Application for Amendment of Condition of Licence Applicable to Corus Entertainment Inc.'s English-Language Group of Services

Supplementary Brief

September 5, 2019

Executive Summary

1. In this application, Corus Entertainment Inc. ("**Corus**") respectfully requests amendments to a condition of licence attached to its English-language group of services.

2. The condition in question – condition of licence #12(a), Broadcasting Decision CRTC 2017-150, Appendix 2 and Appendix 3 – specifies the amount and manner by which Corus may under-expend on Canadian programming in a broadcasting year. Corus specifically requests an increase of its maximum allowable under-expenditure limit from 5 percent to 10 percent, conditional on full payment of its total required Canadian Programming Expenditures ("**CPE**") by the end of the current licence term. To be clear, Corus is not requesting a reduction of its total CPE, which will be maintained over the current licence term. We only request additional timing flexibility within the current licence term in order to effectively manage our CPE obligations.

3. Corus has experienced significant revenue swings over the last two broadcasting years that will drive a dramatic, unanticipated spike in its CPE requirements over a short time frame. That spike would leave us in a more vulnerable financial position in the coming years. Specifically, it will lead to sub-optimal programming decisions, and impede progress on debt repayment.

4. While helpful, the current permitted under-expenditure level of 5 percent is insufficient to moderate a revenue swing on the dramatic scale Corus has experienced this year. If granted, the amendments would provide Corus important and needed flexibility. It would offer us time to develop, curate and deliver high quality programs, while paying down debt, and meeting our regulatory requirements.

5. Corus respectfully requests that the Commission process this application on an expedited basis. We require clarity on this matter as soon as possible, in order to make programming decisions for the upcoming broadcasting years. In light of the time pressures, and Corus' commitment to fulfilling its CPE requirement by the end of the licence term, we believe an expedited process for relief would be appropriate.

Corus has experienced significant revenue swings over the last two broadcasting years

6. Corus is one of Canada's largest regulated broadcasters, but it is in a unique position. Unlike its large broadcasting counterparts – Bell, Rogers and Québecor – Corus is a *pure-play* media and content company. It has no profitable telecommunications or cable distribution businesses to finance its

investments or absorb its losses in an industry increasingly disrupted by foreign Internet giants.

7. Corus and Shaw Communications Inc. ("**Shaw**") are considered 'vertically integrated' for regulatory purposes because they share a common controlling shareholder. However, both Corus and Shaw are separately traded companies on the Toronto Stock Exchange. The market does not judge Corus' performance based on Shaw's, and vice versa. Corus holds no direct financial interest in Shaw, and vice versa. [1] The companies maintain separate strategies, balance sheets, and corporate structures.

8. In the mid 2010s, broadcasting revenues began to decline across the industry,[2] and the discrete market for Canadian programming rights began to erode. These trends were driven in large part by the entry of new direct-to-consumer, Internet-based platforms into the domestic broadcasting market.

9. The combination of falling revenues and rising programming costs left Corus, as a pure play media and content company, uniquely exposed to broader industry challenges. With its debt obligations, Corus had less financial capacity to respond to these challenges than other large regulated broadcasters.

10. Corus' challenges culminated during the 2017-2018 broadcast year (Corus' fiscal year 2018, "**F2018**"). Consolidated revenues for the year were down 2 percent from the previous year, driven by a 4 percent decrease in television advertising revenues and flat subscriber revenues. Additionally: the company incurred broadcast licence and goodwill impairment charges of roughly $1 billion; the Competition Bureau stopped us from selling two French-language discretionary services to Bell Media costing $200 million in proceeds and a significant deleveraging opportunity; and Corus cut its dividend by roughly 80 percent. All told, Corus' share price declined approximately 70 percent over the course of F2018, reaching an all time low of roughly $3.62 per share. In F2018, Corus generated roughly $73 million less broadcasting revenue than its board-approved budget.

11. Faced with increasing audience fragmentation and competition for programming as well as a challenging distribution market, Corus took a clear-eyed and realistic view in building the assumptions and estimates for the 2018-2019 broadcast year (Corus' fiscal year 2019, "**F2019**"). This resulted in

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[1] Shaw divested all of its Class-B non-voting shares in Corus in a secondary market offering on May 31, 2019.
[2] See CRTC Communications Monitoring Report 2018, Figure 9.2, which shows that advertising and subscription revenues for private conventional television stations and discretionary and on-demand. services declined 2.8% and 1.2% respectively in 2017.

a financially conservative operating plan that anticipated broadcast revenues declining **[CONFIDENTIAL]** year over year in F2019.

