SKYLINE SECURITIES

27 October 2003

CORUS ENTERTAINMENT INC.

CJR.B: TSX; C$23.67

Recommendation: SELL

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STOCK QUOTE

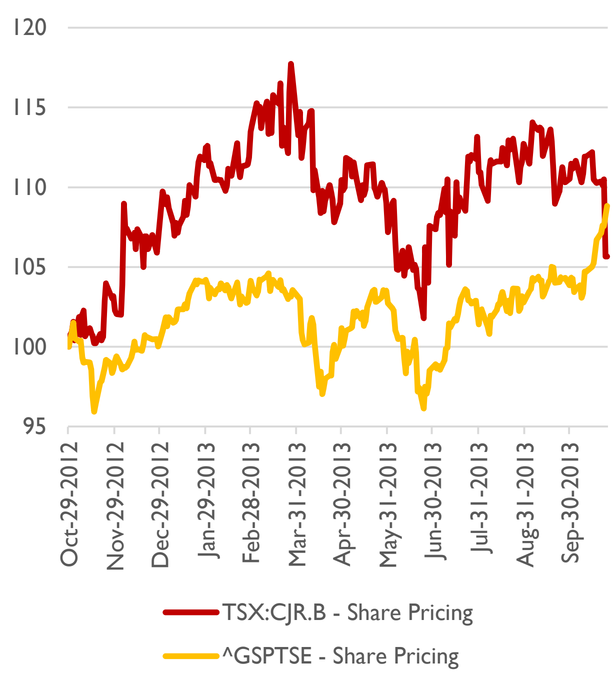
Market Cap (mm)	2001.5
Shares Out. (mm)	84.6
Float %	91%
Dividend Yield %	0.043
P/Diluted EPS Before Extra	11.60x
Avg Vol 3M (mm)	0.13
Previous Close	23.67
52 wk High/Low	26.49/ 22.17
Volume (mm)	0.22
Beta 5Y	0.76

EARNINGS SUMMARY

2013 EV/EBITDA Multiple	9.1x
10Y Historical EV/EBITDA Multiple	8.4x
Market Cap at 9.1x (mm)	1997.7
Market Cap at 8.4x (mm)	1721.16
Current Price (CAD)	23.67
Target Price (CAD)	21.26

SHARE PRICE PERFORMANCE

Index Oct 29 2012 = 100



MEDIA - BROADCASTING

CLOUDY OUTLOOK WITH HEADWINDS

- Corus' disappointing earnings from 4Q and FY 2013 underline broader structural problems and persistent cyclical headwinds that beset the Media-Broadcasting sector. The report highlights the market dynamics that we believe will continue to adversely affect top line growth for Corus.

- We examine factors that impinge on Corus' key revenue drivers- advertisement and subscription fees. On the cyclical front, weakness in the economic outlook, and inherent cyclicality in the advertisement industry are likely to weigh on revenues in the near term.

- On the structural front, A) online substitutes, B) margin squeeze given higher content costs and lower pricing power, and C) displacement of advertisement from traditional media to the internet will weigh on subscription rates and advertisement revenues. These structural changes also introduce fragility and volatility to earnings in the future.

Recommendation: SELL

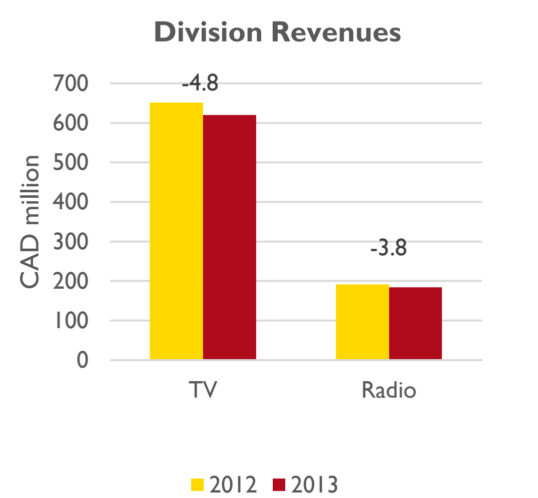
Our Sell recommendation is underpinned by our belief that current valuations have not sufficiently priced in the challenges to earnings that we have identified. We note too that the market's "hold" consensus anticipates A) an upturn in advertising revenue B) successful acquisition and integration of Bell's assets, with CRTC's approval on Nov 5, C) potential upside from a Shaw re-acquisition of Corus. We believe these to be over-vaunted. In view of limited upside in the near-term, and persistent structural impediments in the medium term, we recommend a Sell at current valuation.

Disappointing close to 2013

Corus Entertainment Inc., is a Canadian-based media and entertainment company. Corus' business comprises the radio and television divisions, which account for 23% and 77% of revenue respectively. The radio division operates 37 stations nationwide in a variety of formats. The television portfolio targets three segments, Kids, Women and Family, and holds assets in Pay Television, conventional television stations, animation, merchandise licensing, and children's book publishing.

