225 RESEARCH

Corus Entertainment

TSX: CJR.B

Target Price: $10.40
Price at Valuation: $5.36

Implied Upside: 93.98%

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Summary

Corus Entertainment is one of the largest broadcasting companies in Canada, which emerged after a spin out from the old Shaw Communications. The company owns many of the brands Canadians watch everyday, including Global News, W network, Teletoon, YTV, and the Food Network, to name a few. In terms of specialty channels, the company has deals in place where they are granted rights for the Canadian market, including the Cartoon Network, Disney Channel, National Geographic, and the History Channel. This means that it's likely that if you have cable or any television, you have Corus Entertainment's offerings in your bundle. However, Corus isn't just in television, with a large number of radio stations primarily in tier 1 Ontario markets such as the GTA and Ottawa, a large animation and distribution studio in Nelvana, and StackTV, a streaming service that embodies shows from 12 of the company's specialty networks. We believe that fears of the rapid growth of streaming and a more challenging advertising landscape has offered up an interesting value investment opportunity in Corus. The market is currently pricing Corus as a rapidly declining business, which must sacrifice margins in order to slow it's declining top line. We share this belief, in part. We believe that Corus will be able to sustain its current margins while declining top line revenues and a slower pace than expected. In our valuation we found our expectations imply a fair value for Corus at around $10.40/share, representing a 93.98% upside to its most recent price.

About the Business

Corus Entertainment was formed in 1999 as a spin out from Shaw Communications. In 2000 the company began rapidly acquiring local TV channels and networks, completing over 1 billion in acquisitions in 2000. A year later Corus acquired Nelvana, making it a vertically integrated entertainment company, both creating content and delivering it to viewers. Corus has since continued this pattern of acquiring channels, networks and studios to vertically integrate. Today, Corus encompasses 52 TV channels, 3 original content studios, 39 radio stations and a number of digital distribution assets including apps. They also hold the Canadian distribution rights for the likes of Disney, Viacom, and Warner Media, as well as a partnership with Amazon to distribute Corus' StackTV package to prime users.

Going forward, the company is focusing on three core strategies. These strategies include; owning and controlling more content, engaging their audience, and expanding into international markets. To assist with this, Corus has been heavily investing in digital media assets, as well as integrating their advertising model with the introduction of so.da, a wholly owned social digital agency.

Recent Events

<u>May Sell Off</u>- on May 15th, Corus shares slid over 15% just as they started getting going, as a result of Shaw Communications selling out its 39% stake. Since then the shares have been pressured. A move like this did not impact the business at all, rather impacted sentiment and supply and demand of shares. It is, in part, for this reason we see such a radical discount in value for the business.

Key Drivers

Considering Corus is a mature business with a strong position in Canada already, key drivers will likely come from their streaming services, such as Stack TV, and Global TV on the Go.

As far as streaming goes, StackTV is an effort for Corus to get away from subscriber reliance with traditional cable companies like Bell and Rogers, which currently make up 30% of revenues. StackTV has a strong distribution partner in Amazon, allowing them to target prime members. StackTV isn't quite the same as Netflix, with Stack having commercials, however it's seen as a way for customers to have live TV without paying for a full package or TV box like traditional TV.

Content growth as well is an area that Corus is investing in to continue to grow original content, especially children's content. Through Nelvana, continued growth of children's animation should allow more opportunities to partner with other streaming services to distribute their content elsewhere, as well as further vertically integrating the company to fight in the battle of cord cutting.
The Last key driver will be the continued advertising strength at Corus, with 6% Y/Y growth. Advertising is the largest segment for the company and should help negate the headwinds in Radio and Subscriber losses from cord cutting. Another aspect of ad revenue that should help its growth is through connected TV’s and new ad software. These innovations should help deliver advertisers higher ROI on their Ad spend. This growth in ROI should make television advertising more competitive against online, which may help continue the solid Y/Y growth.

Brands

Corus has positioning with some of the biggest known brands in North America, with strong distribution rights.

<u>Kids Brands</u>

Corus has what is almost a distribution monopoly in Canada with popular Canadian channels YTV, Treehouse, Teletoon, and the distribution of Disney Channel, Cartoon Network and Nickelodeon. The only other viable alternatives are streaming services with large amounts of children's content like Disney plus, and Family Channel (owned by Wildbrain). Corus also has plenty of its original content aside from distribution rights for content, through Nelvana and Corus studios.

