Corus Entertainment Inc.: Beware the Looming Dividend Cut

Description

Corus Entertainment Inc. (TSX:CJR.B) is a mainstay of Canadian popular culture, reaching nine out 10 Canadians every week and 96% of Canadians at least once every month. Corus owns 45 specialty television channels, 15 traditional television stations, and 39 radio stations in addition to a global business dedicated to the production, distribution, and merchandising of the company's content.

With the advent of broadband internet and mobile technology, audiences have more options available to them than ever before in terms of how, when, and where they get their content. Bargaining power had decidedly shifted to the consumer over the past 10 years, and the competitive environment has never been more difficult for companies like Corus and **DHX Media Ltd.**

Despite this, Corus saw sales increase $356 million over the past year ended August 31, 2016. This was largely due to the company's 2014 acquisition of the specialty television services Historia, Séries+ and the remaining 50% of TELETOON Canada Inc. that the company did not already own. While sales increased, the company's profit margin fell to 10.8% from 18.1% two years prior, and EPS fell to $0.96 from the $1.76 it had earned before the acquisition, leaving the company with a payout ratio of 119%.

In what could be viewed by some as an act of desperation, on January 13, 2016, Corus announced that it would be acquiring Shaw Media Inc. from **Shaw Communications Inc.** in a transformational move that would effectively see the size of the company double. Shaw Media would be expected to bring with it an additional $1.9 billion in revenues, $619 million in adjusted EBITDA, and approximately $430 million of free cash flow to the new company.

The price tag for an acquisition of this magnitude wasn't cheap. Corus financed the deal with the help of a $2.6 billion syndicated senior secured credit facility, which nearly tripled the amount of debt on the company's balance sheet. While on the surface, the company's debt-to-equity ratio would only increase from 0.66 times to 0.82 times, the acquisition would carry with it an immense amount of goodwill which, if excluded, would leave the company with a negative tangible net worth.

All in all, Corus today appears to be a different company than in past years. Corus increased its dividend in seven of the past 10 years, and for a long time it was able to keep its payout ratio in the healthy range between 40% and 60% of earnings. However, with a payout ratio already above 100%, significantly increasing fixed debt obligations in the wake of the Shaw Media deal amid an already competitive market environment seems like a risky bet, to put it mildly.

Should you buy?

Management needs the Shaw Media acquisition to start paying dividends immediately if the company hopes to avoid cutting its payout. Even if the company can shore up its cash flows in the near term, what the acquisition doesn’t address is just how much the media landscape has changed and where it will be in five years from now.

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