Investors Looking for Extreme Growth May Find Extreme Danger with BRP Inc.

Description

For investors wondering when the consumer spending cycle may be over, a company such as **BRP Inc.** (TSX:DOO) may be one of the interesting names to play, as a pure play on North American consumer spending. Those who believe consumer spending conditions are likely to continue to improve both domestically and abroad are likely to view the nearly 2% dip in BRP's share price last Friday as a buying opportunity.

For everyone else (and I include myself in this camp), the substantial rise in the valuation of companies like BRP of late, linked to the ability of these companies to continue to churn out higher cash flows, relies on a continued economic recovery and relaxed monetary policy stance. As we have seen in recent months, global central banks appear to be in a less-relaxed mood of late — something which may prove to increase borrowing costs and thereby negatively affect companies such as BRP.

Continued strength in the Canadian economy has meant the Bank of Canada has increased interest rates — a move which could provide downward pressure on the USD/CAD exchange rate, something BRP's chief financial officer noted in the most recent earnings call could "put a bit of pressure on our ability to achieve guidance for the end of the year."

These macroeconomic short-term events aside, a number of analysts have pointed to the fact that we are now in one of the longest consumer spending cycles in history — a reason to cut back on "super-cyclical" names such as BRP and instead begin to look at holding a higher percentage of value plays within a portfolio as a defensive move. Looking at BRP from a long-term perspective, it remains hard for me to suggest a better time to hedge out some of the long-term cyclical downside risk that always remains with companies like BRP.

Bottom line

One thing BRP has shown in recent years is impressive growth; this growth has propelled BRP to higher valuation levels, linked to the company's proven ability to churn out profits and cash flow in a time when growth remains otherwise constrained. What investors need to keep in mind, however, is that these companies are the ones that are typically most prone to large declines in down cycles — a situation which I believe to be right around the corner.
My opinion is that now may be the time for investors who own BRP to consider adding downside

protection, take money off the table, or move towards other names entirely, given the massive cyclical risk profile of BRP compared to the broader market.

Stay Foolish, my friends.

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