



Checklist: 4 Variables to Help us Find a Winning Stock

Description

Sometimes, with all the hype that surrounds the market and certain stocks, it's hard to know what to focus on when looking for a [good buy](#) for our investment portfolios.

So, let's take a step back and go through a checklist of very important variables to look at when considering and evaluating a stock. While there are also many qualitative factors to look at, this checklist is a great starting point.

Strong and growing free cash flow generation

Earnings can be misleading, as they are affected by many non-cash items, such as depreciation, amortization, and depletion, all of which can be subjective to a degree because they depend on assumptions, and this can lead to manipulation by management.

There is less room for manipulation with cash flows, so investors should start there when evaluating a company. But more than this, we need to consider the capital investment that goes into a business as well. This brings us to free cash flow, which is defined as operating cash flow minus capital expenditures.

CGI Group Inc. ([TSX: GIB.A](#))([NYSE:GIB](#)) is a good example of a company that has generated plenty of free cash flow in the last five years. In 2017, CGI generated free cash flow of \$1 billion, which is more than double the company's free cash flow in 2013.

This cash flow has served to improve the company's balance sheet and fund growth via organic methods and various acquisitions over the years.

By contrast, negative free cash flow is a warning sign because it basically means that the company is spending too much money to generate those earnings. This is not sustainable.

Strong balance sheet/manageable debt levels

We all know that in our personal financial lives, too much debt is risky. The same goes for companies.

Every individual and every company must have room and flexibility in their balance sheets to cover the hard times and ensure sustainability. Appropriate debt levels depend on the industry that a company is in, because some industries are, by their very nature, more capital intensive.

In 2015, **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) was on a path that was dangerous, even though the stock price was flying high at over \$300 per share. The company was embarking on its aggressive acquisition strategy that even a debt-to-capital ratio of 70% and a debt-to-EBITDA ratio of over six times could not stop.

Fast forward to today, the stock is trading under \$25, and the company has been embarking on an aggressive divestiture program to stay afloat.

Reasonable valuations

Generally, we should stay away from those companies that are priced for perfection. High valuations make the risk-versus-reward dynamic of a stock less attractive. The [higher the valuation](#) on a stock, the higher the growth rate that the company must maintain to support the stock price.

Canopy Growth Corp. ([TSX:WEED](#)) has a three-month return of -18.1%.

It is clear that Canopy is in a very promising and lucrative business, but the valuation is definitely one problem with the stock, which is trading at 73 times price to sales.

High shareholder returns

A company that is focused on shareholder returns is aligned with your interests. Look out for companies that are growing simply for the sake of growing and companies that are making decisions that are too short-term oriented.

Companies that have consistently high returns on equity are generating real value that investors can hang their hats on.

CATEGORY

1. Investing
2. Tech Stocks

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1. NYSE:BHC (Bausch Health Companies Inc.)
2. NYSE:GIB (CGI Group Inc.)
3. TSX:BHC (Bausch Health Companies Inc.)
4. TSX:GIB.A (CGI)
5. TSX:WEED (Canopy Growth)

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Date

2025/07/22

Date Created

2018/02/20

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