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Long Ideas

CI Financial: An Undervalued Gem

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Summary

- CI Financial's new CEO has helped turn around the company by focusing on wealth management.
- A large buyback is in effect, which along with the healthy dividend provides a very decent total return all on its own.
- The technical setup for the short/medium term is excellent.

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Investment Thesis

CI Financial (CIXX, OTCPK:CIFAF in Canada) is an asset manager in the early stages of a successful pivot towards wealth management, a sector which trades at higher multiples. While shares of CI Financial have grown, they haven't grown in line with these new multiples, which means the company is undervalued. Even if the company remains undervalued, however, management is committed to delivering value for shareholders by aggressively buying back shares.

Company Overview

CI Financial is a Canadian-based asset and wealth management company with over 300 billion assets under management (called AUM). It is dual-listed in the USA and Canada. On the asset management side, it has a suite of mutual funds and ETFs, including instruments for Bitcoin and Ether. There are currently no crypto ETFs in the USA, and CI's Bitcoin ETF has the lowest management fees of any such product in the world. Nearly a hundred of its offerings have beaten the return of SPY (SPY) over the past year.

Image Source: Company Website

However, it is generally understood that the asset management industry is under some pressure, as current trends point to retail investors increasingly picking their own stocks through apps like Robinhood (HOOD). That is why it is important for companies in the space to try to diversify their business, to hedge against the risk of this trend continuing. Fortunately, CI Financial is taking all the right steps, and that began when they appointed their new CEO.

New CEO, New Push for Wealth Management

Kurt MacAlpine was appointed in 2019 and had a new direction for the company: wealth management. Wealth management doesn't have the same disruption risks as asset management, and thus companies involved in it tend to trade at higher multiples than pure asset management firms.

This is a smart way to diversify the company's business, and there's synergy there too: the wealth management side can recommend that clients invest in mutual funds and ETFs from the asset management side. Because of these synergies, CI Financial can acquire smaller wealth management firms and then run them at much higher profit margins, which is exactly the strategy the CEO has been pursuing. Shortly after his appointment, CI Financial started making plans to buy small asset management firms, many of them in the United States, further diversifying the company's revenue sources. In addition, the company dual listed its stock in the US as well, and the shares started to climb rapidly.

Then, the pandemic hit, and CI Financial, along with other asset management companies, crashed hard. Because asset managers make most of their money via fees charged as a percentage of their AUM, the market crash represented a huge hit to their earnings power.

However, Kurt MacAlpine also saw the crash as an opportunity. He accelerated his plans to buy more small wealth management firms, getting them on the cheap thanks to the pandemic depressing valuations.

The strategy worked. CI Financial's stock has more than doubled since March of 2020 and is up nearly 60% YTD in 2021. In Q2 of 2021, the company enjoyed its best quarter in six years of asset management net fund flow, and as of July, wealth management AUM now exceeds asset management AUM. It acquired five small wealth management firms during Q2 alone, showing that the pace of acquisitions is not slowing down.

I cannot overstate the importance of solid management on a company's performance. I've invested in companies with innovative products, only to see them crash and burn thanks to management mistakes, such as Ontrak (OTRK). Sachem (SACH) recently over-promised and under-delivered on finding a less expensive source of financing, and the stock has stagnated ever since. Solid management will help keep the ship afloat during the bad times and reward the shareholder during the good times - which leads us to the dividends and buybacks.

Share Buybacks and Dividends

CI Financial boasts a 2.88% dividend, which it was able to maintain even during the lean days of the pandemic. Additionally, during 2020, CI Financial managed to repurchase 14 million shares of its stock. The pace of share repurchases has accelerated this year, with 12 million shares repurchased in the first half of the year alone, representing nearly 6% of shares outstanding. In other words, buybacks and dividends represent close to a 15% annualized total return all on their own.

Warren Buffet said if you want to judge management, "see how they treat themselves vs. how they treat the shareholder," and in my opinion, CI Financial has passed this test with flying colors.

