Corus Entertainment Inc. (TSX:CJR.B): Things Can and Probably WILL Get Worse

Description

For many deep-value investors, it's hard not to be attracted to **Corus Entertainment Inc.** (TSX:CJR.B) stock after it shed over 83% of its value from peak to trough.

Based on traditional valuation metrics, shares look ridiculously cheap, so to many contrarian investors, the drop may seem like an opportunity to take a page out of Warren Buffett's handbook by being greedy when others are fearful.

Contrarian investing can lead to profound long-term rewards, but it only works if you've actually spotted a discrepancy between a price Mr. Market slaps on a stock and the actual intrinsic value of the underlying business. As such, placing a bet solely because of the cheapness of a company is not an effective strategy if you intend to beat the markets. In fact, I'd argue that doing so without ensuring proper due diligence is speculating, not investing, which can be just as bad as betting on a "bubble" like Bitcoin even though you may think you're value investing like Warren Buffett.

Buying stocks based solely on their cheapness is called "cigar butt" investing. More often than not, the sought-after margin of safety that bargain-hunters assume with a "cheap" name may just be an illusion that serves as a siren song to value hunters.

Is Corus really that cheap?

Let's look at Corus through the eyes of a deep-value investor who may be enticed by Corus and its seemingly cheap valuation.

Looking at traditional valuation metrics, the stock looks like a huge steal. Shares trade at a 4.2 forward P/E, a 0.6 P/B, a 0.5 P/S, and a 2.4 P/CF, all of which are substantially lower than the company's five-year historical average multiples of 14.4, 1.3, 1.9, and 7.8, respectively.

Sounds like an opportunity to pay a dime to get a dollar!

Earlier this year, I predicted that Corus would cut (or reduce) its dividend and that shares would be hit further. The yield at the time was 19%, but the company could have easily continued to support its dividend over the medium term. The payout ratio soared over 186%, but the payout was covered by the ample amount of free cash flow that the company generated.

Corus is not your typical “value trap” that’s in dire financial shape.

While there’s a considerable amount of debt on the balance sheet, it’s not too concerning when you consider the significant amount of free cash flow Corus is pulling in on a consistent basis. That said, the 1.28 debt-to-equity ratio and 3.33 in financial leverage as of the last quarter isn’t indicative of a company that’s destined to become insolvent anytime soon.

Everything appears to be fine so far, and I can therefore understand why some value investors may have been enticed by the siren song of this company.

Why Corus is a value trap

Corus is a stock I’d avoid at all costs in spite of the company’s relatively sound financial footing, its steady free cash flow generation, and its ridiculously low valuation multiples.

Why?

When it comes to companies, if you’re not growing, you’re dying.

Corus is apparently in the latter category, but it may not seem that way when you look at the nice bump in revenue and cash flows from prior acquisitions. While one could argue that Corus could sustain growth by purchasing other media assets that are also in secular decline, the fact remains that such “to be acquired” media assets (and their associated ad revenues) will also just stand to depreciate year after year.

Thus, Corus may be seen as a dumping ground for such depreciating media assets.

I don’t see traditional televised media rebounding, especially when you consider that content digitization is about to accelerate even further. And while free cash flow may be healthy now, I believe the rate of decay will pick up traction with or without more acquisitions.

Moreover, a major reason why Corus generates ample free cash flow is because of the capital expenditures it has made over the years. the use of investment proceeds to double down on more traditional media assets will only make the sinking ship larger and won’t actually stop the rate at which the ship is sinking.

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