Recession Risk: This 1 Vulnerable Stock

Description

If a recession comes to Canada, there's going to be some carnage. Canadian citizens, as well as the federal and provincial governments, have been on historic spending binges which have resulted in the accumulation of massive piles of debt that are not being addressed to any meaningful degree. If there is an economic downturn, there is a very good chance that this balance sheet fragility will spell hard times for consumers.

In Canada, people have taken on massive amounts of leverage to purchase assets. When everything is working well, you feel like a genius. When the economy goes wrong, well, things can go downhill in a hurry.

It might be prudent, therefore, to stay away from lenders with a Canadian focus, at least until debt levels begin to come down. As long as Canadians are highly leveraged, there is an innate risk in these stocks that depend on lending to the overburdened population. **goeasy Ltd.** (TSX:GSY) is one lender that might be under pressure if the economy starts to fail.

But everything is looking great!

goeasy started out as a company primarily focused on lease-to-own furniture. In the beginning, this business represented the majority of the company's earnings and revenue. In recent years, GSY has become more focused on the less capital intensive, higher-margin lending business that has helped the company grow considerably in recent years.

It's true that this company has been posting impressive results over the past few years. GSY has had a compound annual growth rate of 12.7% since 2001. In Q4 2018, it reported an impressive 29% increase in revenues over the same quarter a year earlier. Operating income increased by 44%. These are impressive numbers which are hard to deny.

It has also been posting some impressive dividend growth. Currently, the yield on GSY sits at 2.79% — a decent yield from a growing company. But it is the growth rate that is more impressive. In the latest quarter, the company increased its dividend by 38%, an astounding increase that speaks to management's confidence in its financial performance and future growth.

If the numbers are so amazing, then what's the problem?

My biggest concern is that this company is making loans to people at very high interest rates. On the company website, unsecured personal loans of up to $15,000 are being advertised at rates starting at 29.99%. Even secured personal loans charge rates starting at 19.99%. Maybe people are paying these loans off now, but what happens if jobs start getting cut or housing prices fall?

Further, why are people taking these high-interest loans when rates are still near all-time lows? It worries me that more people are willing to take out loans at these rates. This simply means that they cannot secure funding from more mainstream institutions like the banks, as the loans are too small or too risky to bother with. Goeasy advertises that they say yes to borrowers when the banks say no, which is inherently risky.

Of course, GSY focuses on small amounts at high rates of interest, which means that their risk is spread over numerous borrowers, therefore seemingly reducing risk. Unfortunately, a broad-based recession might negatively impact this company if many borrowers are suddenly unable to meet their obligations.

So what should an investor do?

Ultimately, it comes down to your belief that a recession is on the horizon. If you believe that the economy could tank some time in the near future, it's probably best to stay away from goeasy. But if you believe that the Canadian economy is firm, this is a high-growth stock and the numbers have been fantastic. At the moment, I think the recession risk is a bit too high to step into a stock like goeasy.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
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TICKERS GLOBAL

1. TSX:GSY (goeasy Ltd.)

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Date
2025/08/16
Date Created
2019/03/08
Author
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