October 25, 2013

DH Equity Research

Corus Entertainment Inc. (CJR.B)

Recommendation:	**SELL**

12-18 month price target	**$23.66**
CJR.B-TSX (10/25/13)	**$23.67**

Market Capitalization	**2.00B**
Shares Outstanding	80.97M
Average Daily Volume (3m)	123,117
Floating Outstanding	74.08M
Current Price (2013-10-25)	$23.67
52-Week Range	$21.67-$26.49
Book Value per Share	$14.85
Price to Book	1.73x
Dividend per Share	$1.02
Current Dividend Yield	4.10%
EPS	
2013A	1.65x
2014E	2.02x
2015E	2.17x
P/E	
2013A	14.3x
2014E	11.71x
2015E	10.89x

	2015E	**2014E**	**Average**
Valuation (P/E)	23.63	23.65	23.64
Valuation (P/CF)	23.67	23.67	23.67
		Target Price	**$23.66**

Henry Cao
1 (416) 880-9221
Henry.Cao15@Rotman.Utoronto.Ca

Daniel Phu
1 (647) 261-9013
Daniel.Phu15@Rotman.Utoronto.Ca

Stable cash flow but significant downward pressure

- Results fell short of expectations in Q4. Corus missed its 2013 EBITDA low-end guidance of $293M. Consolidated segment profit decreased by 11% and 7%, in Q4 and F13 respectively. Adjusted net income attributable to shareholders fell 12.6% on a yearly basis. However, FCF is stable.
- Profits declined in all business segments in F13. Annual profit for television and radio decreased by 5.1% and 4% respectively. Corporate division saw an increase in expense of 14.6% as a result of new performance incentive plan, which is expected to stabilize in the future.
- Synergy is anticipated from the pending acquisition of BCE's selected product portfolio. Recent pay-per-view push by CRTC, if implemented, will have significant impact on Corus' advertising revenue.
- Corus entry into CPAX provides some upside potential of advertising revenue growth through the new premium content business model.

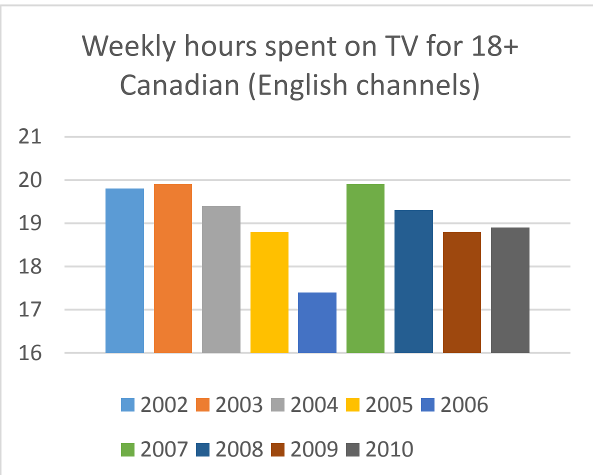
Recommendation

We are issuing a SELL recommendation, as the current challenges in softening advertising demand, elevated expenses, market structural changes and regulatory uncertainty overshadow the company's operating discipline, stable FCF, and potential synergy from acquisitions. Our valuation of Corus Entertainment's 12-18 months price target of $23.66 is based on relative valuation technique by averaging the average of P/E valuation and P/CF valuation. The average P/E valuation of F14 and F15 is $23.64 and the average P/CF valuation of F14 and F15 is $23.67. Averaging the two numbers, the target price is $23.66.

Company Overview

Corus Entertainment is a leading media conglomerate in Canada. As a spin-off from Shaw Communications Inc. in 1999. Its core business segments include television broadcasting, radio broadcasting and production and distribution of media content. Its main brands include YTV, Treehouse TV, W Network, Movie Central, CMT, Teletoon, Encore Avenue, Nelvana, Nickelodeon Canada and Kids Can Press. Corus currently owns 17 television brands, 37 radio stations and 2 content publishers. Even though it is an independent company, Corus Entertainment's majority voting shares is held by the company's founder James Shaw, who also owns Shaw Communications. There has been many partnerships and business collaborations with Shaw Communications since the spin-off in 1999, such as TV programs like Food Network Canada and Dusk. The company's overall strategy focuses on acquisition and strong operating discipline. It's currently in the process of expanding its network in Quebec through strategic acquisitions.

