

## Changing Landscape

The Canadian media landscape is transforming as consumers have many more options in accessing music, TV and movies. As an example, if you are interested in watching old episodes of *Undercover Boss*, a television show in which the CEO of a large company goes into the field for a week, you can either watch it on your local CTV channel or you can watch it on Netflix. Netflix is one of the Over the Top (OTT) providers of movie and television content over the Internet for a monthly fee. If you like to watch HBO programs, such as *Entourage* or *Dexter*, there is only one place to find that programming in Canada and that is through your cable, satellite or Internet Protocol TV provider. Companies such as Astral Media, which is held in many QV portfolios, licenses movies and Pay TV shows from studios and sells them to your cable provider. The question we ask ourselves is: Can Canadian media distributors like Astral retain a competitive advantage from the threat of Internet video consumption?

Since Netflix started offering its service in Canada in July 2010, Astral and Corus have been able to continue increasing their subscriber bases. Netflix has actually been embraced as an incremental purchase rather than a substitute. The reason in our opinion is Astral and Corus have done an excellent job of building relationships with movie studios and the service providers that bring these programs to your home. As an example, Astral and Corus have contracted exclusive Canadian distribution rights to movies from Hollywood studios and programs from HBO and Showtime. On Astral's third quarter conference call yesterday Ian Greenberg, Astral's CEO, stated "if you look at the output of US Studios both the majors and the independents, there are about 130 American features made every year, and we have contracts in hand now for over 100 of the 130." As an example, if we look at the most popular movies watched on Netflix, the list is limited. One of the most popular Netflix downloads is *Liar Liar* starring Jim Carey which was released in 1997! On the flipside, one of the most

popular downloads on Shaw Video on Demand is Golden Globe Winner *Despicable Me*, released in 2010.

The relationships built by Corus and Astral create some protection from competitors. However, this is only until the contracts expire. Astral and Corus will compete fiercely to safeguard their contract positions, but OTT providers will most likely bid up prices for this content. This will put pressure on Astral's Pay TV margins.

We must remember that Astral's other businesses have continued to display solid performance. Astral has seen advertising increase in its radio franchise that contains 83 licenses covering 50 markets. Moreover, Astral continues to see larger increases than the industry in advertising revenue and subscriptions.

## Strong Company

We recognize that technology has changed the landscape of many industries (RIM is a perfect example). Astral started as a camera shop in Montreal, but has been transformed into one of Canada's largest media companies.

Astral is trading at a price to earnings ratio of less than 12, which we believe reflects some of these concerns. Astral generates a significant amount of cash which it has used to pay down its debt substantially over the last few years. Astral has also increased its dividend by 50% over the past year and still maintains a payout ratio of 20% versus 45% for the average Canadian company.

We recognize the business model will need to evolve. Although we do not know what the media landscape in Canada will look like five years from now, we know it will be different. Ten years ago there wasn't an application called Facebook and now we can access it on our TVs. We have seen many companies transform and strengthen their businesses during industry turmoil. A company with a strong balance sheet and strong cash flow generation has the enviable financial resources to make necessary changes.