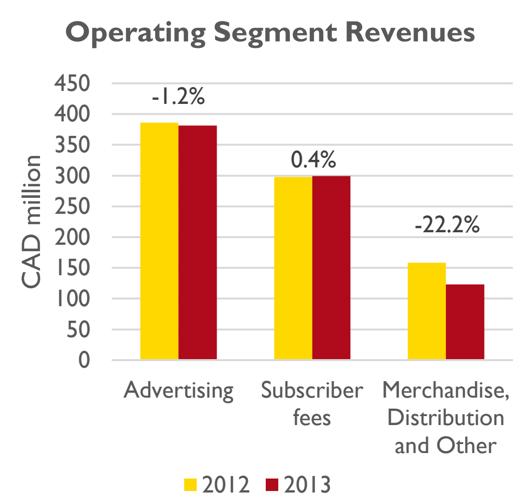
Performance in the fiscal year ending August 31 2013 was weak. In both the television and radio divisions, revenues and profits contracted [Figure 1]. By operating segments, proceeds from Subscriptions remained flat, while Advertising, and Merchandising, Distribution and Other revenues declined [Figure 2].

Figure 1



Source: Corus, 2013

Figure 2



Source: Corus, 2013

We believe current valuations do not fully account for factors that will impinge on Corus over the near to medium term. These factors are cyclical, structural and regulatory in nature. They auger further downside to Corus' share price, in our opinion.

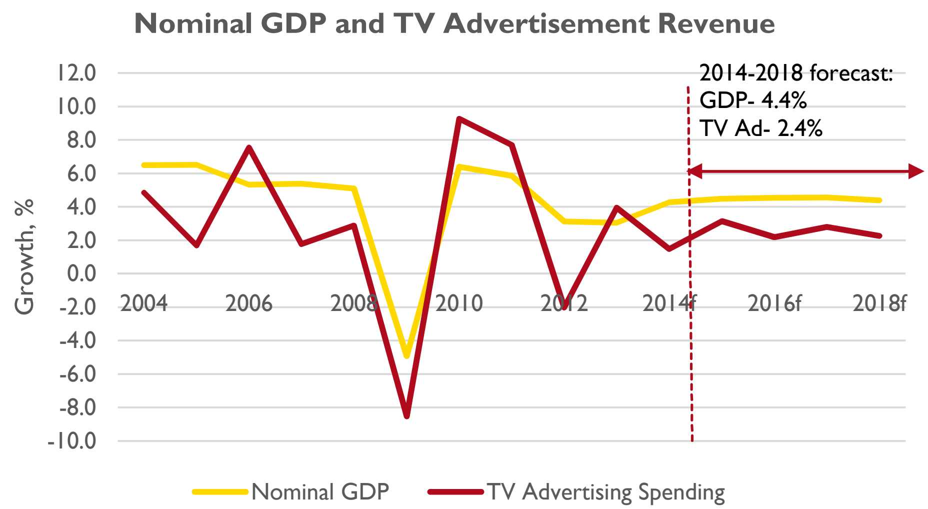
I. Cyclical headwinds

Advertising revenue vulnerable to cyclical fluctuation and weak macro outlook

Advertisement proceeds account for the largest share- almost 50% -of Corus' revenue. However, the firm faces both near and medium term pressures. Over the past decade, Canadian advertisement revenue has risen and fallen with nominal GDP growth, but with even more pronounced swings [Figure 3]. Moreover, advertisement revenue has shown year-to-year fluctuation: an uptick in growth is typically followed by weaker growth the following year, reflecting a "feast and famine" tendency in the industry.

Our model suggests a dampened 2014 outlook for Canadian television advertising revenue growth, in payback for the steep rebound in 2013. Over the medium term, the outlook is subdued on the back of modest macroeconomic growth through 2018. The IMF forecasts that nominal GDP growth will average 4.4% annually, against 5.8% in the pre-crisis years. Through 2018, overall advertisement revenue growth is expected to average 2.4% annually, compared to the pre- Global Financial Crisis average of 3.7% and the 2010-11 rebound of 8.5%.

Figure 3



Source: IMF, 2013; Television Bureau of Canada, 2013; Skyline Securities

II. Structural challenges

Corus faces structural threats to its revenue streams in radio, television and advertising. In each sphere, new substitutes threaten to displace conventional modes of production, distribution and consumption.

