Why it Makes Perfect Sense for Shaw Communications Inc. to Buy Corus Entertainment Inc.

Description

It has not been a good year for **Corus Entertainment Inc.** (TSX:CJR.B) shareholders. Shares are down nearly 50% as the company has gotten slammed with bad news from all sides.

First of all, the CRTC made life a little more interesting for Corus's television business with its decision to allow cable consumers to pick and choose individual channels starting in 2016. Remember, Corus owns a bunch of specialty channels, like Treehouse, Teletoon, CMT, YTV, Cosmo TV, the W Network, and others like those. It also has the rights to show Movie Central and HBO Canada to customers in western Canada.

While Corus is holding out hope that at least a couple of its channels will be included in some sort of basic cable package, it's obvious what the market is thinking. Investors are spooked that Canadians are going to dump Corus's specialty channels once they get the opportunity to do so. This will lead to lower advertiser rates, which is the beginning of a slippery slope no investor wants.

Additionally, the tepid Canadian economy is taking its toll on the advertising market. That, combined with advertisers concentrating their spending on **Rogers Communications**-owned channels—because of the boost in ratings it got with its new NHL content deal—has led to some pretty lackluster results. The radio business has also been soft.

Still, if you look past the headline earnings numbers, things don't look so bad for Corus. It's still on pace to generate some $180 million in free cash flow this year, which puts it at a price-to-free cash flow ratio of just six times. That makes it one of the cheapest stocks in the whole market based on that metric.

It also makes the company an attractive takeover possibility. Here's why I think it's likely to happen, with **Shaw Communications Inc.** (TSX:SJR.B)(NYSE:SJR) as the likely bidder.

A close relationship

Corus was actually spun out of Shaw back in 2000, and the two companies continue to work closely together.

Corus has class A and class B shares, with the investing public holding the class B shares and their limited voting rights. Even though holders of the class A shares have just a fraction of the total shares, they have effective voting control. The Shaw family controls the class A shares, and with them, the fate of the company. The family has a similar setup with their namesake company.

But the Shaw family isn't just sitting off on the sidelines. Both Julie Shaw and Heather Shaw are members of Corus's board of directors, with Heather assuming the role as chairperson. It's not much of a stretch to assume they could work closely with the family members that run Shaw.

Other advantages

There are other advantages to Shaw and Corus getting back together.

It costs Corus millions of dollars annually to stay publicly traded. If Shaw took the company over, it would just be part of a bigger Shaw Communications, saving the costs of filing reports to regulators and having investor-relations employees.

There's also the synergies. Shaw also has its own media division, owning channels like Global, The Food Network, History, and others. Instead of both Shaw and Corus having to work with advertisers, the combined company could offer access to more channels and a broader cross-section of the Canadian population. Other improvements could be made as well, like sharing office space or production facilities.

And finally, it would certainly be accretive to Shaw's bottom line. Shaw generated approximately $600 million in free cash flow in 2014. Adding Corus's $180 million to that is a marked improvement.

With Corus shares trading at levels we haven't seen since 2009, it's a perfect opportunity for Shaw to take the company over. And if it doesn't, Corus shareholders are still getting a dividend of 8.8%. That's not such a bad reward for waiting.

CATEGORY

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