12. Corus has made steady progress towards its strategic goals, and seen improved financial performance in F2019. We generated $1.3 billion of consolidated revenue in the first three quarters of F2019, up 3 percent from the same period in F2018, driven by an 8 percent increase in advertising in our television segment. Thus far, for F2019, Corus expects to generate roughly $83 million more in broadcasting revenue than its board-approved budget.[3] Please refer to Appendix 1, Tab 1 for a comparison of Corus' television broadcasting revenue performance versus budgeted estimates.

13. The swing in Corus' broadcasting revenue performance from $73 million *under* budget in F2018 to $83 million *over* budget in F2019 (a roughly $156 million swing) over the last two years speaks to both the inherent volatility in the media industry and to the company's disciplined operational execution of its strategic plan.

14. Following two years of significant audience losses through F2017 and F2018, audiences stabilized in F2019 while demand remained resilient. This has resulted in television advertising revenue for the industry increasing 1 percent in the first three quarters of F2019 compared to the same period in F2018, following declines in the previous two years.

15. Corus expects this volatility to continue. We do not expect our advertising revenues to remain on their current growth trajectory, particularly given that our advertising revenue growth has outpaced the industry, and advertising revenues have been declining steadily across the industry over the past five years.[4] And while we aim to reach audiences on new platforms, we expect continued erosion in the traditional BDU subscriber base. Furthermore, we anticipate new foreign direct-to-consumer platforms will continue to enter Canada in the coming years. That will further decrease viewership and increase pricing pressure on programming rights. Therefore, following F2019, we expect broadcasting revenues to revert to low single digit declines, as previously experienced.

[3] Corus is benefitting from several factors, including: increased yield on its networks; momentum with its audience-based buying platform; and innovative new advertising formats.
[4] Canadian Radio-television and Telecommunications Commission, Communications and Monitoring Report 2018, Figure 9.2.

The swings of the past two years will drive a dramatic, unanticipated spike in Corus' CPE requirements

16. Licensed broadcasters' total Canadian programming budgets are a complicated formula shaped in part by their conditions of licence, which include their exhibition and CPE requirements.

17. When budgeting, programmers must not only plan for amortization expenses for their next fiscal year, they also must anticipate the needs for the following fiscal year. They engage in this multi-year planning exercise to ensure they can fund and green light productions to air in the following fiscal year, while meeting the current year's CPE requirement. Since licence fees are typically paid throughout production, the following year's programming requirements have a direct and significant impact on the estimated cash programming payments in the fiscal budget. For example, to be compliant in broadcasting year 2019-2020 (Corus' fiscal year 2020, or "**F2020**") Corus is required to make a significant cash expenditure in F2019. Thus, heading into F2019, Corus budgeted not only the amortization expense required to meet its F2019 CPE obligation but also the cash payments related to any remaining invoices for the F2019 programming commitments as well as prepayments for programs that will not air until F2020.[5]

18. This complicated process directly impacts cash flow and earnings, two extremely important factors for a publicly traded company. Corus has focused on generating free cash flow to deleverage its balance sheet, so the expected programming cash spend in F2019 to achieve anticipated F2020 CPE amortization requirements is an equally important metric in the F2019 budgeting process. Please see Appendix 1, Tab 2 for an analysis of the relationship between programming commitments and the related timing of amortization expense and anticipated cash payments.

19. As part of the F2019 budgeting process, when considering its F2020 programming requirements, Corus took guidance from its budgeted broadcasting revenues in F2019, which were based on Corus' recent performance and industry metrics. It did so because its F2020 CPE obligation would flow from its F2019 broadcasting revenues.

20. However, the significant improvement in our broadcasting revenue performance versus budget in F2019 has increased our F2020 CPE requirements dramatically beyond our budgeted expectations. Specifically, Corus' minimum CPE expense in F2020 will be $23 million greater than originally anticipated in the F2019 budget. That increase takes into account current flexibility to under-expend our CPE requirement by 5 percent.

[5] Airing dates may be later depending on production timelines.

21. Because broadcasting regulations require Canadian programming expenditures to be calculated on an amortization basis, the cash burden of the additional CPE expenditure requirement is even heavier. Since amortization occurs over time, only a portion of the additional cash expenditures will count as eligible CPE expenses in the first year of program broadcast. Therefore, in order to meet our dramatic, unanticipated increase in CPE requirements, Corus would have to commission a significantly higher volume of programming in a very short and unrealistic period of time.

