Are DHX Media Ltd.'s Days as an Independent Media Company Over?

Description

Whenever a company announces it's seeking strategic alternatives, it's usually considered investment-industry jargon for putting itself up for sale. Often, when this type of news hits the wires, a stock's price goes up as investors speculate on the ultimate purchase price.

This is not so for **DHX Media Ltd.** (TSX:DHX.B)(NASDAQ:DHXM).

It announced October 2 that it was seeking strategic alternatives, and its stock gained on the news. Unfortunately, the gains didn't last as its share price lost 8% in the next day's trading and closed at a little over $5, putting DHX Media's current enterprise value at $1.4 billion, which includes $749 million in long-term debt and $62 million in cash.

How much will somebody pay?

DHX Media had an operating profit of $41 million in fiscal 2017 on $299 million in revenue. However, after subtracting its interest expense on its long-term debt and income taxes, it lost $3.6 million, or three cents a share, down from a profit of $27.7 million, or $0.22 a share. On an EBITDA basis, it made $45 million in 2017, 33% lower than a year earlier.

So, its enterprise value is currently 31 times EBITDA and 4.7 times revenue, neither of which is very appealing as a standalone company.

However, the deal it made in May to acquire the *Peanuts* business for US$345 million should be the carrot necessary to get possible suitors to open their wallets beyond its current share price. Remember, as recently as September 19, before it announced disappointing fourth-quarter earnings, DHX Media's stock was trading around $7.33, or 44% higher than where it is today.

Will somebody pay $7.33 per share or higher for DHX Media's stock? I believe so.

Disney leaves Netflix

The situation might look bleak for those investors who'd bought two weeks ago, but **Walt Disney Co.'s**

(NYSE:DIS) announcement in August that it will pull all its movies from **Netflix, Inc.** (NASDAQ:NFLX) is good news for the company. Opting to carry its content in the U.S. using a direct-to-consumer streaming service, it's launching sometime in 2019 and expanding here in Canada after that. This will create a big hole in Netflix's children's programming, one that its *Peanuts* acquisition will allow it to fill.

Add to this the deal recently announced by the federal government with Netflix that will see the video streaming service spend at least $500 million over five years on original Canadian productions, and you've got a potentially profitable double whammy for DHX Media.

On the company's fourth-quarter conference call on September 28, DHX Media executive chairman Michael Donovan is said to have been very enthusiastic about the state of children's programming today.

"The price per episode for some programming has jumped recently after being virtually unchanged for about 20 years," the *Canadian Press* reported Donovan saying to analysts. "I have been in this business for 37 years and it has never been this positive."

DHX Media's financial situation is not immediately dire, as it's still generating positive EBITDA, and that's without any revenue or earnings from the Peanuts acquisition, which closed June 30, 2017, the company's last day of its fiscal year.

As I suggested back in May, the *Peanuts* deal will increase its annual revenue by 52% to $443 million and adjusted EBITDA by 40% to $134 million, and it's immediately accretive to earnings. These new numbers bring its enterprise value down to 10.4 times EBITDA and 3.2 times revenue, both much more reasonable for current and future investors.

Bottom line on DHX Media stock

I thought DHX was a double-digit stock four months ago when I discussed the *Peanuts* deal. Despite poor results, I believe the search for a buyer will bear fruit in the way of a substantial premium on its currently discounted share price, or the company will produce better results in the first and second quarters, delivering the same effect while remaining independent.

Either way, I don't see anyone stealing DHX Media's good name and assets from under it. Therefore, patient investors who buy at these levels will be rewarded shortly.

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