Are You Toying With Buying Fairfax Financial Holdings (TSX:FFH) Stock?

Description

Fairfax Financial Holdings (TSX:FFH) stock has nowhere to go but up.

That's what I said about the holding company's stock in early May. Over the next six weeks, it went from $705 to $788.88, reaching an all-time high on June 15. And then it retraced all of those gains over the rest of the summer.

As I write this, it's trading below $690, its lowest level since April. Year-to-date through September 6, it has generated a 5.8% total return for its shareholders. Over the same period, **Berkshire Hathaway** has a 9.3% total return, which is 60% better than Fairfax.

As I stated in May, Fairfax's CEO and founder Prem Watsa was taking the shackles of his holding company, putting its significant cash resources to work — $2.4 billion at the end of 2017 — to grow its book value per share by 15% annually over the next five years.

For its book value per share to get from $454 today to $1,000, Fairfax needs to grow by 17.5% annually over the next five years, 250 basis points higher than its 15% goal.

Not to worry. Since 1985, Fairfax's book value per share has grown 19.5% annually, so there's every reason to believe that it will meet and exceed its goal.

Toying with buying FFH

As you may be aware, Fairfax acquired the Canadian operations of Toys 'R' Us Canada out of bankruptcy for $300 million in June. Because of its relationship with its now liquidated U.S. parent, it was forced to seek creditor protection here in Canada despite its profitability.

Fairfax, having several retail businesses under its umbrella (Golf Town, William Ashley China, Sporting Life, among others), didn't hesitate to get its hand on the toy retailer.

Toys ‘R’ Us Canada generated $1 billion in annual revenue in 2017 with $100 million in operating income and continues to generate positive free cash flow to reinvest in its business.

Here in Canada, the toy market is relatively healthy.

“The Canadian market managed to outpace many other global regions thanks to a boost in e-commerce spending and the strong performance of several Canadian toy companies,” Michelle Liem, former director of toys, video games and movies at market research firm the NPD Group, said in a 2017 report on the global industry’s performance.

“Canadian companies like **Spin Master** and WowWee [founded in Canada, but headquartered in Hong Kong] made strong contributions to the market with top selling toys including Hatchimals and Fingerlings, which helped contribute to the overall strong growth of the Canadian toy industry.”

The problem, not unlike the situation encountered at Sears Canada, is that Toys ‘R’ Us’ U.S. parent was taking all the profits the Canadian operations were generating, choking off the funds necessary to build an omni-channel shopping experience.

With Fairfax’s hands-off approach, I can see its Toys ‘R’ Us investment paying for itself in 3-5 years.

Like Golf Town, Toys ‘R’ Us is a niche retailer serving a specific demographic. It won’t matter that people don’t have as many kids today. What matters is that parents who do have kids will know where to go to get a Made in Canada experience.

That’s something you can’t put a price on.

If you’re toying with the idea of buying Fairfax stock, anywhere below $700 is a good buy.

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Date
2025/08/18
Date Created

2018/09/10
Author
washworth