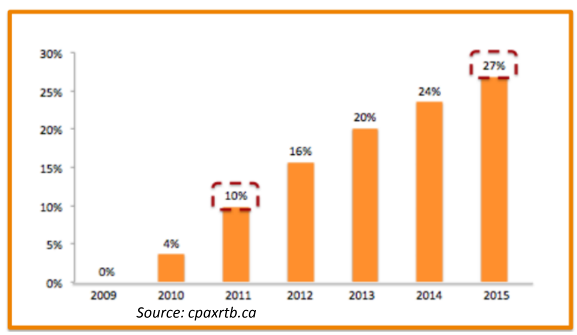
Market Dynamic



Television viewership per capita in Canada remains stable at around 19 hours per week. There is increasing level of vertical integration with recently approved deal of merger between Bell and Astral creating a new company that controls over 35.8% of English-language TV market and 22.6% of French-language TV market. Sales of licensed merchandise worldwide grew by 1.6% in 2013 from 2012, rising to $153.2 from $150.8 of which entertainment/character brands accounted for about 17% of licensed merchandise with a growth rate of about 0.2% annually.

With regulator's plan to enforce "a la carte" pricing model in satellite and cable companies, consumers are expected to switch to basic TV offerings and only subscribe to a small number of premium channels. This will likely reduce the profit for the TV sector.

RTB Based Display Ad Sales as a Percentage of Total Display Ad Sales



Source: cpaxrtb.ca

The latest trend in television segment is the emergence of real-time bidding (RTB) exchange service such as CPAX. This is a data-driven buying model that allows agencies and advertisers to bid for advertising spots on premium content providers. Advertising revenue for participating broadcasters, such as Corus, is expected to be lifted.

Annual growth rate in private radio broadcasting continues to slow down with growth rate of 0.3% for 2012 the lowest since 2000, except for 2009 when revenue were down 5.3% due to global economy crisis. Ontario and Alberta remain the most profitable regions for private radio broadcasting whereas profit declines in Manitoba after 2 consecutive growing years. Profit from private radio broadcasting declines steadily in Atlantic region over the past 7 years with profit margin before interest and taxes falling from 27% in 2005 to 14.5% in 2012. Saskatchewan remains the least profitable province for radio advertising with profit margin falling from 11.8% in 2011 to 11% in 2012. Ethnic radio stations have the strongest growth with 4% increase in operating revenue in 2012 as compared to 0.3% for English-language stations and -0.4% for French-language stations.

Advertising Revenue: Private Radio broadcasters			
Source: Statcan.gc.ca	**2011**	**2012**	**2011 to 2012**
	millions of dollars		**% change**
All private broadcasters	1,580.60	1,589.30	0.6%
AM stations	300.8	296.5	-1.4%
FM stations	1,279.80	1,292.80	1%
All markets	1,580.60	1,589.30	0.6%

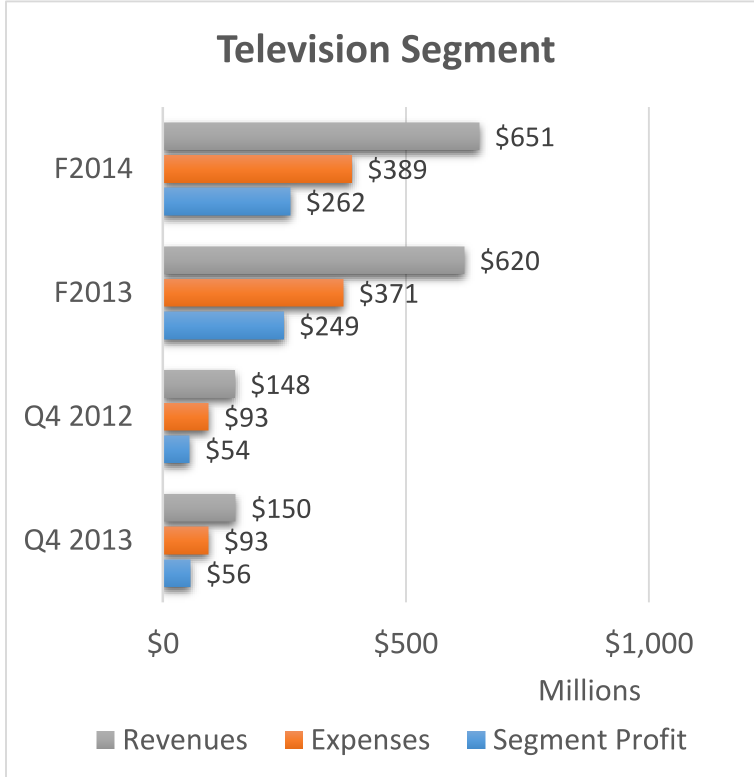
With the growing of smartphones and tablets, a new trend in the media industry is to offer instant gratification for customers anywhere any time by providing innovative products such as on demand mobile TV and automatic TV recording. This trend creates opportunities for media broadcasters to quickly expand into the mobile media sector.

