Why Has Stars Group Inc. (TSX:TSGI) Crashed More Than 20% in the Past Month?

Description

Stars Group Inc. (TSX:TSGI)(NASDAQ:TSG) has been one of the top stocks on the TSX for much of the past year. However, lately the stock has been struggling. In just the past month, the share price has declined by over 20% and it is well down from its high of over $51 that it reached back in June.

What's behind the big drop in price?

There look to be a couple reasons for the decline. The first is that in mid-July, the company announced that it would be issuing 52 million common shares in order to convert all of its convertible preferred shares. Issuing more common stock, whether to fund an acquisition, for a conversion, or whether it is just to get more cash, will put downward pressure on price as there will be more sellers on the market.

In addition, Stars Group also released its quarterly results earlier this week, which sent the stock down even further. While the company continued to show strong growth with revenues climbing by 35%, Stars Group posted a big net loss of over US$154 million.

Why did Stars Group have such a bad quarter?

The company's operating income was barely US$1 million after operating expenses wiped out nearly all of the gross profit. General and administrative expenses soared from just US$110 million a year ago up to US$263 million, more than doubling the prior year's total. Sales and marketing expenses were also up more than US$20 million, but that pales in comparison.

While Stars Group did not specifically mention the cause behind the rise in general and administrative expenses in its earnings release, we do know that it has been busy with some acquisitions lately, and the company did note acquisition-related costs of over US$96 million for the quarter.

Net financing charges of US$160 million were also incurred this past quarter and came below the operating line, putting the company into the red.

Should investors be concerned?

The biggest concern that I would have about Stars Group and its recent results would be how much work the company still has to do to clean up any inefficiency as a result of its recent acquisitions.

Even if we were to assume acquisition-related costs were responsible for the increase in general and administrative expenses, and if we back out the portion that related to the new Australia segment (US$40 million), we would still be left with an increase of US$17 million, or 15% from a year ago. And that still doesn't factor in the increase in sales and marketing expenses.

The danger with expanding is that a company picks up inefficiencies along the way, and it'll take time to eliminate those. However, the good news is that there is still a lot of upside for Stars Group given the opportunities that exist not only as a result of its recent acquisitions, but also because sports betting looks to become legal across several U.S. states.

Stars Group is a great buy despite these disappointing results, and investors might want to consider picking up the stock at its reduced price.

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