<u>Large scale</u>

Corus owns Global, which attracts plenty of viewers in the adult section, with the likes of news and popular worldwide shows. The channel is one of the largest channels in Canada and has strong brand recognition. Should we ever see a Canadian government cut funding to CBC, Global will be one of the news channels with a chance to take plenty of market share.

Specialty

Corus has the rights to some of the biggest specialty brands in the US for Canadian distribution, such as Food Network and History Channel. Along with American brands, Corus also owns some of the largest Canadian brands, targeting a desirable audience in middle aged females with W Network and Slice. The distribution of these brands and the shows that come along with them should continue to generate steady subscribers, as many of the shows on these networks are not as common with streaming services like Disney Plus and Netflix. To add to Corus' advantage, these shows and channels usually have fairly loyal watchers because of the specialty nature of the content.

Radio

Although in secular decline, radio still continues to produce strong cash flows for the business, and happen to be in strong markets like Toronto, KW, London, and Ottawa. The company has a steady variety of stations, with many being news and Top 40 oriented.

Competitive Advantage

A major aspect of why we're bullish on Corus is its strong moat in Canadian broadcasting. The Moat is based off of regulations keeping a focus on Canadian content which Corus has, and Corus' large position in TV bundles. Many of Corus' channels are very strong American brands that the company has agreements in place to distribute, along with Canadian channels the company has in almost every cable package. As well, Corus' relationship with telecoms creates an important barrier to entry of new entrants, as well as the high cost to start in broadcasting.

Although Radio is in secular decline, the company has strong networks in core markets that attract consumers. By being in secular decline, it makes for limited new competition coming in the market and has high costs to enter. Attractive acquisition opportunities may arise as the industry continues to slowly decline, that can help to grow the competitive position in the radio business.

External Analysis

The biggest risk to Corus and any other broadcasting company happens to be the gloomy outlook for growth. Ad revenue is somewhat being sidestepped by advertisers with the large growth of cheaper, better targeting online ads. To make matters worse, streaming services and cord cutting is a big threat, especially with more and more millennials bypassing more expensive cable. The market continues to be ruled by larger stations and companies, all of which have the scale and content to survive in a tougher market.

With the streaming wars going on, the larger companies (Netflix, Disney, Amazon) are all making deals to secure content, which makes companies with original content very desirable. This should lead to potential streaming deals, like in the past where Corus has leased rights to Netflix for original content rights. As well, many broadcasters have been trying to get a piece of the action, by starting their own streaming services.

Investment Thesis

The overall thesis is based on 3 aspects- the dirt cheap valuation, the strong free cash flow profile, and the market position the company has in Canada.

<u>Extremely discounted valuation</u> - Corus is trading at ridiculously cheap levels; 30% FCF yields, with debt sub 3x EBITDA, a pathway to GDP like growth in the advertising division and a big market position in Canada. This exceptional discount is provided in part by the Shaw sell off which scared investors away from the business. Currently the business is being valued as if it won't be around in 10 years. On the current path the companies going on right now, they can effectively buyback all shares outstanding in 4 years while paying the ~5% dividend out yearly. In a market where prices are elevated, finding a name that doesn't require growth to deliver shareholder value is rather attractive. As well, as the company continues to pay off more of its debt, it will grow its cash flows with less interest payments and increase investor confidence. With such a cheap valuation, all the company would need to do is not suffer multiple compression (on an EV/EBITDA basis) to generate strong returns.

<u>Strong Free Cash flows</u> - Corus has an asset light business with very limited capex spend (less than 3% of revenue), meaning the company is able to return cash to shareholders in large amounts. Being a mature business, it's a good bet the dividend can easily grow as the balance sheet continues to deleverage, especially with fairly limited investment opportunities for organic growth. The company has instituted an NCIB which we think is the best way to return cash to shareholders, with shares trading at such a low multiple (30% FCF yield).

