Warning: These 2 Stocks Have Dangerous Levels of Debt

Description

Nearly every company uses some leverage to boost performance. Borrowing money to invest in productive assets isn't necessarily bad. However, if the debt burden grows larger than annual earnings or the book value of the company's equity, the situation becomes decidedly unsustainable.

Stocks with an unsustainable amount of debt are probably the riskiest ones on the market. A sudden rise in interest rates or a sudden drop in earnings could push these companies over the edge and destroy shareholder value.

Here are two stocks that seem to be dealing with such a situation:

Just Energy

Providing utility services is usually a stable business, making it easier for companies in this industry to borrow extraordinary amounts. However, Mississauga-based natural gas and electricity provider **Just Energy Group** (TSX:JE)(NYSE:JE) seems to be overdoing it.

According to its latest filing, the company's long-term debt burden is worth $774.9 million. Meanwhile, the company's total market capitalization is $324 million at the time of writing.

In other words, debt is worth *twice the company's market value*. Debt is also four times greater than operating annual earnings.

There's no doubt that the company is in a tight spot, but management is stepping in to turn the ship around. "I continue to work with the Board and the Special Committee on a robust strategic review process and getting the best outcome for Just Energy's investors," said Founder and Executive Chair Rebecca MacDonald in a statement last year.

Meanwhile, the stock has lost over half its value in 2019 and has been the target of some notorious short sellers. This isn't a stock for the faint of heart.

Advanz Pharma

Supplying specialty pharmaceuticals is a complicated and risky business. Adding debt to the mixture is probably worse. **Advanz Pharma** (TSX:ADVZ) seems to have struggled with debt enough in the past to implement a recapitalization last year and rename the company.

However, the company still holds $1.34 billion in debt on its books, which is 7.6 greater than its market capitalization. Unsurprisingly, the company has been shedding market value despite the corporate restructuring last year. Over the course of 2019, it lost 86% of its value.

The company seems to be pinning its hopes of revival on its development pipeline. There are seven medicines on its portfolio for potential future launches.

However, in my experience, getting drugs to market is notoriously difficult, expensive and time-consuming. And time is a luxury Advanz Pharma doesn't appear to have.

All signs indicate that this is a company in terminal decline.

Bottom line

Corporate debt isn't inherently bad. In fact, some of the best companies in the world use leverage in clever ways in order to create value for shareholders over the long-term.

However, when the debt burden is multiple times annual cash flow or the market value of the entire company, that's a gigantic red flag for investors.

While some investors may still consider these stocks as contrarian or speculative bets that can deliver unbelievable returns with any positive catalyst, I, personally, would rather stay away and invest in reliable growth or high-yield dividend stocks.

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