Looking to Buy Canadian Stocks Today? Here Are 5 Ratios to Help Mitigate Your Risk

Description

Throughout the first half of 2022, uncertainty has increased significantly, which means that the risk in markets has also increased considerably. Therefore, several of the best Canadian stocks you can buy have fallen in value, as investors are worried about the potential for an economic slowdown later this year or potentially even in 2023.

It's always crucial to manage your risk and do a tonne of research before making any investment. However, it's even more important in this environment.

If you're looking to limit your risk and ensure each of your stocks is well positioned for the current environment, here are five of the most popular ratios that can help you manage your risk.

The interest coverage ratio is crucial to consider before you buy Canadian stocks

Almost every company has debt, so it's crucial for investors to ensure that the debt is manageable. In many cases, debt is positive, because companies use debt to leverage their operations and increase their return on equity.

However, when companies underperform, or the economic situation worsens, debt can often get companies into trouble. So, the first ratio you'll want to consider is the interest coverage ratio.

The interest coverage ratio is calculated by taking a company's earnings before interest and taxes (EBIT) and dividing it by its annual interest expense. This shows how easily a company can pay off its interest. A lower number means it's harder for the company in question to meet these financial obligations.

Debt-to-equity ratio

Sticking with debt, another critical ratio to consider is the debt-to-equity ratio.

Having enough cash flow to pay interest is one thing, but managing total debt is another. This is why it's crucial to see how much debt a company has on its balance sheet compared to how much equity there is.

It's also important to note that you'll have to compare stocks by their industry, as some industries tend to take on more debt than others. In general, though, ensuring that a company's debt isn't growing too fast compared to its equity is crucial for managing long-term risk.

Debt-to-EBITDA ratio

Perhaps the most important debt metrics are those that compare total debt to earnings, such as the debt-to-EBITDA ratio.

Not only will a company's earnings be crucial for managing debt, but often many companies have debt covenants, and debt to EBITDA is typically one of the most important. Therefore, because these companies get their credit ratings based on these metrics, it's crucial to ensure that EBITDA levels are high enough and aren't under threat of having debt covenants breached.

When companies breach their covenants, it often means a downgrade in credit ratings, which can be a significant problem for the business going forward and will almost certainly impact the share price.

In fact, one of the reasons that **First Capital REIT**, one of the best REITs in Canada, trades so cheaply is because it got into trouble over the last few years, and investors were worried that its debt covenants might be breached.

The quick ratio can be crucial to check before you buy Canadian stocks

There are several other ratios you can use to analyze a company's risk. One of the most basic ratios is the quick ratio, which looks at a company's current assets minus its inventory and compares it to its current liabilities.

A number below one would indicate that the company could have a liquidity issue and may have trouble paying its upcoming debts.

Payout ratio

Lastly, one of the most important ratios to consider, especially if you're looking to buy Canadian dividend stocks, is the payout ratio. The payout ratio tells us how much of a company's earnings it's using to fund its dividend. It's one of the simplest ways to analyze how easily a company can continue to pay its dividend.

This is a crucial ratio, but it can be different by industry depending on the accounting that's used. For example, if you're analyzing REITs, you would likely use the REITs' funds from operations to calculate the payout ratio. With bank stocks, though, it's more accurate to use earnings per share.

So, if you're looking to buy top Canadian dividend stocks, the payout ratio is one of the most important factors to research.

CATEGORY

1. Investing
2. Stocks for Beginners

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Quote Media
6. Sharewise
7. Smart News
8. Yahoo CA

PP NOTIFY USER

1. danieldacosta
2. kduncombe

Category

1. Investing
2. Stocks for Beginners

Date
2025/08/05
Date Created
2022/06/11
Author
danieldacosta