Online providers muscle in: In television, Over-the-Top (OTT) providers (including Netflix, Hulu, or Now TV) as well as online video sharing sites (notably YouTube) are salient contenders to Corus. While traditional TV remains dominant, these substitutes are expected to displace viewers further. Widespread broadband diffusion and the proliferation of mobile devices will underpin this trend. As viewership time shifts increasingly towards these alternatives, subscription rates in Pay-TV- a key source of revenue for Corus - is expected to decline. Likewise, in radio, consumers are expected to shift further toward online providers such as Pandora and Spotify, or other alternatives such as satellite radio, and even personal playlists on mobile devices.

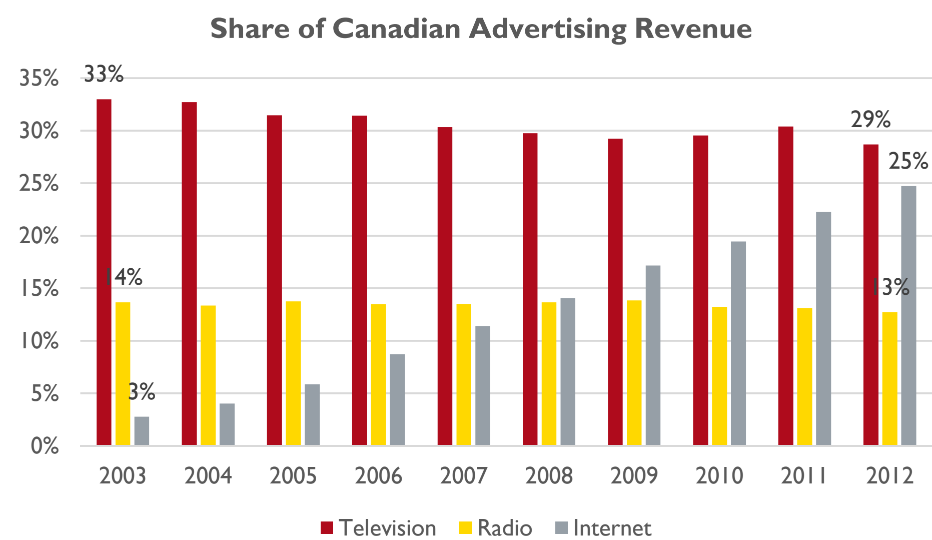
Between a rock and a hard place- rising content costs v. limits to pricing power: One reason for traditional TV's dominance hitherto has been the rising quality and variety of its programmes. Therefore, Corus' ability to procure or produce outstanding content is crucial for securing viewership and subscriptions, and therefore, for fending off the threat of online TV. We note however that this is likely to weigh on the firm's profitability. Suppliers of strong content wield superior bargaining power, raising procurement costs for content buyers like Corus. At the same time, Corus's ability to transfer cost increases to consumers may be limited, given the substitutes consumers enjoy— in quantity, quality, variety and price competitiveness.

One estimate suggests that costs to consumers in traditional TV could be as high as 36% more than that for Hulu[1].

Sonic Youth- online embrace undermines Corus' Youth focus: The shift towards online content consumption is most pronounced among youth. This could undermine Corus' focus on Kid's and Youth media (prize assets include Nickelodeon, ABC Sparks). Already, it has been estimated that 33% of millennials watch mostly online video and no broadcast TV, compared to 20% of GenX viewers and 10% of baby boomers[2]. For consumers aged between13-35 in the US, Internet radio services accounted for 23% of average weekly music listening time at the end of 2012, a steep increase from 17% in 2011, and challenging traditional radio's share of 24%. (The NDP Group, April 2013). We believe youth preference for online media will not reverse and could even rise further. Over time, as youths mature, overall demand for traditional radio and TV could therefore decline further. In just the past four years, the percent of online adults who watch or download online videos rose from 69% to 78%[3]. More time spent online could displace television viewership.

Advertisement displacement: The anticipated decline in traditional television and radio consumption, as well as potential cost efficiencies of online advertising will impinge on demand for advertising through traditional media. Over the last decade, the Internet's share of Canadian advertising revenue catapulted from 3% to 25% [Figure 4]. In contrast, television's share declined, from 33% to 29%, while radio's share has also stagnated at about 13%. While much of the Internet's gain has been at the expense of print media, we expect television and radio's shares to be eroded further in the future, in tandem with the decline in TV viewership and radio listenership.

Figure 4



Source: Television Bureau of Canada, 2013

[1] Waterman, D., Sherman, R., & Ji, S.W. (2012) The Economics of Online Television: Revenue Models, Aggregation, and "TV Everywhere". Working Paper.
[2] New York Times Video Study (2013)
[3] Purcell, K. *Online Video* (2013), Pew Internet.

