Viacom Inc. – Content Remains King

Target Price Analysis Versus $25.70 PPS (as of 10/24/17)

Valuation Case 1: Target Price = $57.00; 30% IRR for 3-year hold period

Valuation Case 2: Target Price = $58.00; 31% IRR for 3-year hold period

Valuation Case 3: Target Price = $58.90; 32% IRR for 3-year hold period

(See Section I.B herein for calculations)

"[In 1996,] content vs. distribution was the great debate, and the big money was on distribution. I told everyone who would listen that content is king. Content is still king."
—Sumner Redstone, 2006 (source)

Shares of Viacom Inc. (ticker: VIAB) have been discarded by investors like yesterday's print newspaper. Flung on to the trash heap and now trading meekly in the mid-20s, the stock price reflects investors' view the company is an aging dinosaur, soon to be put out of its misery by the likes of Netflix. Yet the shift from cable to online viewing is not unprecedented in the history of entertainment. If one looks back over the past 100 years, one can discern numerous distribution channel evolutions: vaudeville gave way to movies and radio, which then gave way to over-the-air television, which then gave away to cable, etc. The evolution continues—but the creators of content (as opposed to owners of any particular distribution channel) will always be needed.

With the likes of MTV, Nickelodeon, BET, Comedy Central, CMT and Paramount Pictures, Viacom has been and should for the foreseeable future continue to be one of the preeminent creators of content. Creating compelling content is their core competency. Consumers of media may migrate from cable to Internet TV, but Viacom should be able to migrate as well. Currently trading at an anemic 7X expected 2018 earnings, we believe that Viacom's B shares remain a compelling investment opportunity for the patient investor, with our ***blended target price of $58/share representing an expected IRR of 31% over the next 3 years***.

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I. Description of Investment Opportunity.

A. Introduction to Viacom

In Viacom's 2016 10-K (page 1), the company's business is described as follows:

> Viacom is home to premier global media brands that create compelling television programs, motion pictures, short-form content, applications ("apps"), games, consumer products, social media experiences and other entertainment content for audiences in more than 180 countries. We operate through two reporting segments: *Media Networks* and *Filmed Entertainment*….
>
> On October 31, 2016, we announced the appointment of Robert Bakish as Acting President and Chief Executive Officer, effective November 15, 2016. We also announced that Mr. Bakish was being appointed, effective immediately, to the new role of President and Chief Executive Officer of the recently established our Global Entertainment Group within our *Media Networks* segment.
>
> **Media Networks**
>
> Our Media Networks segment provides entertainment content and related branded products for consumers in targeted demographics attractive to advertisers, content distributors and retailers. We create, acquire and distribute programming and other content for our audiences across multiple platforms, which allows our audiences to engage and interact with our content in a variety of ways: through cable and satellite distribution; through over-the-top ("OTT") services, such as subscription video-on-demand ("SVOD"); on connected televisions, PCs, tablets, smartphones and other connected devices; using apps, browsers and other interfaces; and through a variety of social media platforms.
>
> Viacom Media Networks operates our media networks businesses through three brand groups: the Global Entertainment Group, the Nickelodeon Group and BET Networks. Viacom Media Networks conducts our global media networks operations, reaching approximately 530 million households in more than 180 countries and more than 40 languages worldwide, via more than 250 locally programmed and operated television channels, including Nickelodeon®, Comedy Central®, MTV®, VH1®, SPIKE®, BET®, CMT®, TV Land®, Nick at Nite®, Nick Jr.®, Channel 5® (in the United Kingdom ("UK")), Logo®, Nicktoons®, TeenNick® and Paramount Channel™. Viacom Media Networks also operates branded experiences including channels on streaming services and social media platforms such as DIRECTV NOW and Snapchat Discover.
>
> On October 31, 2016, we announced that the Global Entertainment Group had been established as a new brand group to combine Viacom International Media Networks ("VIMN"), our former Music & Entertainment Group (which included MTV, Comedy Central, VH1, Spike and Logo), as well as TV Land and CMT. We also announced that our former Kids & Family Group would be reestablished as the Nickelodeon Group.
>
> Our *Media Networks* segment generates revenues from advertising sales, affiliate fees and ancillary revenues. Revenues from the *Media Networks* segment accounted for 79%, 78% and 73% of our revenues for the fiscal years 2016, 2015 and 2014, respectively, after the elimination of intercompany revenues.

