever strategy at any pullback.

Bottom line

TMX Group is an exceptionally rare company in a very lucrative industry. Owning the national stock market and making money off every trade as the economy grows is usually enough for most companies, but TMX has always been an innovator in this space.

It's well diversified internationally and is pushing for growth through data services that overlap the core business. For investors, this is a dividend income stock unlike any other. Mildly overpriced at this time, I suggest monitoring the stock closely and jumping in at the next pullback.

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Date

2025/08/27

Date Created

2019/03/25

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