Corus Entertainment: Television Segment

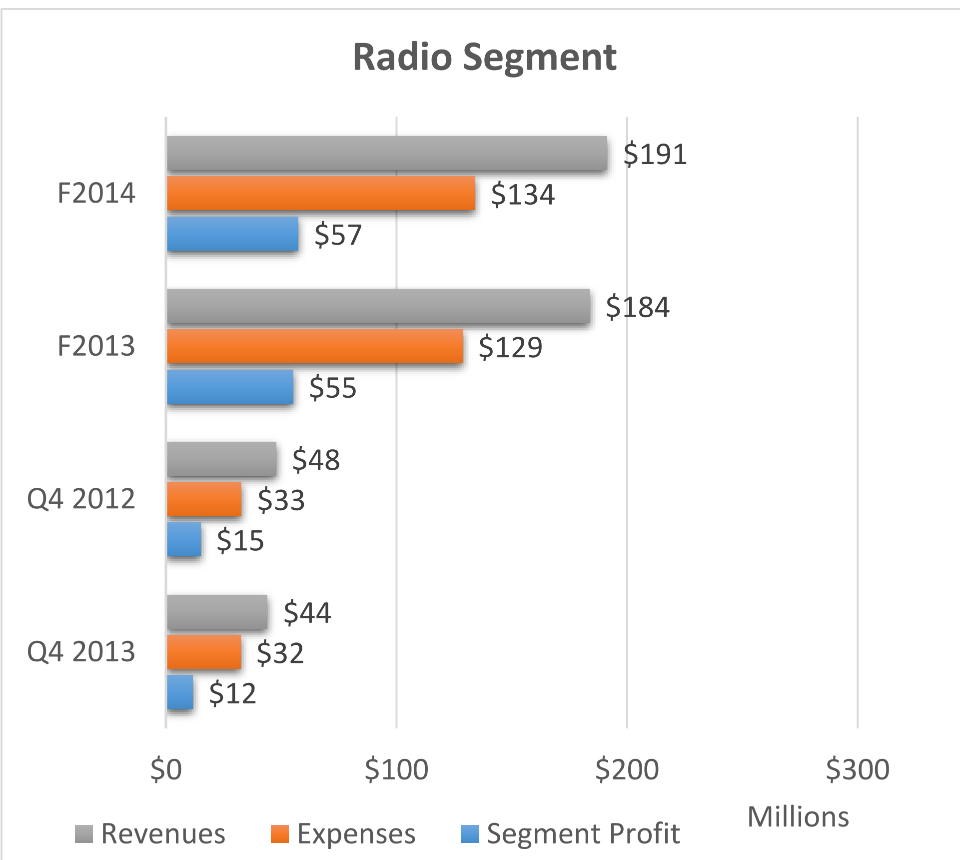
While segment revenue increased by 1.01% in Q4 for F13 from prior year, the TV segment experienced an overall yearly decline of 4.78% in total revenue, led by 24% decrease in merchandising, distribution and other revenues due to the softening demand for the popular cartoon show *Beyblade*. Segment profit for F13 also decreased by 5.10%. Profit margin remained consistent at 40% for the fiscal year due to efficient cost management.