Filmed Entertainment

Our Filmed Entertainment segment produces, finances, acquires and distributes motion pictures, television programming and other entertainment content under the Paramount Pictures®, Paramount Animation®, Nickelodeon MoviesTM, MTV Films® and Paramount TelevisionTM brands. Paramount Pictures is a major global producer and distributor of filmed entertainment and has a library consisting of approximately 3,500 motion pictures and a number of television programs. Paramount distributes motion pictures theatrically and through download-to-own, DVDs and Blu-ray discs, transactional video-on-demand ("TVOD"), SVOD, pay, basic cable and free television and other platforms and devices in the United States and internationally for itself and for third parties. Paramount TelevisionTM develops, finances and produces programming for television and other platforms.

Our Filmed Entertainment segment generates revenues primarily from the release and/or distribution of motion pictures theatrically, through home entertainment, and by licensing to television and digital platforms. It also generates revenue from the licensing and distribution of television programming and through ancillary activities. Revenues from the Filmed Entertainment segment accounted for 21%, 22% and 27% of our revenues for the fiscal years 2016, 2015 and 2014, respectively, after the elimination of intercompany revenues..

B. Analysis of Investment Opportunity

1. Valuation Case 1 – Enterprise Value Metrics

Comparison of enterprise value to subscriber of Netflix to Viacom:

Viacom branded networks reach almost 4 billion cumulative subscribers in more than 180 countries and territories via some 270 locally programmed and operated TV channels in more than 40 languages; it also owns many digital media and mobile TV properties (source). With channels in over 700 million households (source), the company has an enterprise value of just over $21 billion[1]. If one subtracts $4 billion from the enterprise value for Paramount[2], then the remaining enterprise value of slightly over $17 billion divided by 700 million households served equals $24.40 per household (or $2.03/household per month). If we further assume that 10% of the total possible viewership is reached per month (i.e., assuming 10% of TV viewers watch a Viacom channel at least once per month—this seems a reasonable, if not conservative, estimate), then Viacom (ex-Paramount) has an enterprise value per monthly viewer of $42.60[3].

In comparison, Netflix has slightly over 104 million subscribers worldwide[4]. At an enterprise value of $90.4 billion[5], Netflix has an EV/subscriber of $869, meaning

[1] Viacom EV = 402.6 million O/S shares X $25.7 PPS = $10.4 billion market cap, plus $10.7 billion net debt = $21.05 billion enterprise value.

[2] "Hollywood-based Paramount is worth about $4 billion, according to analysts and investors. Some analysts have suggested the studio could be valued at as much as $10 billion if Viacom was able to make a deal with an investor eager for a trophy like Paramount, one of the original Hollywood studios" (source).

[3] Calculation: ($21.05 billion minus $4 billion) / 400 million.

[4] "Millions of new subscribers continue to stream in to Netflix thanks to its ambitious lineup of original shows. Netflix on Monday announced adding more than 5 million subscribers in the June quarter, bringing its total

that Netflix's EV/subscriber is valued at 20.4X Viacom's EV/monthly viewer(!). Granted, Netflix has a subscription model via which it can raise prices, while Viacom is dependent on both affiliate fees and ad revenues (so only partially an indirect subscription model), but the value disparity still seems quite extreme. Is a Viacom monthly viewer worth to Viacom just 4.9% (1/20.4) of the value of what a Netflix subscriber is worth to Netflix? Last quarter, for example, Netflix generated $2.985 billion in revenues from its 104 million paid subscribers, or $28.70/subscriber during the quarter [about $9.55/month]. In comparison, Viacom generated $2.56 billion in revenues from its estimated 400 million "subscribers" in Q2 2017[6], or $6.40/subscriber [about $2.13/month]. Based on respective revenues generated, these numbers suggest that a Netflix subscriber is actually only about 4.5X as valuable as a Viacom "subscriber", not 20.4X as indicated above (meaning that Netflix's EV is overstated by about 4.5X or Viacom's Media Networks' EV is understated by about 4.5X, or a combination thereof). In other words, based on current revenue generation Netflix's 104 million subscribers should really be worth about 468 million Viacom "subscribers" (4.5 X 104 million), but they are actually valued by the market as being worth 2.1 billion Viacom "subscribers" (20.4 X 104 million). Clearly the market is predicting blue skies forever for Netflix's online delivery business model and/or assuming that Viacom can never transition its content to online delivery instead of cable (yet, skinny bundles seem to be at least a partial solution).

