The Beaten-Down Stock Billionaire Investor Prem Watsa Continues to Buy

Description

Like many Canadian investors, I took the time to read billionaire investor Prem Watsa's annual shareholder letter, and I'd suggest you add it to your reading list too.

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The founder, chairman, and chief executive of **Fairfax Financial Holdings** (TSX: FFH) talked about all sorts of interesting stuff, including the risk of a credit bubble in China, overvalued North American equity markets, and outrageous valuations for stocks like **Amazon** and **Tesla**.

Watsa is relatively bearish on equity markets in general, and has made a huge bet against them going forward. In 2013, Fairfax lost more than $1 billion on poorly performing derivatives even though stock markets performed well. Watsa remains confident in his bet going forward, and in the meantime will continue to buy large positions in stocks that he likes.

Last week, Watsa announced an investment in one of the stocks he's bullish on. On the surface, Watsa's love of the name is confusing. This company is in a declining industry. It lost money in 2013 on decreased revenue. It currently pays a 9% dividend, which is high enough that the market isn't confident in its viability going forward. This company just doesn't seem like a good place to invest.

And yet, Watsa bought an additional 2.385 million additional shares, boosting his ownership stake up to 23% of the company. What exactly does the billionaire investor see in **Torstar** (TSX: TS.B) that has him investing millions in the name?

The publisher of the *Toronto Star* newspaper is trading at multi-year lows, falling all the way from an all time high of $30 to current levels at around $6. Revenue keeps persistently going down, even though the company a put a $10 per month paywall on its newspaper's website. Torstar did record a loss in 2013 of 35 cents per share, but that was because of asset writedowns. If you exclude the writedowns, profit was 53 cents per share.

Analysts are expecting a profit of 92 cents in 2014, giving the company a forward P/E of just over 6x. Considering Torstar also trades at a 40% discount to book value, it starts to become obvious why

Watsa is interested in the company. How many other companies trade at such discounts? If you compare Torstar to its main rival **Postmedia** (TSX:PNC.B), the comparison isn't even close. Postmedia isn't profitable, has a worse balance sheet, and doesn't even pay a dividend.

The future doesn't look horrible either, at least in the short term. Because *The Star* is Toronto's most popular paper — even beating out national rivals in total circulation — it's levered to news activity in its home market. There's no sign of this activity slowing, as Rob Ford's antics probably aren't going away. There's also the the buildup to October's municipal elections, which is bound to pique the interest of the public.

Even the lofty dividend is safe, at least for now. Even if the company can't even get close to analysts' 2014 earnings projections, there's still a large margin of safety between that number and the dividend. Last year was Torstar's worst since the financial crisis, and there was still easily enough cash flow to make sure shareholders got paid.

There are a couple of issues that should concern investors. One is the book publishing division, which continues to show weakness. Sales of the division's main product, Harlequin romance novels, have struggled thanks to e-books and the popularity of other offerings. The vast majority of the division's sales come via paperback, which does present opportunities for higher margins if the company can convince people to read using their e-readers.

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And secondly, the company's debt is a little concerning. It continues to pay down its obligations and easily earns enough to cover the interest, but if earnings decline for any sustained period of time, investors can wave goodbye to that sweet dividend.

Foolish bottom line

Watsa didn't become a billionaire by making foolish investments. Torstar is beaten up, but trades at attractive valuations. It pays a generous dividend, is a leader in its industry, and owns a compelling portfolio of websites. Interest in Toronto politics should continue to be strong in the near term, which should convince some people to shell out $10 a month to read all the articles. Torstar is an interesting value play, even if it's a newspaper.

CATEGORY

1. Investing

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1. TSX:FFH (Fairfax Financial Holdings Limited)
2. TSX:TS.B (Torstar)

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