22. Generally Accepted Accounting Principles ("**GAAP**") require programmers to amortize the costs of their programming assets over their useful life. A standard GAAP-compliant amortization schedule allocates expenditures on a 50/30/20 percent basis over a three-year period. Since programming start dates are staggered throughout the broadcast year, and amortization begins when the contracted term of a program begins, in such a scenario approximately 35 percent of the asset value would typically be amortized in the first fiscal year.[6] Using that schedule, in order to meet the incremental $23 million CPE expenditure requirement in the first fiscal year, Corus would have to commit to commissioning about $67 million more in programming assets that would be amortized over roughly three years: $23 million would be amortized in the first fiscal year; $24 million in the second fiscal year; $15 million in third year; and, the remaining $4 million would carry over to following year.[7] However, the majority of the incremental $67 million in F2020 programming commitments would need to be funded in cash in F2020 in order to get programming on air within the year.

23. Put simply: a roughly $67 million increase in Corus' Canadian programming cash investment will be required to achieve a $23 million CPE increase in F2020. Please see Appendix 1, Tab 3 for details on the variance between current estimates of F2020 CPE requirements and those incorporated in the F2019 Budget at the time.

24. To be clear, Corus is encouraged by our recent revenue performance and the progress against our strategic priorities. Moreover, we accept that under the current framework an increase in broadcast revenues comes with an obligation to spend more on Canadian programming, and we are committed to meeting that greater obligation. However, a CPE increase on a dramatic scale, over a very short time frame with limited visibility to revenue stability, will create significant operational challenges for Corus as we embark on a new

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[6] Estimated based on Corus' historical practices, in accordance with GAAP. Please refer to line B4 of Appendix 1, Tab 2.
[7] This would fall outside the current licence term of the English group, but is anticipated because of staggered program starting dates.

broadcast year. If unaddressed, these challenges would leave our company in a more vulnerable financial position.

The dramatic, unanticipated spike in Corus' CPE requirement would leave it in a more vulnerable financial position

25. As noted, Corus' recent financial performance and current CPE rules will require it to dramatically increase its cash investment in Canadian programming in a very short time frame. That spike would: (a) require Corus to make sub-optimal programming investments; and, (b) impede progress on Corus' debt repayment strategy. Both events would leave our company in a more vulnerable financial position in coming years.

(a) The dramatic, unanticipated spike in Corus' CPE requirement would lead to sub-optimal programming decisions

26. The roughly $23 million in incremental investment cannot simply be used to increase budgets for existing projects in the pipeline for the upcoming broadcasting year. For the upcoming broadcasting year, television schedules have already been set, series have already been ordered, casting and script decisions have been made. Production budgets have already been finalized on this basis.

27. Practically speaking, in the business of television broadcasting, a project already in progress with a production budget of $X cannot simply be transformed into one with a production budget of $Y because the commissioning broadcaster is required to spend more money on that project. Incremental investment in programs that are already in production will not result in an incremental improvement in programming quality nor will it generate a positive financial return for the commissioning broadcaster. It simply makes those projects more expensive, and less economical.

28. Given the very short time frame that we would have to create new programming, the new programs will inevitably be rushed and of lower quality. That, in turn, will lead to an over-supply of single-season shows, with limited export potential. Normally, we depend on a several-month development period to: prepare multiple iterations of concepts and scripts; attract talent (hosts, actors, directors, writers) who are popular with audiences; produce the show; shoot re-takes; and, perform post-production work, as needed. And these programs, which will inevitably have limited lives as single seasons, will continue to be amortized over three years. As noted above in paragraph 23, the incremental $23 million in F2020 CPE amortization will drive $67 million of programming commitments, which will result in $24 million in F2021 CPE amortization. Therefore, this glut of

programming will not only impact F2020 but also limit our ability to invest dollars into high quality programming in subsequent broadcast years. Time is an essential ingredient in a successful program. It is a luxury we would not have in this case.

29. The resulting sub-optimal programming investments could have a lasting impact on our business. Effectively, programs would be quickly produced for the sole purpose of meeting a required level of annual expenditure. It is unlikely they would be green-lit for subsequent seasons when CPE levels normalize, thereby leaving us with an over-supply of single-season programs. That would be antithetical to our programming strategy, which is based on making high quality, exportable shows, which meet the demands of audiences. That, in turn, could make Corus a less attractive partner for top talent, who tend to seek multi-year commitments. It would also be antithetical to Commission policy, which has expressly shifted the emphasis from quantity to quality of Canadian programming in recent years.[8]

(b) The dramatic, unanticipated spike in Corus' CPE requirement would stall its progress on debt repayment

30. Corus has moved aggressively to reduce its debt in the last two years. For example, despite the challenging revenue outlook in F2018, we remained focused on reducing our leverage to under three times net debt to segment profit. In the fourth quarter of F2018 Corus announced its revised capital allocation policy and adjusted its annual dividend rate to $0.24 per Class B share and $0.235 per Class A share, a reduction of roughly 80 percent.