Let us cut through all of this neatly: It is simply irrational to believe that a Netflix subscriber is over 20X as valuable as a Viacom subscriber. Instead, keeping in mind the 4.5X revenue disparity noted above, we would posit that a range of 5X to 7X would be reasonable (this range skews higher than the 4.5X revenue multiple to give Netflix credit for future subscriber and revenue growth). There is an easy way to get to the upper end of this range (to be more conservative in favor of Netflix)—simply value Netflix at 60% of its current EV and Viacom (excluding Paramount) at 180% its current EV, i.e., Netflix at an EV of $54.2 billion[7] and Viacom at an EV of $30.6 billion (or $34.6 billion including Paramount)[8]. If we do this, a Viacom subscriber is now worth $76.50[9] and a Netflix subscriber is now worth $521[10], or 6.8X that of a Viacom subscriber. ***Tellingly, at these adjusted EVs, Viacom's shares should trade at $59.40[11] and Netflix's at $117.30[12].***

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subscriber base to about 104 million. The vast majority of new subscribers -- more than 4 million -- came from its overseas markets. In fact, Netflix's international subscriber base is now larger than the U.S. for the first time." (source).

[5] Netflix EV = 447.4 million shares X $196 = $87.7 billion + $2.7 billion net debt = $90.4 billion total enterprise value.

[6] Per Viacom's Q3 FY 17 earnings press release: "Media Networks revenues grew 2% to $2.56 billion in the quarter, with affiliate revenues up 4% to $1.19 billion and advertising revenues up 2% to $1.24 billion".

[7] Calculation = $90.4 billion X 0.6.

[8] Calculation = $17 billion X 1.8 + $4 billion for Paramount.

[9] Calculation = $30.6 billion/ 400 million subscribers.

[10] Calculation = $54.2 billion / 104 million subscribers.

[11] Calculation = ($34.6 billion minus $10.7 billion net debt) / 402.6 million O/S shares.

[12] Calculation = ($54.2 billion minus $2.7 billion net debt) / 447.4 million O/S shares.

Comparison of enterprise value to EBITDA of Netflix and Viacom with competitors:

As a check on our above conclusions, we can also look at the EV/EBITDA multiples for various media companies in comparison to Viacom. Below are the relevant numbers, which show Netflix completely off the charts high and Viacom at the bottom:

EV/EBITDA Competitive Comparison Data

Ticker	***Company***	***Market Cap (MM)***	***EV-to-EBITDA***
NFLX	Netflix Inc.	$87,690	107.7
TWX	Time Warner Inc.	$79,204	13.4
CBS	CBS Corp.	$23,686	12.1
DIS	Walt Disney Co.	$153,422	10.2
FOXA	Twenty-First Century Fox Inc.	$50,377	9.0
VIAB	Viacom Inc.	$10,350	7.2

(Source – Note that we have corrected Netflix's market cap and EBITDA to reflect Q3 2017 results and Viacom's EV/EBITDA multiple to reflect $2.92B in TTM EBITDA (each per Yahoo! Finance).

First, we note that Netflix is an extreme outlier at 108X EV/EBITDA. In order for Netflix's multiple to match the peer group (excluding Viacom) average multiple of 11.2X, either its market capitalization would need to decrease by 92.7% to $6.4 billion (***in which case its stock price would be $14.30/share[13]***) or its EBITDA would need to increase by 885% to $8.02 billion (or some combination in both directions). Conversely, for Viacom to trade at the peer multiple (excluding Netflix), either its market capitalization would need to increase by 104% to $21.9 billion (***in which case its stock price would be $54.50/share[14]***) or its EBITDA would need to decrease by 34% to about $1.92 billion (or some combination in both directions). Such a decline does not appear likely to us, however, at least in the near term, since Viacom renewed its carriage agreement with Charter Communications last week, preserving its main channels (MTV, Nickelodeon, Comedy Central, Paramount Network and BET) on Spectrum's cheapest tier package covering 16.6 million homes, and also earlier this year signed an agreement with Altice to restore Viacom channels to Suddenlink covering 1.5 million homes[15].

2. Valuation Case 2 – SOP

In order to check independently whether our EV/subscriber and EV/EBITDA expected values of $54.50/share to $59.40/share (with a midpoint of $57.00/share)

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[13] Calculation = ($9.1 billion EV (i.e., 11.2X TTM EBITDA) minus $2.7 billion net debt) / 447.4 million O/S shares = $14.30/share.
[14] Calculation = ($32.6 billion EV (i.e., 11.2X TTM EBITDA) minus $10.7 billion net debt) / 402.6 million O/S shares = $54.47/share.
[15] For Charter renewal details, see https://www.reuters.com/article/us-viacom-charter-commns/viacom-charter-deal-to-include-eight-networks-in-basic-package-source-idUSKBN1CN2GJ. For Altice agreement, see http://www.fiercecable.com/cable/altice-carriage-deal-returns-viacom-channels-to-suddenlink.

for Viacom's equity is reasonable, we also have calculated the expected value using a sum-of-the-parts methodology, as follows:

<u>Paramount</u>: Valued at $4 billion to $10 billion per press reports (see, e.g., footnote 2 above). For our base case and to be conservative, we will use a value of $4 billion. Note that the Chinese financing partners for Paramount, Shanghai Film Group and Huahua Media, which were supposed to supply half of the financing for the next 3 years' slate of the studio's movies, did not fulfill their contractual obligations and will need to be replaced[16].