Market position - the Canadian regulators coupled with strong brands and relationships make Corus a name with a strong moat. Since Corus' brands are entrenched in many Canadian TV packages and lives, it's tough to imagine the business falling off a cliff, which the low share price is implying. Although competitive pressures from streaming are prevalent, Corus will still make good money off its subscribers and therefore advertising.

Valuation & Expectations

Currently we believe the market is expecting Corus' topline to reverse its path and begin declining by ~1.5% into perpetuity and have its gross margins decline by roughly 1%. These expectations seem to be driven by the perceived decline in advertiser dollars due to increased competition from internet alternatives. While a valid worry, we believe that Corus' efforts to integrate and handle its own advertising, investments in digital assets and its own original content product will allow it greater stability in the coming years.

We believe that it is more realistic that Corus' revenue will continue growing in the short term and then decline at a modest rate over the next 10 years an average of 0.43% vs the expected -1.5%. We then foresee it declining at -1.00% into perpetuity as streaming comes to dominate more traditional TV offerings like news and specials. We also believe that Corus can actually increase its gross margin slightly, thanks to its integration of both original content and advertising. While TV advertising dollars will become scarcer and more expensive, Corus can mitigate this through its own advertising initiatives and agencies.

With these assumptions in mind we believe that Corus should be trading in the range of $10.40/share, which represents a current upside of 93.89%

See Appendix 1. For our DCF Valuation

Additionally, we find Corus trading at an extreme discount to peers, including other, smaller, Canadian broadcasters. Given Corus' market position it should be trading at a premium to peers, given it's greater scale, brands allowing it to command higher advertising revenues than others.

See Appendix 2. For our Comparable Companies analysis

Risks

Cord cutting- a large risk with the prevalence and growth of streaming services should have a large impact on subscriber growth and likely means losing many subscribers. Corus is combating this loss with the prevalence of its streaming service StackTV, which could help mitigate the loss of subscribers, which make up 30%+ of the company's revenue. Cord cutting and the lack of growth in Subs expected is a main reason why Corus and other broadcasters trade at such compressed valuations.

History of value destruction- since Corus was spun out from Shaw 20 years ago, the stock is down 40%. It's difficult to get behind a company that has continued to disappoint shareholders with a tough path to sustained growth. Another potential area of value destruction could occur if the company decides to make an acquisition that hurts the business more than helping it, especially with shares so cheap. We think that with a 30% FCF yield the better move would be to return cash to shareholders with a strong share buyback, unless the acquisition is transformative or done at a very cheap price.

Reliance on Telecoms- because Corus receives 30%+ of its revenue through subscribers, the company relies on the oligopoly of television providers to maintain their content in TV bundles. Should the big Telecoms try to lower how much there going to give Corus, it could hurt their subscriber revenue. However, with Corus' brands being so strong and a big part of Canadians TV experience, Rogers and Bell would likely think twice about starting a fight over fees.

Shaw Family ownership- the family owns a large portion of the voting shares, which can create an overhang in terms of having 80% of the voting power. It takes away the voice of many shareholders with its large voting majority.

Gloomy outlook - Beyond the company's past performance, the market is expecting that traditional TV bundles eventually become obsolete. Despite the mispricing, investors may be scared to invest in a business in a declining market and may be distracted by the "gloom and doom" hanging over the entire industry.

Conclusion

Although Corus is in an industry with a gloomy outlook based off continual cord-cutting and an increasingly competitive ad space, we believe the market is grossly overestimating the pace and effect this trend will have on Corus. While we agree that streaming will be the way of the future rather than cable TV, we feel that cord-cutting will be driven by a new generation moving out and simply not getting cable, rather than an active decision to get rid of it. This coupled with Corus' integration of both content and advertising make it better suited to weather the declining market than competitors. It is this that we believe the market is missing. There is still a lot of value within this business, and we believe that, in time, value investors will notice this gross mispricing and flock to the business, bringing the rest of the market with them.

