Corus Entertainment Inc.: This Transformational Deal Is Great News

Description

Shaw Communications Inc. (TSX:SJR.B)(NYSE:SJR) and **Corus Entertainment Inc**. (TSX:CJR.B) made headlines on Wednesday morning when the two companies announced a transformational deal.

Shaw agreed to sell its media division to Corus for $2.65 billion. Included in the deal are specialty channels such as the Food Network, HGTV, History, Showcase, National Geographic, and the Global family of channels. Before the deal, Corus had 10% of Canada's television market share. Once the deal closes, it'll have 35%.

This is obviously a big deal for Corus. Shares of the media company got hammered in 2015 as investors speculated that new CRTC rules–which will allow consumers to easily pick individual channels instead of expensive bundles–would hurt Corus's bottom line. Corus's market cap shrank from $2 billion to less than $1 billion, even though the company actually increased free cash flow compared with the year before.

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To finance the deal Corus will issue 71 million shares to Shaw, which will be forced to hold on for at least 24 months after closing. This will take care of approximately $800 million of the sale price. The rest will come from a $2.3 billion loan from RBC Capital Markets, which will refinance an existing $550 million loan at the same time. The company is also weighing either raising additional capital by issuing new unsecured notes or a potential offering of subscription receipts for its class B shares.

When the deal closes, Corus will have approximately $2.4-2.6 billion in long-term debt, which is a lot. But according to management, the new Corus should be able to generate approximately $430 million in free cash flow annually, which works out to $2.70 per share even after accounting for the 71 million new shares issued to Shaw.

Shaw has also committed to taking its dividends in the form of new shares until at least the end of Corus's fiscal 2017, which comes in August of that year. Which means in the first year Corus will have approximately $350 million in free cash flow after dividends to pay down the debt. Current shareholders shouldn't see any reduction in their dividends either.

Even after Shaw starts taking its dividends in cash, Corus should still have $270 million annually to put towards debt repayment. And that's before any cost synergies, which management says will be between $40 and $50 million annually within 24 months after closing.

Even just assuming modest free cash flow growth and these synergies, it's easy to see a scenario where the new Corus will be able to generate $500 million in free cash flow annually. Based on the current market cap of the company and the potential dilution in shares issued to Shaw, there's potential for Corus to generate between $3.10 and $3.20 per share in free cash flow by 2017 or 2018. At a current share price of just $11.22, there's an argument to be made that Corus is one of Canada's cheapest stocks.

Sure, Corus will have a lot of debt after this deal closes. And that’s a concern, especially if Canada’s television market continues to be soft and ad spending moves on to the Internet. But the cash flow should be there to make quick work of the debt, and investors should continue getting their dividends. And Corus will emerge from it as a dominant player in Canada’s television scene.

I like the deal. I think other shareholders should, too.

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