Specialty advertising revenue increased by 6% for Q4 and 2% on a yearly basis, driven by strong demand in the Women's vertical and ABC Spark. Subscriber revenues also increased at similar rate. In particular, Movie Central gained 20,000 subscribers from the previous years.

Total expenses are comparable to the previous quarter, with a modest decrease of 0.25%. On a yearly basis, total expenses decreased by 4.56%, reflecting the company's focus on cost management and strategic timing of expenses.



Corus Entertainment: Radio Segment

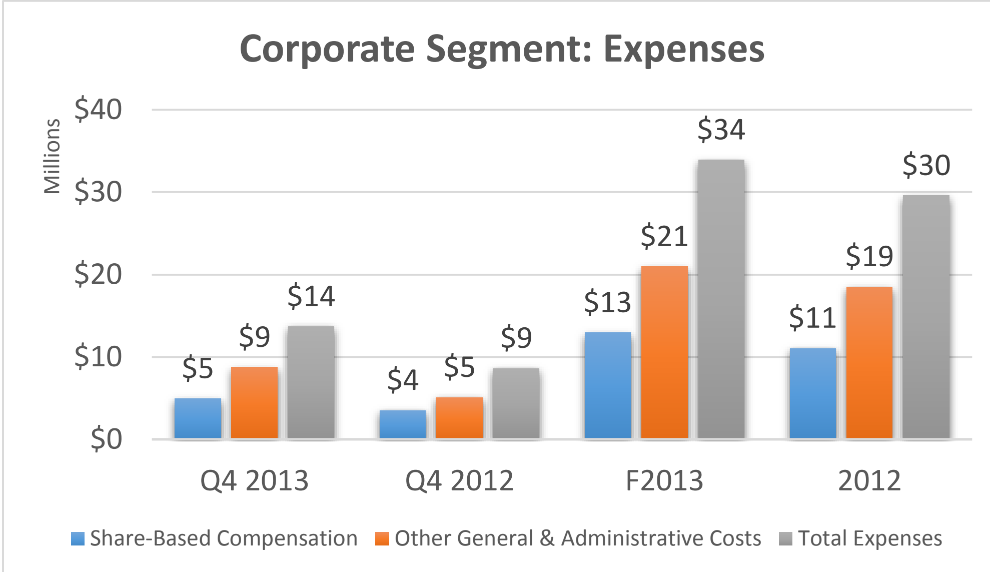


Both the segment revenue and profit decreased significantly in Q4 and F13. Segment revenue decreased by 7.83% in Q4 and 3.99% for F13. Segment profit decreased by 22.21% in Q4 and 3.97% for F13. The significant reduction is due to soften demand in Manitoba and Ontario where most of Corus Entertainment's operation resides. Alberta and British Columbia remain stronger in ratings and economic conditions but they were not enough to offset the lighter demand in densely populated Ontario where Corus mainly operates.

Total expenses decreased by 1.24% on a quarterly basis and 4.00% on a yearly basis due to the lower hockey broadcast rights fee, lower marketing budget and also the recognition of an Ontario Interactive Digital Media Tax Credit.

Corus Entertainment: Corporate Segment

Corporate expense increased significantly by 58.74% from \$8.6M to \$13.7M on a quarterly basis and 14.63% from \$29.6M to \$33.9M on a yearly basis. This is mostly due to the increasing shared-based compensation which comprises of Company's stock options and long-term incentive plans. Part of the increase is a result of changes in valuation assumption of the options such as share price and units estimated to vest.



Seasonal Fluctuation

Corus Entertainment's main revenue stream is from advertising which experiences strong seasonal fluctuation. The company depends on general economic forecast, retail cycle, and advertising patterns, especially those associated with retail consumer behavior. First quarter tends to come very strong due to the fall and winter holiday season, then tapers off in Q2. On an annual basis, the dilute EPS for F13 is \$1.90 compared \$1.78 for F12. However, the \$1.90 diluted annual EPS for F13 includes a onetime \$55.4M gain on disposition of Food Network Canada and a few other onetime items. On an adjusted basic EPS fell to \$1.65 in F13 from \$1.90 in F12, representing a 13.14% annual decline.