<u>U.S. Media Networks</u>: Valued at 8X EBITDA[17] of $4 billion (2017 estimated domestic $3.82 billion operating profit[18] + $180 million Depreciation), or $32 billion.

<u>International Media Networks</u>: Valued at $3 billion, or approximately 1.5X the first 9 months of 2017 revenue runrate of $2 billion. Note that Viacom purchased channel 5 in the UK for £450 million ($747 million at the prevailing exchange rate) in 2014 and Argentina's Telefe Network for $336 Million in 2016. Just these two acquisitions represent over $1 billion in value.

Tying the foregoing together, we arrive at the following Sum-of-the-Parts Valuation:

1. Value of Paramount = $4 billion; <u>plus</u>
2. Value of US Media Networks = $32 billion; <u>plus</u>
3. Value of foreign media networks = $3 billion; <u>minus</u>
4. Capitalized cost of corporate operations = $5 billion (12.5X $400 annual operating loss for corporate and restructuring); <u>minus</u>
5. Net debt = $10.7 billion net debt; <u>equals</u>
6. ***<u>SoP = $23.3 billion [versus $10.3 billion current market cap], or $58/share.</u>***

3. Valuation Case 3 – Free Cash Flow Per Share

Finally, we value Viacom on a free cash flow (FCF) per share basis. We begin by assuming that Viacom trades at a 25% discount to the market multiple, due to its supposed vulnerability to cord cutting. The FCF yield for the S&P 500 (excluding utilities, which have negative FCF in aggregate) is approximately 4.4%, meaning that the FCF multiple for the index (ex-utilities) is 1 divided by 4.4%, or 22.7X. Thus, assigning a 25% discount to this number results in a 17X FCF/share multiple for Viacom. Next, let us examine Viacom's FCF on a trailing 12-month basis (TTM) basis:

- In the first nine months of FY2017, FCF was $515 million[19];

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[16] See http://variety.com/2017/film/news/paramount-chinese-investors-billion-1201964118/ and http://deadline.com/2017/09/paramount-slate-financing-dallas-billionaire-consortium-china-huahua-media-shanghai-film-group-1202170487/.

[17] Discount of 24% to the 11.2 multiple is the average of the EBITDA multiples listed above for Time Warner, 20th Century Fox, CBS and Disney.

[18] Source: Credit Suisse analyst report on Viacom dated 8/3/17, page 6.

- For all of FY2016, FCF was $1.2 billion[20]; and
- For the first nine months of FY2016, FCF was $320 million[21];
- Therefore, for the final quarter of FY2016, FCF was $880million ($1.2 billion minus $320 million);
- Thus, on a TTM basis through Q3 FY17, FCF for Viacom is $1.395 billion ($515 million plus $880 million), or $3.46/share based on 402.6 million shares outstanding.

Assigning Viacom 17X multiple to the $3.46/share of TTM FCF for Viacom produces a valuation of ***$58.90/share for Viacom stock***.

[19] Per Viacom's Q3 FY17 earnings release, "In the nine months, net cash provided by operating activities increased $253 million, or 63%, to $653 million, *free cash flow increased $195 million, or 61%, to $515 million* and operating free cash flow increased $228 million, or 71%, to $548 million." (emphasis added)

