COVID-19 Casualty: 1 Cheap TSX Stock to Buy for the Long Term

Description

As the equity market remains fragile amid the COVID-19 outbreak, some stocks are getting hammered more than the others. One such stock is **Spin Master** (TSX:TOY), which is under immense selling pressure. The Spin Master stock has corrected about 66% since it announced the fourth-quarter results earlier this month. Moreover, the stock is down about 75% year to date and is trading nearly 44% lower than its IPO price of $18.

Why did the Spin Master stock plunge?

Part of the problem has been the company's weak financial performance. The decline in sales, margin contraction, and the tepid outlook is taking a toll on Spin Master's stock price. Spin Master posted a 1% decrease in gross product sales in 2019, which led to a 3.1% decline in revenues. Margins came in weak with the gross margin and adjusted EBITDA margin contracting by 60 basis points and 480 basis points, respectively. Meanwhile, adjusted net income fell about 43% year over year.

Making matters worse, management expects gross product sales to continue to stay low in 2020 and decline in the mid-single-digit range. Notably, the guidance excludes the negative impact of the COVID-19 outbreak. Including the supply-chain disruption from the COVID-19, Spin Master's gross product sales are likely to go down further.

Investors should note that Spin Master has its manufacturing base in China, which produces about 60% of its goods. With the COVID-19 outbreak, the production flow is taking a hit and not operating at full capacity. Management warned that its second-quarter shipments in particular are likely to take hit from COVID-19, which in turn will affect its gross product sales.

Attractive long-term play

The decline in the Spin Master stock is due to good reasons. However, with the sharp fall, Spin Master stock is trading cheap with negatives priced in. The stock is an attractive long-term play, as the production flow issue is transitory, and revenues will return to growth beyond 2020.

China has successfully managed to contain the epidemic statistics, which implies that production flow will normalize soon. Also, the company is diversifying its procurement activities beyond China with new manufacturing capabilities in India, Vietnam, and Mexico.

Barring near-term headwinds, Spin Master is likely to benefit from its innovative and robust product line. It's fair to call Spin Master an integrated children's entertainment company rather than just a toy company. The company's diversified portfolio of traditional toys, games, digital toys, and entertainment franchises gives it a competitive advantage over peers. For instance, Spin Master's gross product sales fell by 1% in 2019, as compared to a 3% decline in the industry.

Though sales are likely to remain muted in 2020, the adjusted EBITDA margin is expected to be in line with 2019, which is comforting. Besides, management expects adjusted EBITDA margins to return to the prior 18% level beyond 2020, thanks to its focus on cost management, operational efficiency, and productivity initiatives.

The Spin Master stock trades at a forward P/E ratio 7.9 times, as compared to the industry average (for recreational products) of 10.1 times. Investors should note that the negative market sentiments could continue to limit the upside in Spin Master stock in the near term. Hence, it's prudent to accumulate Spin Master stock in steps like a systematic investment plan.

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