Warning: If You Own goeasy Ltd. (TSX:GSY) Shares, Then You Gotta Read This

Description

I'm generally a pretty big bull on **goeasy** (TSX:GSY), which has quietly grown into one of Canada's top non-prime lenders.

Growth has been fantastic, with earnings per share increasing by 22% annually since 2001. The company recently surpassed a $1 billion loan portfolio. It has also expanded into two big markets it traditionally hasn't served: car loans and mortgages secured against real estate. Adding these to the company's main line of business — unsecured loans — give it the potential to be a true powerhouse.

Despite this growth, goeasy shares trade at a downright decent valuation. The company earned $3.78 per share over its last four quarters. Shares currently trade hands at a little more than $45 each. That gives the stock a price-to-earnings ratio of just 11.9.

Analysts are even more bullish for 2019, predicting earnings will increase to $5.35 per share. That gives shares a forward P/E ratio of just 8.4. It's not often investors can buy a growth stock for that kind of valuation.

But at the same time, it's useful to take a closer look at situations like this. The market isn't stupid. There's a reason why goeasy trades at such a low valuation. It's obvious investors see some major red flags here.

Let's take a closer look at the bear case. These risks, if not properly managed, could cause an investment to end in tears.

Lender-of-last-resort stigma

Folks desperate for short-term cash used to go to payday loan places — companies that would charge 25% interest on a loan for just a week or two.

The payday loan industry has been permanently crippled today, thanks to various pieces of legislation introduced at the provincial level. Rates have been capped and customers can't extend loans indefinitely.

Now that the payday loan industry has been contained, some politicians are beginning to focus on goeasy and its loan of last resort. Although goeasy's product is much better than a traditional payday loan, it's hardly a good deal for the average consumer. The annual interest rate is as high as 46%, which doesn't include costly add-ons like loan-protection insurance. This insurance is optional, but critics contend goeasy employees push it as if it's mandatory.

Although these loans are well under the criminal rate of interest — which is currently 60% in Canada — the company is starting to generate some pretty negative attention. Just one bill reducing the criminal rate of interest in Canada could hit goeasy hard.

A bill doing just that was introduced in the Canadian Senate in 2017. Bill S-237 would lower the criminal rate of interest to the current Bank of Canada overnight rate plus 20% for consumer loans, while keeping the current limit for business loans. Fortunately for goeasy shareholders, this bill doesn't seem to have much support, at least for now.

The bottom line

The overall point is this: a company that charges high interest rates for unsecured loans will never be popular. goeasy shareholders are already well aware of this, of course.

This unpopularity is bound to increase, especially as the company's impressive growth continues to make headlines. This just increases the risk of politicians passing some sort of consumer protection law that does major damage to goeasy stock.

This is why shares trade at just 8.4 times forward earnings.

I'm not saying investors should avoid owning shares just because some bill might be introduced in the future. Perhaps buying just a small position would be prudent. Or maybe a hard stop loss to protect capital should be implemented.

Just remember, this risk exists. That's the important message to get from this article.

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