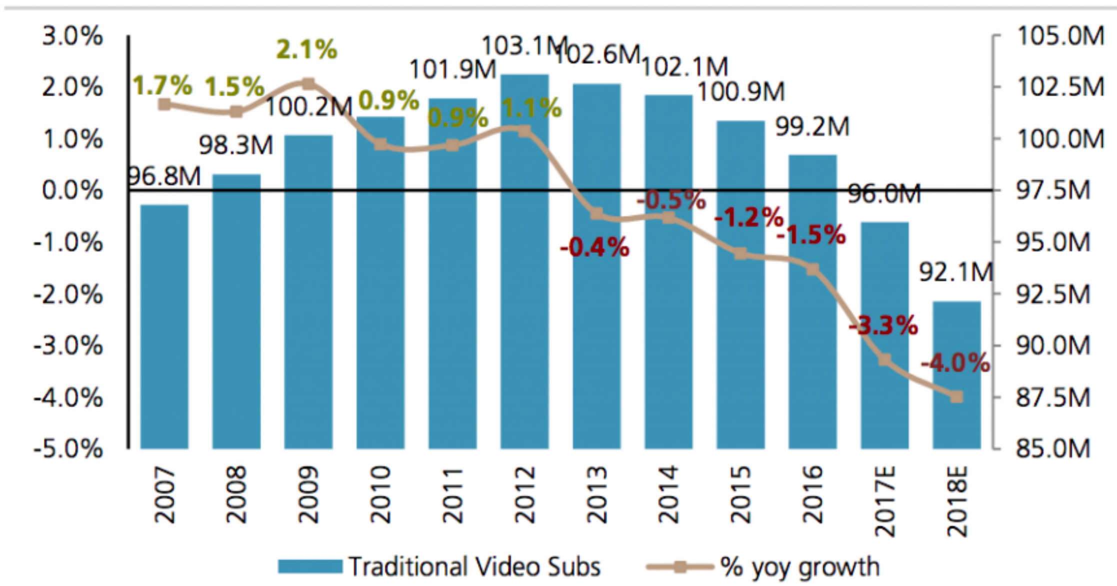
[20] Per the statement of cash flows in Viacom's 2016 Form 10-K, cash provided by operations for FY2016 was $1.37 billion and capex was $170 million.

[21] Per the statement of cash flows in Viacom's Q3 2016 Form 10-Q, cash provided by operations for the first nine months of FY2016 was $400 million and capex was $80 million.

C. Examining the Bear Case

Bears (or at least those investors currently holding off on buying Viacom stock) believe that cable is dying or will die soon, with cord cutting eventually making the industry obsolete. Consequently, it is believed, the steady revenues enjoyed by the likes of Viacom from affiliate fees and advertising will gradually dry up. Only under such a draconian scenario would it make sense to value Netflix's EV at 10X that of its cable competitors. Below is one recent bearish take from UBS, showing a dramatic drop in cable subscribers expected in 2017/2018 (source):

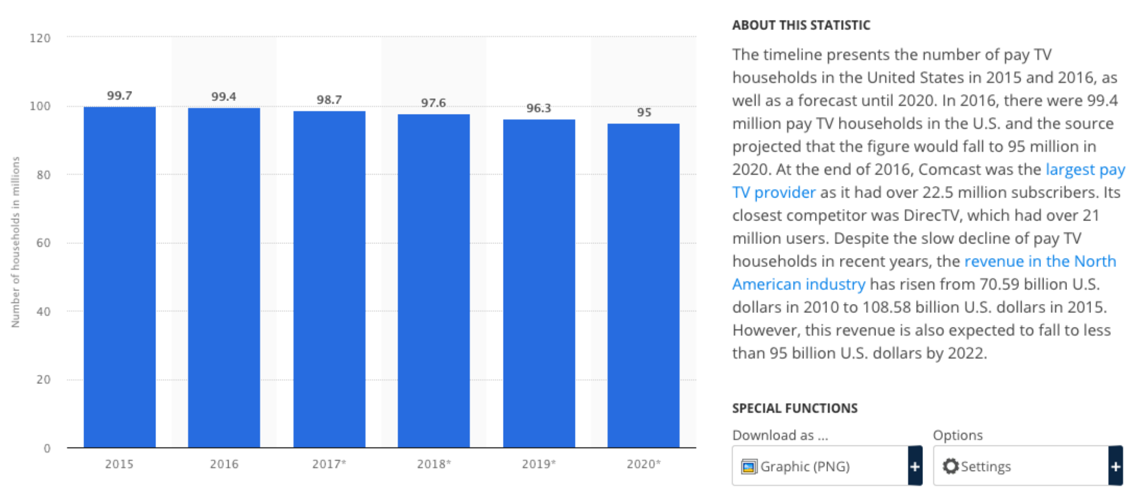
Figure 7: Traditional video subscribers



Source: Company data, UBS estimates

A different forecasting service has a much more gradual expected decline (source):