Appendix

Appendix 1 - Corus Entertainment DCF Analysis

In millions except for per share items	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Television	**653,770**	**1,015,609**	**1,529,792**	**1,499,322**	**1,544,892**	**1,575,790**	**1,604,942**	**1,632,226**	**1,657,525**	**1,679,073**	**1,696,704**	**1,710,277**	**1,723,104**	**1,723,104**	**1,710,181**
% Growth		55.35%	50.63%	-1.99%	3.04%	2.00%	1.85%	1.70%	1.55%	1.30%	1.05%	0.80%	0.75%	0.00%	-0.75%
Radio	**161,545**	**155,705**	**149,216**	**148,025**	**142,590**	**137,355**	**131,625**	**125,475**	**118,986**	**112,238**	**105,311**	**98,285**	**91,236**	**84,237**	**77,353**
% Growth		-3.62%	-4.17%	-0.80%	-3.67%	-3.67%	-4.17%	-4.67%	-5.17%	-5.67%	-6.17%	-6.67%	-7.17%	-7.67%	-8.17%
Revenue	**815,315**	**1,171,314**	**1,679,008**	**1,647,347**	**1,687,482**	**1,713,144**	**1,736,567**	**1,757,701**	**1,776,512**	**1,791,311**	**1,802,014**	**1,808,562**	**1,814,340**	**1,807,341**	**1,787,534**
% Growth		43.66%	43.34%	-1.89%	2.44%	1.52%	1.37%	1.22%	1.07%	0.83%	0.60%	0.36%	0.32%	-0.39%	-1.10%
Cost of Goods Sold	538,128	760,300	1,100,925	1,071,719	1,102,397	1,114,879	1,130,121	1,143,876	1,156,117	1,165,748	1,172,714	1,176,975	1,180,735	1,176,180	1,163,290
% of Revenues	*66.00%*	*64.91%*	*65.57%*	*65.06%*	*65.33%*	65.08%	65.08%	65.08%	65.08%	65.08%	65.08%	65.08%	65.08%	65.08%	65.08%
Gross Profit	**277,187**	**411,014**	**578,083**	**575,628**	**585,085**	**598,266**	**606,445**	**613,826**	**620,395**	**625,563**	**629,301**	**631,587**	**633,605**	**631,161**	**624,244**
% Margin	34.00%	35.09%	34.43%	34.94%	34.67%	34.92%	34.92%	34.92%	34.92%	34.92%	34.92%	34.92%	34.92%	34.92%	34.92%
SG&A	60,701	-77,399	23,030	22,763	36,790	51,394	53,741	54,395	54,977	55,435	55,767	55,969	56,148	55,931	55,318
% Revenue	*7.45%*	*-6.61%*	*1.37%*	*1.38%*	*2.18%*	3.00%	3.09%	3.09%	3.09%	3.09%	3.09%	3.09%	3.09%	3.09%	3.09%
EBITDA	**216,486**	**488,413**	**555,053**	**552,865**	**548,295**	**546,871**	**552,704**	**559,431**	**565,417**	**570,128**	**573,534**	**575,618**	**577,457**	**575,230**	**568,926**
% Margin	26.55%	41.70%	33.06%	33.56%	32.49%	31.92%	31.83%	31.83%	31.83%	31.83%	31.83%	31.83%	31.83%	31.83%	31.83%
D&A	154,057	135,217	91,750	1,095,553	182,354	200,054	202,789	205,257	207,453	209,181	210,431	211,196	211,871	211,053	208,740
% Revenue	*18.90%*	*11.54%*	*5.46%*	*66.50%*	*10.81%*	11.68%	11.68%	11.68%	11.68%	11.68%	11.68%	11.68%	11.68%	11.68%	11.68%
EBIT	**62,429**	**353,196**	**463,303**	**-542,688**	**365,941**	**346,818**	**349,915**	**354,174**	**357,964**	**360,946**	**363,103**	**364,422**	**365,587**	**364,176**	**360,185**
% Margin	*7.66%*	*30.15%*	*27.59%*	*-32.94%*	*21.69%*	*20.24%*	*20.15%*	*20.15%*	*20.15%*	*20.15%*	*20.15%*	*20.15%*	*20.15%*	*20.15%*	*20.15%*