31. With strategic and operational discipline, we achieved our target of decreasing our leverage to below three times net debt to segment profit in the third quarter of F2019. But there is still work to do.

32. Corus' focus on debt reduction is deliberate and strategic. As a large pure-play Canadian media and content company, we are uniquely exposed to volatility in the industry and the economy as a whole. Deleveraging provides Corus the financial flexibility and security to evolve the business as it faces uncertainty in the coming years. The Canadian market has embraced Netflix and several global content producers have recently announced plans to launch similar subscription video on demand offerings in the coming years. These new entrants will further disrupt the market.

33. Financial analysts who follow the media industry closely continue to highlight deleveraging as an organizational priority for Corus. For example, in a June

[8] See Broadcasting Regulatory Policy CRTC 2015-86, Section B, paras 163-230.

27, 2019 research note, Maher Yaghi from Desjardins Capital Markets noted, "While the company [Corus] still generates healthy cash flows, we believe the TV environment will be challenging for the foreseeable future. Hence, the company's relatively elevated leverage remains an issue for us, as currently strong free cash flow could change quickly."[9] Similarly, Drew McReynolds from RBC Capital Markets noted in a June 26, 2019 research note, "Despite ongoing structural headwinds, we continue to believe management is striking a prudent balance between debt repayment and proactively making the necessary investments to drive the business forward."[10]

34. Because Corus has focused on generating free cash flow to deleverage its balance sheet, a dramatic increase in our programming cash spend would require us to direct funds away from debt repayment, thus impeding our strategic plans at a critical time. Furthermore, it would be unreasonable for us to direct a significant portion of these monies to meet a sudden, dramatic spike in our CPE requirement, when timeframes are too short to invest those monies wisely, and there is no evidence to support a continued, stronger revenue picture.

35. To reiterate, Corus has taken difficult actions to stabilize and grow its core business, including reducing dividend payments to shareholders, and it is committed to meeting all of its CPE obligations by the end of the current licence term. We only request additional timing flexibility in order to effectively manage our CPE obligations.

Corus requests an amendment of its conditions of licence to manage the dramatic, unanticipated increase in its CPE requirement

36. Currently, the Commission recognizes the potentially detrimental impact of sudden broadcaster revenue fluctuations. For that reason, it offers licencees the flexibility to expend up to 5 percent less than the minimum required CPE for a broadcasting year.[11] When licencees avail themselves of the under-expenditure flexibility they are then required to spend the full amount of under-expenditure in the next broadcasting year, on top of the minimum required expenditure for that year.

37. Corus does not question the merits of the CPE under-expenditure tool. It remains an effective way for broadcasters to accommodate the inherent uncertainty of estimating CPE costs in a volatile industry. However, the current permitted under-expenditure level of 5 percent is insufficient to

[9] Desjardins Capital Markets, June 27, 2019.
[10] RBC Capital Markets, June 26, 2019.
[11] See Broadcasting Regulatory Policy CRTC 2011-441, para 63.

moderate a revenue swing on the dramatic scale Corus has experienced this year.

38. Requiring a broadcaster to make up the under-expenditure in the subsequent year limits flexibility in subsequent years. For example, in F2018, the Corus English-language group under-expended its F2018 obligation by approximately 3 percent (equalling $12 million). As we look toward Corus' F2019 expenditures, although we anticipate under-expending our F2019 requirements by 5 percent (equalling $17 million), since we must carry forward the previous year's under-expenditure, this represents only an incremental $5 million cushion. If we under-expend by the full 5 percent in F2019, there will be no cushion for F2020.[12]

39. Corus therefore requests that its conditions of licence be amended to increase the maximum allowable CPE under-expenditure limit to 10 percent conditional on full payment of the total required CPE being made by the end of the current licence term. These amendments would provide Corus much needed flexibility. It would offer us sufficient time to develop, curate and deliver high quality programs, while continuing to pay down debt, and meeting the same CPE expenditure obligation over the same licence term.

