2020 Recession: This 1 Stock Could Tank!

Description

Spin Master (TSX:TOY) is involved in the children's entertainment industry and it creates, designs, manufactures, and markets a portfolio of innovative toys, games, products, and entertainment properties. The company's three reportable operating segments include North America, Europe, and the rest of the world.

The company reported a market capitalization of $4.06 billion with a 52-week high of $46.61 and a 52-week low of $34.82. The stock has been volatile in recent years.

Intrinsic price

Based on my calculations using a discounted cash flow (DCF) valuation model, I determined that Spin Master has an intrinsic value of $19.93 per share. Assuming less-than-average industry growth, the intrinsic value would be $19.24 per share, and higher-than-average industry growth would result in an intrinsic value of $20.71 per share.

At the current share price of $39.75, I believe Spin Master is significantly overvalued. Investors looking to add a toy-manufacturing company to their TFSA or RRSP should avoid Spin Master at current prices. Given a bear market in 2020, there may be opportunities to buy the stock at less than intrinsic value.

Spin Master has an enterprise value of $2 billion, which represents the theoretical price a buyer would pay for all of Spin Master's outstanding shares plus its debt. One of the good things about Spin Master is its low leverage with debt at 0% of total capital versus equity at 100% of total capital.

Financial highlights

For the nine months ended September 30, 2019, the company reported a mediocre balance sheet with US$11 million in negative retained earnings (although this is substantially up from negative US$92 million as at December 31, 2018). Negative retained earnings are not a good sign for investors as it suggests the company has experienced more years of cumulative net loss than net income.

Despite this, the company's cash balance is strong at US$151 million. With no long-term debt, the company is able to use the cash for other purposes, such as growing the business or finding operational efficiencies.

It should be noted that the company reported no long-term debt. This is a very impressive feat, as it suggests the company has been funding growth with internally generated cash.

Overall revenues are down from US$1.2 billion in 2018 to US$1.1 billion in 2019. With relatively flat operating expenses, the company's pre-tax income decreased materially from US$194 million in 2018 to US$110 million in 2019 (-44%).

In August 2019, the company acquired all the issued and outstanding shares of The Future Trends Experience Limited for cash consideration of US$9.4 million. This has given the company licensing and production rights for various editions of Hedbanz, a kid-friendly board game, which helps to grow Spin Master's offerings.

Foolish takeaway

Investors looking to buy shares of a toy manufacturer should avoid Spin Master. With negative retained earnings and decreasing revenues year over year, Spin Master is in for rough times ahead, especially with a looming recession. Fellow Fool Kay Ng believes Spin Master is a good investment.

Although the company is financially solid with no long-term debt and an adept senior management team focused on business growth through internally generated cash, I still believe at the current share price of $39.75, it trades at a premium compared to an intrinsic value of $19.93.

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