Sell Alert: These Previously Great Canadian Companies Will Sink Your Portfolio

Description

I've been spending an exorbitant amount of time recently exploring the health of companies' balance sheets. These are metrics I always consider before investing in a company.

However, I see balance sheet stability as more important now than ever. This is because the recent market volatility we saw in the first quarter. Companies with weak balance sheets were punished to a much larger degree than those showing pristine numbers.

In this article, I'll highlight two companies I think have too much balance sheet weakness right now in this economic environment and should therefore be avoided by investors.

BRP Inc.

Formerly Bombardier Recreational Products, **BRP Inc**. (TSX:DOO) has exhibited some of this outsized volatility in its stock price of late. Despite an impressive rebound from March lows, the company's business model is obviously highly susceptible to recessionary headwinds.

The idea that consumers will not dish out thousands of dollars for recreational toys when unemployment shoots through the roof is not a difficult one to understand. The fact that this company's share price has rebounded to the degree it has remains baffling to me.

It appears investors are banking on Sea-Doo riding increasing this summer. After all, folks may be looking for a way to have fun while safely socially distancing. The company's earnings have not shocked investors yet. Sales appear to be better than most analysts have anticipated.

That said, betting on highly discretionary non-essential consumer spending to pick up does not seem to be a very safe or logical bet right now.

Also, the company's debt is very high — a factor which makes its valuation untenable for me. BRP's valuation, in the context of its debt load and current balance sheet state, is one which does not make sense.

At more than three-times EBITDA, BRP'S debt load is sufficiently high to warrant significant investor scrutiny at this point. This is a company I would encourage investors to exhibit extreme caution with at this point in time.

Interpipeline

In the pipeline space, **Interpipeline Corp.** (TSX:IPL) is my least favourite of the Canadian energy infrastructure companies right now. This is due in large part to balance sheet uncertainty.

Inter Pipeline is prone to the headwinds the entire energy infrastructure space is facing. Low commodity prices his led to increased concern around counterparty risk in the sector. With atypical cash flow uncertainty facing this sector broadly, the backdrop behind energy infrastructure companies ought to be painted in a pessimistic light.

There is a key differentiator between Interpipeline and its peers. This is what warrants this company making the bottom of my list of pipeline plays. This differentiator is the company's polypropylene facility it is planning to build in Alberta.

Interpipeline's priorities differ from its peers

This multi-billion-dollar project has been an overhang for some time. Investors have begun to worry about the financial impact this plant will have on the company's balance sheet. Selling high-quality assets or issuing a large amount of debt right now is not what investors generally want to see.

While many of Interpipeline's peers have been paying down debt, Interpipeline could be on the outside looking in, if investors show their disdain for this move through continued selling.

Interpipeline's dividend cut

The company's dividend cut of around 70% in April was one move the company made to shore up cash but is one I view as a big negative for long-term investors. Cutting distributions to shareholders in favour of building a costly plant with little in the way of cash flow certainty over time, at a time like this, is not good optics.

Many investors buy companies like Interpipeline for income only. Such investors have likely been turned off and are unlikely to invest moving forward. A yield of 3.5%-4% may seem attractive. However, when one considers the dividend distributions of other high-quality peers in the sector, Interpipeline soon loses its attractiveness.

It may be that the company's polypropylene business will turn out to be a huge cash flow machine. However, the short-term strain this investment will place on the pipeline operator's balance sheet is unnerving to me.

This is also not the company’s core business. Generating market-beating cash flow results from said business will therefore prove difficult to forecast.

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