III. Regulatory road blocks

Successful acquisition not a foregone conclusion: On Nov 5, the Canadian Radio-television Telecommunications Commission (CRTC) will review Corus's $494 million acquisition of television channels, including children's networks Teletoon and Cartoon Network, from Bell Canada Enterprises Inc. We believe that the market consensus of CRTC's approval is too sanguine, and the risk of rejection has not been adequately priced in. CRTC recently raised concerns over the ownership structure of Corus; stating that it is looking for proof that Corus is independent from Shaw Communications. The concern primarily stems from the Shaw's family substantial control over Corus. Should the CRTC consider the combined market share of Shaw Communications and Corus to be excessively concentrated, it may prevent Corus's acquisition from going through. In such a scenario, Corus would be liable to indemnify Bell for any loss up to a maximum of $400.6 million that Bell may suffer upon a subsequent sale of applicable assets to a third party[4]. The CRTC's ruling would thus undermine not only short-term profitability, but also Corus' long-term growth strategy – particularly its move to position itself as Canada's top Kid's programming provider.

Un-Bundling of TV Packages: CRTC has indicated that the current practice of channel bundling in Pay-TV packages undermines consumer welfare. Users should instead be granted the flexibility to pick and pay for specific channels they want. While there is scepticism over whether the CRTC could administer such requirements in the near term, the push to unbundle nevertheless remains a looming threat on the horizon for Pay-TV providers. From Corus' perspective, unbundling makes the subscription market more competitive and revenue more volatile and less sticky. There would also be adverse knock-on effects on advertising revenue if the subscriber base erodes. These consequences could be substantial for Corus- currently, 44% of Corus's revenue is derived from its Pay-TV service. Unbundling would only exacerbate the threat that OTT already poses to the Pay-TV industry.

Shaw's reacquisition of Corus?: Ever since Shaw Communications sold its wireless spectrum to Rogers, there has been heavy speculation that Shaw could seek to beef up its media unit by reacquiring Corus, which is Canada's only remaining large independent media firm. Reacquisition appears compelling as the Shaw family already owns a controlling stake in Corus and could realise greater value by combining both companies' media assets and cutting costs. We believe that the market's valuation of Corus' stock price has priced in the potential for upside arising from a Shaw takeover. However, such a takeover may run counter to CRTC's intention to scrutinize any deal that takes the market share of a media company beyond 35%, a threshold the combined Shaw-Corus entity will exceed, assuming that Corus successfully acquires Bell's assets. Shaw's subscription losses and profit slump in Q4 2013 could also quell its appetite for acquisition.

[4] M D&A commitments Contingencies and Guarantees

IV. Valuation

The financial results for 2013 underscore the structural problem discussed earlier in this report. Corus has a solid track record of acquiring, rebranding and re-launching channels, which has historically generated topline growth. However, two of its fundamental growth drivers, Radio and Pay-TV (accounting for 23% and 44% of revenue respectively) are facing pressure on account of changes in consumer preferences, new substitutes and program cost inflation. Corus trades at 9.1x EV/EBITDA for 2013 and 9.2x EV/EBITDA for 2014E [Figure 5]. This looks expensive when compared to its historical average of 8.42x and comparable firms' ratios (Quebecor 5.8x; Cogeco 6.0x; Shaw 7.1x).

Figure 5

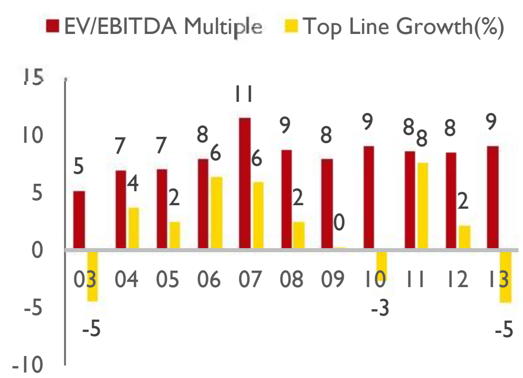


Figure 6

Figures in millions	Revenue	Segment Profit	Diluted EPS
2013			
4th Quarter	193.63	54.45	0.14
3rd Quarter	200.06	68.23	1.07
2nd Quarter	183.70	54.65	0.07
1st Quarter	226.15	92.69	0.63
2012			
4th Quarter	195.62	60.86	0.28
3rd Quarter	204.08	75.66	0.52
2nd Quarter	205.68	62.25	0.38
1st Quarter	236.89	91.21	0.61

**Company Report

V. Risks to the outlook

Our Sell recommendation is based on our outlook for cyclical, structural and regulatory factors that we expect will undermine Corus' position. Any change in the attributes discussed above, or credible move by Corus to mitigate these adverse forces are risks to our Sell assessment.

For example, an upturn in economic growth could translate into higher topline growth from both Consumer and Advertising revenues. Moves to mitigate subscription base erosion and provide greater immunity to the revenue mix from structural changes, perhaps in partnership with OTT content providers, could provide for further growth. A successful takeover by Shaw may also unlock value from vertical integration and economies of scope.