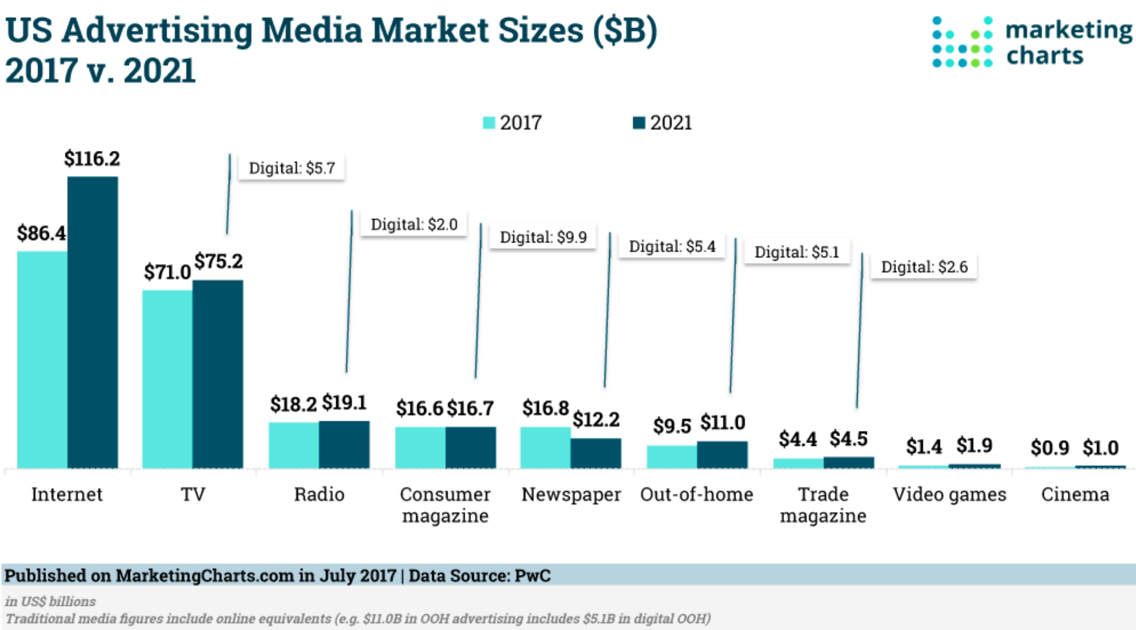
Number of pay TV households in the United States from 2015 to 2020 (in millions)



The facts on the ground suggest that the cable ecosystem (and its reliable income stream) will not evaporate into nothingness anytime soon, however, for the following reasons:

- While it is true that traditional cable subscriber numbers may trend lower over time, this trend should eventually bottom out, as there are only so many people who prefer a la carte viewing (i.e., OTT) to an all-in-one package (i.e., cable). Although the cost of Netflix and other OTT services is low vis-a-vis cable, one does not receive the same content. If a consumer of video wants the regular networks, live sports and news, etc., he or she will need to buy either cable or rely on combination of a TV antenna and a skinny bundle (which is a hassle and not much cheaper than cable, once the cost of high-speed Internet is factored in). Cable TV should also retain pricing power, which should at least partially offset the negative subscriber trends and preserve affiliate fees.

- Despite conventional wisdom, advertising revenues have NOT been migrating from TV to online; rather, they've been migrating from print (newspapers, magazines) to online. Ad revenues for pay TV have stayed relatively constant in recent years and are expected to grow 6% between now and 2021, as seen in the chart below (per PwC – source):



- OTT services will need quality content (as opposed to amateur-hour YouTube videos), and Viacom should be available to supply such content. For example, Disney will be launching its own OTT package in 2019. The following news excerpt describes current plans for the service (source):

> Films from Marvel and *Star Wars* that now go to Netflix will move to Disney's planned ad-free direct-to-consumer streaming service, CEO Bob Iger said today at an investor gathering. "We're going to launch big, and we're going to launch hot" by late 2019, he told the Bank of America Merrill Lynch 2017 Media, Communications & Entertainment Conference. Iger adds that it's "possible" that it will launch in some overseas markets "earlier than we launch in the United States due to windowing opportunities that we have on the motion picture side." There'll be four or five original Disney-branded films made exclusively for the online service, as well as four-to-five original Disney-branded TV series. The app will also have Disney's film library of nearly 500 films, and 7,000 episodes from the TV library. The CEO expects to have "thousands" of shorts and "will produce more original short-form content" for it.

In addition, non-sports content providers recently teamed up to launch their own skinny bundle service called Philo, on which Viacom content will appear (the service is priced at just $20/month, due to the absence of costly sports content) (source):

Media companies band together for sports-free streaming

Sep. 11, 2017 7:46 PM ET | By: Jason Aycock, SA News Editor

- A number of "loner" networks in the new streaming era are banding together along with their parent companies to offer a new direct service counterprogrammed for those who don't care for sports, *The Wall Street Journal* reports.
- A soft launch is weeks away for a service from Discovery Communication (DISCA -2.1%), Viacom (VIA -1.5%, VIAB -0.3%), AMC Networks (AMCX -0.7%), Scripps Networks Interactive (SNI -0.3%) and A&E (co-owned by Walt Disney (NYSE:DIS) and Hearst).
- Subscriptions will be less than $20 a month -- helped along by the fact that the service will save on what has become very high costs for live sports programming.
- The exact list of networks is still to be determined, but sources say the parent companies all expect their core channels will be part of the service.
- It will be branded Philo after the college-campus streaming specialist that will be powering it (itself named for TV inventor Philo Farnsworth).