Profitability by Quarters					
				Earnings Per Share	
	Revenues	Segment Profit	Net Income	Basic	Diluted
2013					
Q4	$193,634	$54,445	$11,879	$0.14	$0.14
Q3	200,060	68,226	89,913	1.07	1.07
Q2	183,700	54,648	5,944	0.07	0.07
Q2	226,147	92,693	52,159	0.63	0.62
2012					
Q4	195,624	60,862	23,341	0.28	0.28
Q3	204,078	75,656	43,221	0.52	0.51
Q2	205,683	62,247	31,571	0.38	0.38
Q1	236,891	91,214	50,548	0.61	0.61

Earnings Per Share				
	Three months ended, August 31		Year ended, August 31	
	2013	2012	2013	2012
Basic earnings per share	$0.14	$0.28	$1.91	$1.79
Adjusted basic earnings per share	$0.31	$0.38	$1.65	$1.90
Diluted earnings per share	$0.14	$0.28	$1.90	$1.78

Competitive Analysis

On a competitive basis, Corus Entertainment exhibits a medium P/E multiples compared to the industry. Its profitability, as measured by ROA is in line with its peers. However, Corus' ROE is significantly lower than the industry, even compared to Shaw Communications Inc. Its high operating margin reflects Corus' management's operating discipline and effective cost management.

	P/E	EV/EBITDA	Operating Margin	ROA	ROE	Current Ratio
Corus Entertainment (CJR'B)	14.3	9.32	30.25	7.48	13.8	1.85
Shaw Communication Inc (SJR'B)	15.29	7.26	26.57	5.86	19.52	0.54
Quebecor Inc (QBR'B)	10.51	5.24	18.46	1.86	12.25	0.91
Cogeco Inc (CGO)	9.64	3.73	23.26	2.58	20.82	0.95
Asian Television Network (SAT)	23.75	14.85	14.33	18.38	30.8	2.16

Valuation

We believe that structural changes in the commercial broadcasting industry is evident by the continuous slowdown of advertising demand in densely populated areas where Corus operates in coupling with pending regulatory changes that require de-bundling of specialty TV programs. Increasing vertical integration in the industry also creates downward pressure that may adversely affect advertising revenue. Corus has been slow in capturing the new trend in digital media and online TV and expenses have been elevated due to changes in compensation plan, both of which reduce the upside potential. The revised forecasted earnings per share and cash flow in F14 and F15 are provided below. In light of the company's stable cash flow and based on revised estimation of earnings for F14 and F15, we use the relative valuation methods of P/CF and P/E to estimate the 12-18 months price target. We take the equally weighted average estimate of the valuation from the P/E and P/CF models for F14 and F15 to arrive at the target price of $23.66 in the next 12-18 months. Compared with current trading price of $23.67, we recommend a SELL for this stock.

	8-31-2015E	8-31-2014E	8-31-2013A	8-31-2012A	8-31-2011A
Adjusted EPS	2.17	2.02	1.65	1.87	1.72
EBITDA	344.29	325.67	270.01	289.98	285.89
Revenue	963.57	917.22	803.54	842.28	825.21
P/E	10.89	11.71	14.30	12.86	11.63
EV/EBITDA	7.17	7.58	9.32	8.43	7.85
EV	2469	2469	2516	2445	2244
P/Cash Flow	10.16	10.81	12.65	11.31	10.30
Cash Flow Per Share	2.33	2.19	2.05	1.98	1.78
Valuation (P/E)	**23.63**	**23.65**	23.60	24.05	20.00
Valuation (P/Cash Flow)	**23.67**	**23.67**	25.93	22.39	18.33

Risk Analysis

General market slowdown in densely populated area softens the demand for advertising in television and radio. On the regulatory front, the plan to enforce "a la carte" pricing model in satellite and cable companies will lead to reduced bundle purchase and will likely reduce the profit for the TV sector.

Structural change in the broadcasting industry due to increasing vertical integration poses new uncertainty, as evident by the approved merger of Bell and Astral.

Increasing level of customer preference for advertising through alternative online channels such as YouTube and online news portals will likely dampen the demand for traditional TV and radio advertisement.