2 Highly Leveraged Companies You Might Want to Avoid

Description

When deciding whether or not to invest in a company, there are many factors for investors to consider that go beyond earnings, such as how the company is managing its debt levels, and how vulnerable it will be if cash flow becomes a problem. Higher debt means higher interest costs and more cash flow that is needed just to keep the company's head above water. Even if times are good, and a company has good interest coverage, that may not always be the case, especially if the company runs into trouble.

For value investors, a debt-to-equity ratio of more than 0.5 is less than ideal, while a debt amount that is more than equity is certainly a red flag. I'll have a look at two companies that have significant debt levels that you might want to avoid.

Restaurant Brands International Inc. (TSX:QSR)(NYSE:QSR), in its most recent quarter, had over $11 billion in debt compared to just $3 billion of equity. Year to date, the company has paid over $205 million in interest, which is about 42% of the company's cash from operations and half of its net income. Without much interest coverage, the company is susceptible to liquidity issues if it runs into some bad quarters.

However, with the company's current assets being more than three times the value of its current liabilities, there are no near-term issues that would concern Restaurant Brands. The company is involved in expansion and is growing its brands, so debt is an easy way to finance operations. The challenge will come if the expansion becomes too costly or does not go as well as expected; meanwhile, the company remains straddled with the added debt.

Dollarama Inc. (TSX:DOL) has a negative equity balance in its most recent quarter, as the company has been repurchasing its own shares at stock prices that are significantly higher than book value, which causes equity to decrease. In its most recent fiscal year, the company had $1.3 billion in debt compared to just $100 million in equity. However, for the full year, Dollarama paid out $28 million in interest, which was just 5% of the company's cash from operations.

Although interest coverage is not an imminent concern for Dollarama, the company has been taking out debt to cancel existing shares, and if that trend continues, then the company's interest payments will only continue to rise. In three years, the company's debt has more than tripled, and in the past year, it has gone up by almost 25%.

Why should investors care about debt if the company is performing well?

Debt for companies is just as risky as it is for individuals. When times are good, debt levels aren't a real concern, but when times are more challenging that can change in a hurry. An individual with a lot of debt might not be concerned while a regular stream of income is coming in, but when that stops, debt becomes a major problem. There are many forces that could impact these companies, from minimum wage hikes to poorly performing stores, many factors could erode profits, which would make rising debt levels a greater concern.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:QSR (Restaurant Brands International Inc.)
2. TSX:DOL (Dollarama Inc.)
3. TSX:QSR (Restaurant Brands International Inc.)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Investing

Date
2025/08/25
Date Created
2017/09/14
Author
djagielski