



Growth Investors: Avoid These 2 Companies With Negative Shareholders' Equity

Description

Growth investing is a tricky game of picking the right company at the right time in the right sector; with 2017 being yet another incredible year for growth companies, the question of whether or not sectors that exploded in 2017 (Bitcoin, cannabis, technology, base metals) will continue their upward trajectory in 2018 remains to be seen.

That said, the search for the next great growth company/sector is always underway, and investors will be scouring the options in early 2018 in a bid to get a head-start on beating the TSX Composite Index.

I'm going to discuss **Bombardier, Inc.** ([TSX:BBD.B](#)) and **Dollarama Inc.** ([TSX:DOL](#)), two popular growth companies, and why growth-oriented investors should steer clear of these two names in 2018. Both companies share one thing in common (a rare trait at that): both companies have negative equity balances as of their most recently released financials.

What does negative shareholders' equity mean?

What negative equity implies for a particular company is that said company's liabilities are greater than its assets, leading to a situation in which the paper value of the equity owned by the investor is zero. In other words, in the event of a default, an investor in such a company would receive nothing, resulting in the absence of any sort of "investor safety net," so to speak.

In the finance sector, the amount of equity set aside by banks is scrutinized heavily; banks are required to maintain a minimum equity threshold via various tiered capital ratios to continue functioning. In other sectors, the scrutiny is much more muted for a number of reasons.

First of all, the paper value of assets and liabilities on a balance sheet can be very off. Consider a piece of land purchased decades ago in a metropolitan area which has seen tremendous price appreciation. Such an asset would be listed on the books at its purchase price, distorting the asset/liability balance significantly. In this regard, calculating a "true" measure for shareholders' equity can be a very difficult and subjective exercise, requiring significant accounting acumen.

Shareholders' equity also does not factor in the equation-improving fundamentals or expectation of

future growth — shareholders in both Bombardier and Dollarama have certainly priced in a great deal of growth in their valuations of these firms.

Does shareholders' equity matter?

Shareholders' equity should matter for investors and should be a key fundamental factor considered in any share purchase. Seeing a big, juicy equity balance is an indication that a company has a significant amount of assets in relation to its liabilities — a recipe for long-term growth and prosperity.

After all, buying a percentage ownership in an asset for \$100 which comes along with a promise to pay \$110 should be an immediate concern, regardless of the size of future cash flows.

Investors need to be wary of all the risks of investing in securities — those with negative shareholders' equity balances provide additional risks to the table, which need to be accounted for.

Stay Foolish, my friends.

CATEGORY

1. Investing

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1. TSX:BBD.B (Bombardier)
2. TSX:DOL (Dollarama Inc.)

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