40. Accordingly, Corus requests that condition of licence #12(a) applicable to the services in its English-language designated group (see Broadcasting Decision CRTC 2017-150, Appendix 2 and Appendix 3) be amended. Currently, condition of licence #12(a) states:

> In each broadcast year of the licence term, excluding the final year, the licensee, in concert with the other undertakings that form the Corus Group, may expend an amount on Canadian programming and/or on programs of national interest that is **<u>up to 5% less</u>** than the minimum required expenditure for that year calculated in accordance with conditions 11(a) and 11(b), respectively; in such case, the licensee shall ensure that the undertakings that form the Corus Group expend **<u>in the next broadcast year</u>** of the licence term, in addition to the minimum required expenditure for that year, the full amount of the previous year's under-expenditure; [emphases added]

We request that condition of licence #12(a) be amended as follows:

> In each broadcast year of the licence term, excluding the final year, the licensee, in concert with the other undertakings that form the Corus Group, may expend an amount on Canadian programming and/or on programs of national interest that is **<u>up to</u>**

[12] See current estimates in Appendix 1, Tab 3 for more details.

<u>10% less</u> than the minimum required expenditure for that year calculated in accordance with conditions 11(a) and 11(b), respectively; in such case, the licensee shall ensure that the undertakings that form the Corus Group expend **<u>by the end</u>** of the licence term, in addition to the minimum required expenditure for **<u>the final</u>** year **<u>of the licence term</u>**, the full amount of the previous year**<u>s'</u>** under-expenditure**<u>s</u>**; [emphases added]

41. To be clear, if granted, the amendments would not change the amount of our total required CPE expenditures in the current licence term. It would only change the schedule of those expenditures. Corus will commit to catching up on its under-expenditures by the end of the current licence term (August 31, 2022). We plan to do so by increasing the volume of commitments for new shows and by making subsequent seasons of the shows that have proven to be strong on our networks, and have generated international sales.

42. Appendix 1, Tab 4 provides CPE estimates under the current condition of licence #12(a) and Appendix 1, Tab 5 provides CPE estimates under the proposed amended condition. The appendices demonstrate that the total estimated eligible CPE for the licence term is the same under both scenarios. Under the current conditions of licence, after the initial increase in CPE in F2020, Corus anticipates CPE to decline through the end of the licence term. However, under the proposed amended conditions of licence, Corus expects CPE to increase gradually over time allowing for less volatility in commissioning levels.

Increased under-expenditure flexibility should raise no concerns about Corus' commitment to Canadian programming

43. If granted, the amendment to our conditions of licence would not change the amount of our total required expenditure on Canadian content in the current licence term. It would only change the timing of that expenditure. It should raise no concerns about Corus commitment to Canadian programming.

44. Indeed, Corus' recently-announced programming slate for the upcoming broadcasting year is evidence of that commitment. In June, Corus announced its 2019-2020 order of more than 40 newly commissioned seasons and titles. With an increase in Canadian production year over year (37 in 2018, and 40 in 2019), we continue to demonstrate our commitment to home grown talent. Our diverse portfolio of networks is investing in premium original content across all genres in collaboration with creators across the country. In addition to the Canadian series being announced in June, more scripted and lifestyle series will be unveiled in the coming months.

45. Corus also continues to cement its position as a leading exporter of Canadian programming through our Corus Studios content and our industry-leading kids content company, Nelvana.

46. Corus Studios develops, produces and distributes programs across an array of genres, distributed globally in over 150 territories. This year, Corus Studios will deliver 11 new series, and seven returning hits.

47. As a world-leading producer and distributor of children's content, Nelvana's content is broadcast across Corus' collection of leading kids' networks and is distributed in more than 160 countries worldwide. For the 2019-2020 broadcast year, Nelvana will create two new series and a short film, along with a number of returning series across a slate of a dozen productions, including 26 episodes of the live action series, "The Hardy Boys". In total, we have 12 series that will be delivered or are in production this year, an increase from nine series in 2018.

Corus requests that this application be dealt with as expeditiously as possible

48. Corus respectfully requests that the Commission process this application on an expedited basis. We require clarity on this matter as soon as possible in order to make programming decisions for the upcoming broadcasting year.

49. This application should not raise concerns with respect to Commission policies, regulations or conditions of licence, because Corus is committed to fulfilling its CPE requirement by the end of its current licence term. Again, if granted, the amendments would not change the amount of our total required expenditure in Canadian content in the current licence term. It would only change the schedule of that expenditure.

50. In light of the time pressures, and the fact that Corus is committed to fulfilling its CPE requirement by the end of its current licence term, we believe an expedited process for relief is appropriate.

Conclusion

51. For the foregoing reasons, Corus respectfully requests the Commission's approval of this application on an expedited basis. Once again, if granted, the amendments we seek would provide important and needed relief. They would offer us time to develop, curate and deliver high quality programs, while continuing to make progress on our deleveraging efforts, and meeting our Canadian content obligations.

52. We thank the Commission in advance for its consideration of this application.

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