How Low Can DHX Media Ltd. Go?

Description

It's not a list that you want to end up on, but that's what happened to **DHX Media Ltd.** (TSX:DHX.B)(NASDAQ:DHXM) last week when it was named by the *Globe and Mail* as one of the TSX's most oversold stocks down almost 11%.

Ouch.

To say it's not been a good year for long-time DHX shareholders is an understatement. Starting 2017 with a market cap just shy of $1 billion, it's now $554 million, falling $54 million last week alone.

It's this evaporation of market cap that's forced the company to explore strategic alternatives, including selling itself to any or all bidders. It seems so long ago that DHX Media announced it had acquired 80% of the *Peanuts* and *Strawberry Shortcake* characters from **Iconix Brand Group Inc.** (NASDAQ:ICON), but it was only this past May.

Consider the timeline

When I wrote about DHX Media's big acquisition in May, its stock was trading around $6.35 per share. Then in mid-September, Fool contributor Jason Phillips wondered if the company could be a takeover target after **Disney's** decided to drop its programming from **Netflix** to put on its soon-to-be launched video-streaming service. At a market cap of $700 million and a share price of $6.70 for DHX Media, Phillips was convinced DHX Media was an attractive buy for a larger studio.

His assessment was good, but his timing wasn't — no fault of his own.

Almost two weeks later, the company announced its fourth-quarter results, and they were disappointing.

"Management was disappointed with the results for Q4 and Fiscal 2017 overall," said Dana Landry, CEO of DHX Media. "*Teletubbies* in the U.S. market has underperformed, and execution on the content side of the business did not match the tremendous opportunity in the kids' and family content market."

Investors never like to see the words “disappointed” in an earnings release. In two days trading after delivering weak results, its stock dropped from $6.37 to $5.03 — a 27% decline. Since the strategic review announcement on October 2, it’s walked itself down to the low $4s.

Where to next?

It’s hard to imagine DHX Media falling much further.

The TSX hit a record high October 27 of 15,951 — its highest level since February. With oil prices rising, a surefire way to keep the index moving higher, there seems to be few headwinds to worry about.

However, without a catalyst to move it higher, the upside seems limited for now. That being said, it is working on cutting costs.

In its Q4 2017 report, it said its cost-reduction program had reduced SG&A expenses by $3 million annually with another $3 million expected within 12 months. That goes right to operating profits, but investors won’t know the exact amount until sometime in calendar 2018.

As for cost synergies from the *Peanuts* acquisition, DHX expects to obtain $5 million in year one and $25 million by the fifth year post-acquisition. Those also pad the bottom line.

From an acquisition perspective, the fact that it’s already done much of the heavy lifting finding cost efficiencies will make it more attractive to potential suitors.

Bottom line on DHX Media’s stock

In early October, after the company announced its strategic review, I believed DHX stock was trading a significant discount to what it’s worth. Patient investors would be rewarded shortly. Since then it’s dropped another 15%.

How low can it go?

Well, it’s already traded below $4, so I’d say $3.50 is possible in the next month. If the overall markets suddenly reversed course, which seems unlikely at this point, it could even test $3 by the end of the year.

Although they say never to catch a falling knife, I see good profits for anyone willing to endure the short-term risk of the next three to six months. By this time next year, it either will be acquired or achieving better quarterly results.

Use the uncertainty to your advantage.

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Date
2025/06/29
Date Created
2017/11/02
Author
washworth