During the Q2 earnings call, management was asked if the buybacks would continue. The CEO stated that while the share price has gone up, it has only gone up in line with earnings growth. The multiple at which the company trades has remained the same, meaning the market is currently not appreciating the shift towards the higher multiple wealth management businesses. Until the shares are re-rated to appreciate this shift, Kurt MacAlpine stated that the share repurchases will continue.

Valuation

Just how high would CI Financial climb if it did re-rate? A good comp is Focus Financial Partners (FOCS), which is a similar size and has similar growth rates to CI Financial. Focus, though, primarily is in the wealth management business. It has a forward P/E of 12.28, while CI Financial has a forward P/E of 7.24.

In my opinion, forward P/E is the best way to compare valuations for these companies, because it takes into account analyst estimates of future growth and acquisitions that have not closed yet, which is highly relevant since both companies have made several recent acquisitions.

CI Financial doesn't break down its adjusted EBITA by sector, however, some back-of-the-envelope math can help make some good estimates. On their Q2 earnings presentation, CI noted that their adjusted EBITA for Q2 was roughly $242 million, while the annualized run rate of the wealth management sector (once recent acquisitions close) was estimated to contribute $196 million of adjusted EBITA - meaning that roughly 20% of the company's EBITA is expected to come from solely from wealth management. I would expect that number to rise quickly further in the future, given that this EBITA figure is nearly six times higher than it was in 2020.

However, even if we assume no further growth in wealth management EBITA, that still implies a decent upside for the re-rating. If CI Financial's forward P/E appreciated just 20% of the way towards Focus Financial's multiple, that would be a share price gain of about 14% - and that's on top of the buybacks, the dividends, and the growth in share price we could expect from earnings growth.

Whenever a company is cheaply valued, it is always worth asking the question why. Cheap can be cheap for a reason, and you never want to invest in a value trap. I believe that the low valuation is likely the result of investors not being aware of the recent growth of the wealth management segment. Information about the company isn't easily forthcoming if you only know the American ticker of CIXX: many screeners such as Finviz lack key metrics such as P/E, which limits how often the company can be discovered in searches. Some sites only post the company's earnings call transcripts under the Canadian ticker - and reading these transcripts was essential to my understanding of the key elements of the investment thesis I have laid out above.

Furthermore, that Canadian ticker is referred to inconsistently by various investing sites - TSE:CIX on TipRanks, CIX.TO on Yahoo, and CIFAF here. This further limits the information that can be easily discovered by a few casual searches.

Trading volume is also fairly low for a 4 billion dollar company, lending further credence to the theory that this (likely temporary) lack of awareness about the company is the prime contributor to the low valuation.

Technical Setup is Superb

Image Source: finviz.com

For those of you who are more chart-oriented, the technical setup for CI Financial is near perfect. The channel uptrend has been slow and steady ever since the start of the year, and it has not strayed from that channel in any meaningful way even once. At 61, the RSI is decent, and the stock's current position near the bottom end of the upward channel makes a great entry point.

Furthermore, the stock exhibited excellent price action on earnings - a nice surge in price on great results, followed by a gap fill that dutifully stayed in the channel and never dipped below the price before the report. It's hard to imagine a chart that looks better than this one.

In my view, these technical indicators are a great way to measure investor sentiment. Investors are believing this turnaround story, and as time goes by, they are liking it more and more. "The trend is your friend," as they say.

Risks

CI Financial has two primary risks. First, a market downturn. As mentioned earlier, asset managers tend to fare very poorly during bear markets. They face the risks of both AUM dropping due to asset prices dropping, as well as decreases in AUM from people selling their holdings. CI Financial has shown it can recover quickly and has a management team capable of taking advantage of the opportunities that downturns can bring, but I still expect it to be a below-average performer in a bear market.

The second risk is that there could be an acceleration of trends away from asset management before CI Financial has time to complete its pivot towards wealth management. If the entire asset management sector is viewed as obsolete, then CI Financial won't be a solid performer until most of its earnings come from wealth management. While that part of the company is growing, I estimate that milestone might be 2-3 years away.

Bottom Line

CI Financial has smart management, a fast-growing new business in wealth management, a healthy dividend, a large buyback program, a discounted valuation relative to peers, and an ideal chart pattern. Unless you think we're headed into a bear market soon, this is a buy.

This article was written by

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