D. Price Disparity Between Viacom "A" and "B" Shares

There currently exists a wide spread between the price of Viacom's "A" and "B" shares[22]. With the "A" shares (ticker: VIA) trading at $32.35/share and the "B" shares at $25.70/share, the spread currently stands at substantial 26%. Below is a chart showing the historical spread:

From the above we can see that from inception of trading in 2006 until the spring of 2010, there was no real spread between the "A" shares and the "B" shares. However, the spread widened significantly for about two years from 2010 to 2012, before disappearing. Only in the past couple years has the spread widened yet again. But based on past history, we should expect that the spread will eventually close, in which case the "B" shares could see additional upside versus the "A" shares. (Note that this also offers a potential arbitrage if one were to short the "A" shares and go long the "B" shares, thereby removing market risk from the investment equation.)

[22] The only fundamental difference between two share classes is that the "A" shares enjoy voting rights, whereas the "B" shares do not.

II. Financial Information and Corporate Governance

A. Viacom's Historical Financial Data

For reference, below please find past 5-year financial operating and balance sheet data for Viacom:

CONSOLIDATED STATEMENT OF EARNINGS DATA

	Year Ended September 30,				
(in millions, except per share amounts)	2016	2015	2014	2013	2012
Revenues	$ 12,488	$ 13,268	$ 13,783	$ 13,794	$ 13,887
Operating income	$ 2,526	$ 3,112	$ 4,082	$ 3,836	$ 3,901
Net earnings from continuing operations (Viacom and noncontrolling interests)	$ 1,471	$ 2,002	$ 2,464	$ 2,449	$ 2,385
Net earnings from continuing operations attributable to Viacom	$ 1,436	$ 1,922	$ 2,392	$ 2,407	$ 2,345
Net earnings from continuing operations per share attributable to Viacom:					
Basic	$ 3.62	$ 4.78	$ 5.54	$ 4.95	$ 4.42
Diluted	$ 3.61	$ 4.73	$ 5.43	$ 4.86	$ 4.36
Weighted average number of common shares outstanding:					
Basic	396.5	402.2	432.1	486.2	530.7
Diluted	398.0	406.0	440.2	494.8	537.5
Dividends declared per share of Class A and Class B common stock	$ 1.40	$ 1.46	$ 1.26	$ 1.15	$ 1.05

CONSOLIDATED BALANCE SHEET DATA

	September 30,				
(in millions)	2016	2015	2014	2013	2012
Total assets	$ 22,508	$ 22,143	$ 22,985	$ 23,710	$ 22,210
Total debt	$ 11,913	$ 12,285	$ 12,699	$ 11,818	$ 8,112
Total Viacom stockholders' equity	$ 4,277	$ 3,538	$ 3,719	$ 5,193	$ 7,448
Total equity	$ 4,330	$ 3,599	$ 3,747	$ 5,190	$ 7,439

For reference, below please find 1st half of 2017 financial operating data for Viacom:

(in millions, except per share amounts)	Quarter Ended June 30, 2017	Quarter Ended June 30, 2016	Nine Months Ended June 30, 2017	Nine Months Ended June 30, 2016
Revenues	$ 3,364	$ 3,107	$ 9,944	$ 9,262
Expenses:				
Operating	1,788	1,575	5,551	4,822
Selling, general and administrative	756	708	2,205	2,080
Depreciation and amortization	53	55	167	166
Restructuring	21	—	237	—
Total expenses	2,618	2,338	8,160	7,068
Operating income	746	769	1,784	2,194
Interest expense, net	(155)	(156)	(469)	(466)
Equity in net earnings of investee companies	47	19	78	85
Gain on sale of EPIX	285	—	285	—
Gain/(loss) on extinguishment of debt	16	—	(20)	—
Other items, net	(18)	3	(17)	(1)
Earnings from continuing operations before provision for income taxes	921	635	1,641	1,812
Provision for income taxes	(233)	(195)	(417)	(602)
Net earnings from continuing operations	688	440	1,224	1,210
Discontinued operations, net of tax	3	—	3	—
Net earnings (Viacom and noncontrolling interests)	691	440	1,227	1,210
Net earnings attributable to noncontrolling interests	(8)	(8)	(27)	(26)
Net earnings attributable to Viacom	$ 683	$ 432	$ 1,200	$ 1,184
Amounts attributable to Viacom:				
Net earnings from continuing operations	$ 680	$ 432	$ 1,197	$ 1,184
Discontinued operations, net of tax	3	—	3	—
Net earnings attributable to Viacom	$ 683	$ 432	$ 1,200	$ 1,184
Basic earnings per share attributable to Viacom:				
Continuing operations	$ 1.69	$ 1.09	$ 3.00	$ 2.99
Discontinued operations	0.01	—	0.01	—
Net earnings	$ 1.70	$ 1.09	$ 3.01	$ 2.99

