Can this thinly traded value stock withstand the Netflix onslaught?

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SPECIAL TO THE GLOBE AND MAIL
PUBLISHED 16 HOURS AGO

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In the brave new digital entertainment universe, is there still value to be found in a thinly traded stock in the traditional broadcasting space?

In March of this year, one of my HBA student groups chose Montreal-based TVA Group Inc. for their final project submission. TVA was selected for further analysis as a possibly undervalued stock. It passed the key requirements of obscurity (a small cap with low analyst coverage) and undesirability (low price-to-earnings and price-to-book ratios, implying investor pessimism about growth).

At the time, TVA Group (TVA.B-TSX) had a market capitalization of $96.4-million, with fewer than three designated analysts covering the stock. Moreover, TVA had a P/E of three and a price-to-book of 0.3.

TVA – previously known as Télé-Métropole Corp. – was founded in 1960 and operates as a subsidiary of Quebecor Media Inc. It has four main operating segments: broadcasting; magazines; film production and audiovisual services; and production and distribution.

TVA's largest revenue driver is advertising from its broadcasting segment. Broadcasting companies traditionally competed with other local, regional, or national providers. However, the rise of online streaming has increased international competition for viewing time with platforms such as Netflix , Hulu and Amazon Prime.

There are definitely risks in the Canadian broadcasting industry in the new digital age. Interestingly, anglophone broadcasters are facing significantly more competition from streaming services than their francophone counterparts. This is largely due to differences between French as spoken in Quebec and that spoken in France – with important differences in pronunciation and vocabulary in informal conversations. Such differences seem to be particularly noticeable in movies and television shows produced overseas. Moreover, content that reflects their unique culture is important to French-Canadian viewers. A study by Statista found that Netflix, for example, had a penetration rate in Canada among francophones of 30 per cent compared with 57 per cent for anglophones.

Nevertheless, it is not all smooth sailing for TVA. The proliferation of advertising on the internet has negatively affected growth in the television broadcasting segment.

TVA's total market share in 2020 was 40.4 per cent, growing at a 3 per cent compound annual growth rate over the past five years. This makes TVA the largest French-Canadian broadcasting and magazine company by market share. Competitors to TVA in francophone broadcasting include Bell Media (BCE Inc.), Noovo, Télé-Québec and Ici Radio Canada-Télé (CBC). Given that this market is highly concentrated, TVA prioritizes customer retention and acquisition by focusing on tailoring content to consumers' preferences. In response to declining revenues in its magazine and broadcasting segments, TVA has restructured its business to reduce costs.

Chief executive France Lauzière has been with TVA and Quebecor Media since 2001, rising through the ranks before becoming CEO of TVA in 2017. She is highly experienced with content programming and the Quebec broadcasting market. (Ms. Lauzière took a leave of absence of up to six months in April owing to family reasons. Pierre Karl Péladeau, CEO of Quebecor, has assumed her duties during this period.)

TVA's client base includes a few large customers. If TVA loses one or more of these customers, profitability will be significantly affected. Additionally, TVA's labour force is largely unionized; therefore, there is a risk its employees go on strike, harming TVA's ability to operate.

Ownership of TVA is broken into two classes of shares. class A shares are owned by parent company Quebecor Media. Non-voting class B shares are

68.4-per-cent owned by Les Placements Péladeau, a subsidiary of Quebecor Media, with the rest publicly traded. This shows Quebecor has significant control over the strategic direction of TVA. Since TVA is a small cap, institutional ownership is low, decreasing the likelihood of activism. It was also noted TVA's executives own very few shares, suggesting management may not be highly incentivized to improve company performance.

On balance, students concluded that the francophone segment in the Canadian broadcasting industry is of medium business risk (as is TVA's business risk) owing to high barriers to entry, stagnant broadcasting growth expectations and low direct competition from large online streaming companies.

TVA has historically operated with low debt levels. Its debt-to-capital ratio has averaged about 16 per cent over past few years, well below what is expected for companies with medium business risk. Based on that, students reckoned that TVA has low financial risk. This led them to an estimated cost of capital of 6 per cent. The company's adjusted return on invested capital was calculated to be 2 per cent, which is quite low and a cause for concern. TVA's intrinsic value was estimated to be $4.56 and, accounting for the margin of safety, the entry price to be $3.04. With the stock trading at the time of valuation at about $2.23, students felt TVA was a strong buy.

TVA Group's stock closed Tuesday on the Toronto Stock Exchange at $2.98, and hence it continues to be a buy.

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