TMX Group (TSX:X): After a 30% Surge, Is it Time to Sell?

Description

TMX Group (TSX:X) has seen its market value surge 30% since the start of the year. As the stock approaches triple digits for the first time in the company's history, should investors pour more money in or pull some off the table?

As the owner and operator of the country's capital markets, including the Toronto Stock Exchange, TSX Venture Exchange, TSX Alpha Exchange, and Montréal Exchange, the TMX group is a proxy for the wider economy. The company is well diversified with four different income streams: insights & analytics, capital formation, equities & fixed-income trading, and derivatives trading.

According to the company's latest filings, the segment with the highest gross margins (insights and analytics) is also growing the fastest. The segment expanded by 55% between 2017 and 2018 while delivering an operating margin of 60% over the period. In the first quarter of 2019, the insights and analytics segment also accounted for 38.5% of the company's total revenue.

Last year, the company announced a foray into cryptocurrency trading and custodian services, which could help diversify the business further and bolster revenue growth for decades.

Operating the national stock market is a position of natural monopoly that allows the company to generate incredible returns and deliver a healthy 5.1% free cash flow yield to equity. Management pays out nearly half of that yield in the form of a dividend, which places the dividend yield at 2.75%.

In short, TMX is a strong business with an unparalleled competitive edge that is deeply intertwined with the nation's economy. The only concern investors should have is timing.

Capital markets are cyclical, and the next downturn will reduce the fees and listings on the stock exchange. A recession or bear market will have an instant impact on TMX's bottom line.

Predicting a stock market crash is a fool's errand, but investors must use the relative valuation of the stock indices and consider the market cycle before investing in TMX. A bear market could offer a better point of entry for value-seeking investors.

The **S&P/Toronto Stock Exchange Composite Index** currently trades at a price-to-earnings ratio of 17.36, which is lower than its five-year average of 24.6. Meanwhile, the number of initial public offerings (IPOs) so far this year were flat from last year, which indicates the market is still cautious after the turmoil in 2018.

Macroeconomic tensions regarding Brexit and the trade war, along with an overheated local economy in Canada, could keep investors on the sidelines. These unavoidable risks loom large over TMX's core businesses, which is why the company's efforts to diversify across borders and into cryptocurrencies is well justified.

Bottom line

The TMX group is a one-of-a-kind business that deserves a spot as a stabilizing force on everyone's investment account. However, bad timing is the only risk TMX investors face, and it's difficult to say what stage the Canadian market is in at the moment.

Considering the recent turmoil in stocks, lack of IPOs in the first quarter, and fair valuation of the broader stock index, it may be a good time to accumulate the stock before the next bull run.

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