5 Barely Profitable Companies Priced to Sell

Description

Context is critical in the world of investing. As are expectations. When we're evaluating stocks, we must not only understand the underlying business and how it has performed over the years, but also how the market expects that business to perform in the coming years.

One way to quickly analyze the strength of a company is by examining its return on equity (ROE) over time. Companies that are able to consistently crank out a high ROE are typically very strong. Think the Canadian banks.

However, a company's historical ROE does not indicate how the underlying stock is going to perform in the short to medium term. The market will often times gravitate to historically weak (low ROE) businesses if for some reason the future appears bright.

This will be reflected by the stock's multiples. Over the long-term however, should the future resemble the past for these businesses, these multiples will decline. Therefore, investing in a low ROE business that carries an elevated multiple is typically not a great recipe for long-term investing success.

Put 'em together

To try and uncover companies that might be trading at elevated, and maybe even expensive valuations, let's look for consistently low ROEs and high multiples – and specifically when dealing with ROE, price/book multiples.

You see, ROE and the P/B multiple are anchored by the same denominator – shareholder's equity. ROE is calculated by dividing net income by equity, and the Price to Book multiple is calculated by dividing current market value by equity.

Taking it one step further, if we divide a company's ROE by the P/B multiple, with some fancy math (not really), we're left with net income/market value, which is just a company's earnings yield (EY).

To illustrate, a company that consistently sports an ROE of 10% and trades at a P/B of 5 (EY = 2%) is potentially far less attractive to an investor, all else being equal, than a 10% ROE and a P/B multiple of

2 (EY=5%).

Get to the stocks

Ok, ok. The following table consists of 5 companies that currently offer this unappealing combination of consistently low ROE and a relatively high current P/B multiple.

Company Name	5 Yr. Avg ROE	Current P/B	“Earnings Yiel
Canfor (TSX:CFP)	0.4%	2.3	0.2
Canexus (TSX:CUS)	2.2%	5.3	0.4
Valeant Pharmaceuticals (TSX:VRX)	3.7%	8.0	0.5
Agnico-Eagle (TSX:AEM)	1.9%	1.4	1.3
Progressive Waste Solutions (TSX:BIN)	3.0%	2.1	1.4

Source: Capital IQ

Foolish Takeaway

By no means do these metrics capture the entire story for any of these 5 names. However, this combination does serve as an indication that the market’s expectations for each are misaligned with the historical performance of the respective underlying businesses. Be mindful of these expectations when considering all 5.

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1. Investing

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