Free Cash Flow Build

		2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
EBIT		62,429	353,196	463,303	-542,688	365,941	346,818	349,915	354,174	357,964	360,946	363,103	364,422	365,587	364,176	360,185
(-) Tax	28.00%	30,993	41,575	82,498	88,129	71,445	97,109	97,976	99,169	100,230	101,065	101,669	102,038	102,364	101,969	100,852
NOPAT		**31,436**	**311,621**	**380,805**	**-630,817**	**294,496**	**249,709**	**251,939**	**255,005**	**257,734**	**259,881**	**261,434**	**262,384**	**263,222**	**262,207**	**259,333**
(+) D&A		154,057	135,217	91,750	1,095,553	182,354	200,054	202,789	205,257	207,453	209,181	210,431	211,196	211,871	211,053	208,740
(-) Capex		16,671	22,550	26,989	16,117	30,055	34,263	34,731	35,154	35,530	35,826	36,040	36,171	36,287	36,147	35,751
(-) Changes in NWC			11,362	17,250	-3,779	-31,222	-13,705	-13,893	-14,062	-14,212	-14,330	-14,416	-14,468	-14,515	-14,459	-14,300
Unlevered Free Cashflow		**168,822**	**412,926**	**428,316**	**452,398**	**478,017**	**429,205**	**433,889**	**439,169**	**443,869**	**447,567**	**450,241**	**451,877**	**453,321**	**451,572**	**446,623**

DCF

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Discount Period	1	2	3	4	5	6	7	8	9	10
Discount Factor	0.90	0.81	0.73	0.66	0.59	0.53	0.48	0.43	0.39	0.35
Discounted Cash Flows	**386,284**	**351,450**	**320,155**	**291,223**	**264,284**	**239,277**	**216,131**	**195,140**	**174,948**	**155,728**

Hurdle Rate	10%
Terminal Growth Rate	-1.00%
PV of Discounted Cashflows	2,594,619
Terminal Value	4,019,610
PV Terminal Value	1,401,551
EV	**3,996,171**
(+) Cash	82,568
(-) Debt	1,731,745
(-) Minority Interest	145,512
(-) Preferred Equity	0
Equity Value	2,201,482
Shares O/S	*211,735*
Implied Share Price	$10.40
Current Share Price	*$5.36*
Margin of Safety	93.98%

Sensitivity Analysis

Terminal Growth Rate \ Hurdle Rate	8.25%	8.50%	8.75%	9.00%	9.25%	9.50%	9.75%	10.00%	10.25%	10.50%	10.75%	11.00%	11.25%	11.50%	11.75%
2.50%	$20.85	$ 19.60	$ 18.45	$ 17.39	$ 16.40	$ 15.49	$ 14.63	$ 13.83	$ 13.08	12.37595	11.71353	11.08905	10.49929	9.941389	9.412801
2.00%	$19.51	$ 18.40	$ 17.37	$ 16.41	$ 15.51	$ 14.67	$ 13.89	$ 13.16	$ 12.46	$ 11.81	$ 11.19	$ 10.61	$ 10.06	$ 9.54	$ 9.04
1.50%	$18.36	$ 17.36	$ 16.43	$ 15.55	$ 14.73	$ 13.97	$ 13.24	$ 12.56	$ 11.92	$ 11.31	$ 10.73	$ 10.18	$ 9.67	$ 9.17	$ 8.70
1.00%	$17.38	$ 16.47	$ 15.61	$ 14.81	$ 14.05	$ 13.34	$ 12.67	$ 12.03	$ 11.43	$ 10.86	$ 10.32	$ 9.80	$ 9.31	$ 8.84	$ 8.39
0.50%	$16.52	$ 15.68	$ 14.89	$ 14.15	$ 13.45	$ 12.78	$ 12.15	$ 11.56	$ 10.99	$ 10.45	$ 9.94	$ 9.45	$ 8.99	$ 8.54	$ 8.11
0.00%	$15.76	$ 14.99	$ 14.26	$ 13.56	$ 12.91	$ 12.29	$ 11.69	$ 11.13	$ 10.60	$ 10.09	$ 9.60	$ 9.14	$ 8.69	$ 8.27	$ 7.86
-0.50%	$15.10	$ 14.37	$ 13.69	$ 13.04	$ 12.42	$ 11.84	$ 11.28	$ 10.75	$ 10.24	$ 9.76	$ 9.29	$ 8.85	$ 8.42	$ 8.02	$ 7.62
-1.00%	$14.50	$ 13.82	$ 13.18	$ 12.57	$ 11.99	$ 11.43	$ 10.90	**$ 10.40**	$ 9.91	$ 9.45	$ 9.01	$ 8.58	$ 8.18	$ 7.78	$ 7.41
-1.50%	$13.96	$ 13.33	$ 12.72	$ 12.14	$ 11.59	$ 11.06	$ 10.56	$ 10.08	$ 9.62	$ 9.17	$ 8.75	$ 8.34	$ 7.95	$ 7.57	$ 7.21
-2.00%	$13.48	$ 12.88	$ 12.30	$ 11.75	$ 11.23	$ 10.73	$ 10.25	$ 9.78	$ 9.34	$ 8.92	$ 8.51	$ 8.12	$ 7.74	$ 7.37	$ 7.02
-2.50%	$13.04	$ 12.47	$ 11.92	$ 11.40	$ 10.90	$ 10.42	$ 9.96	$ 9.51	$ 9.09	$ 8.68	$ 8.29	$ 7.91	$ 7.54	$ 7.19	$ 6.85
-3.00%	$12.64	$ 12.10	$ 11.58	$ 11.08	$ 10.60	$ 10.13	$ 9.69	$ 9.27	$ 8.86	$ 8.46	$ 8.08	$ 7.71	$ 7.36	$ 7.02	$ 6.69
-3.50%	$12.28	$ 11.76	$ 11.26	$ 10.78	$ 10.32	$ 9.87	$ 9.45	$ 9.04	$ 8.64	$ 8.26	$ 7.89	$ 7.53	$ 7.19	$ 6.86	$ 6.54
-4.00%	$11.94	$ 11.44	$ 10.96	$ 10.50	$ 10.06	$ 9.63	$ 9.22	$ 8.82	$ 8.44	$ 8.07	$ 7.71	$ 7.37	$ 7.03	$ 6.71	$ 6.40
-4.50%	$11.64	$ 11.15	$ 10.69	$ 10.25	$ 9.82	$ 9.41	$ 9.01	$ 8.62	$ 8.25	$ 7.89	$ 7.55	$ 7.21	$ 6.89	$ 6.57	$ 6.27

Appendix 2 - Corus Entertainment Comparable Companies Analysis

Company	Ticker	Price	Mkt Cap	Revenue Growth	Gross Margin	EBITDA Margin	Profit Margin	EV/Revenue	EV/EBITDA	P/E	P/FCF
Canadian Broadcasters											
STINGRAY GROUP INC	RAY/A	$6.91	$514.66	0.00%	0.00%	21.42%	6.77%	3.16x	11.56x	40.12x	9.84x
WILDBRAIN LTD	WILD	$1.62	$276.92	21.14%	43.98%	-0.26%	-14.27%	2.34x	9.54x	.x	3.18x
US Broadcasting & Media											
FOX CORP - CLASS A	FOXA	$47.61	$29,352.95	0.00%	0.00%	23.48%	18.71%	2.05x	9.2x	16.46x	10.15x
COMCAST CORP-CLASS A	CMCSA	$58.44	$265,862.67	9.82%	69.00%	31.53%	11.99%	2.88x	9.x	17.03x	13.46x
DISCOVERY INC - A	DISCA	$41.59	$28,121.75	11.30%	65.87%	40.68%	9.78%	2.85x	6.57x	11.05x	5.9x
SINCLAIR BROADCAST GROUP -A	SBGI	$41.55	$3,827.56	17.85%	46.49%	23.18%	-5.33%	4.78x	16.69x	23.06x	4.66x
SIRIUS XM HOLDINGS INC	SIRI	$9.21	$40,723.25	13.73%	56.19%	30.25%	12.23%	4.98x	15.54x	32.48x	19.15x
Average				10.55%	40.22%	24.33%	5.70%	3.29x	11.16x	20.03x	9.48x
Median				11.30%	46.49%	23.48%	9.78%	2.88x	9.54x	17.03x	9.84x
CORUS ENTERTAINMENT INC-B SH	CJR/B	$5.36	$1,136.48	13.37%	29.08%	34.67%	6.08%	1.7x	4.83x	6.38x	3.62x
Discount								*-40.74%*	*-49.35%*	*-62.54%*	*-63.17%*