For reference, below please find the 1st half of 2017 balance sheet for Viacom:

VIACOM INC.
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(in millions, except par value)	June 30, 2017	September 30, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 425	$ 379
Receivables, net	3,302	2,712
Inventory, net	930	844
Prepaid and other assets	477	587
Total current assets	5,134	4,522
Property and equipment, net	955	932
Inventory, net	4,074	4,032
Goodwill	11,648	11,400
Intangibles, net	325	315
Other assets	990	1,307
Total assets	$ 23,126	$ 22,508
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$ 325	$ 453
Accrued expenses	878	773
Participants' share and residuals	848	801
Program obligations	746	692
Deferred revenue	406	419
Current portion of debt	70	17
Other liabilities	523	517
Total current liabilities	3,796	3,672
Noncurrent portion of debt	11,103	11,896
Participants' share and residuals	370	358
Program obligations	468	311
Deferred tax liabilities, net	337	381
Other liabilities	1,381	1,349
Redeemable noncontrolling interest	209	211
Commitments and contingencies (Note 7)		
Viacom stockholders' equity:		
Class A common stock, par value $0.001, 375.0 authorized; 49.4 and 49.4 outstanding, respectively	—	—
Class B common stock, par value $0.001, 5,000.0 authorized; 353.0 and 347.6 outstanding, respectively	—	—
Additional paid-in capital	10,108	10,139
Treasury stock, 393.8 and 399.4 common shares held in treasury, respectively	(20,591)	(20,798)
Retained earnings	16,589	15,628
Accumulated other comprehensive loss	(697)	(692)
Total Viacom stockholders' equity	5,409	4,277
Noncontrolling interests	53	53
Total equity	5,462	4,330
Total liabilities and equity	$ 23,126	$ 22,508

Below please find past 3-year statements of cash flow for Viacom:

VIACOM INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended September 30,		
(in millions)	2016	2015	2014
OPERATING ACTIVITIES			
Net earnings (Viacom and noncontrolling interests)	$ 1,473	$ 2,002	$ 2,463
Discontinued operations, net of tax	(2)	—	1
Net earnings from continuing operations	1,471	2,002	2,464
Reconciling items:			
Depreciation and amortization	221	222	217
Asset impairment	—	—	43
Feature film and program amortization	4,568	4,925	4,206
Equity-based compensation	163	101	122
Equity in net earnings and distributions from investee companies	(83)	(95)	(39)
Deferred income taxes	254	(82)	(290)
Operating assets and liabilities, net of acquisitions:			
Receivables	149	124	(106)
Inventory, program rights and participations	(5,102)	(4,826)	(4,245)
Accounts payable and other current liabilities	(229)	(9)	252
Other, net	(41)	(49)	(27)
Cash provided by operations	1,371	2,313	2,597
INVESTING ACTIVITIES			
Acquisitions and investments, net	(58)	(115)	(732)
Capital expenditures	(172)	(142)	(123)
Grantor trust contributions	(69)	—	—
Net cash flow used in investing activities	(299)	(257)	(855)
FINANCING ACTIVITIES			
Borrowings	—	990	1,484
Debt repayments	(368)	(1,400)	(600)
Purchase of treasury stock	(100)	(1,548)	(3,529)
Dividends paid	(635)	(564)	(541)
Excess tax benefits on equity-based compensation awards	—	43	84
Exercise of stock options	11	146	173
Other, net	(81)	(144)	(171)
Net cash flow used in financing activities	(1,173)	(2,477)	(3,100)
Effect of exchange rate changes on cash and cash equivalents	(26)	(73)	(45)
Net change in cash and cash equivalents	(127)	(494)	(1,403)
Cash and cash equivalents at beginning of period	506	1,000	2,403
Cash and cash equivalents at end of period	$ 379	$ 506	$ 1,000

For reference, below please find 1st half of 2017 cash flow data for Viacom:

VIACOM INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(in millions)	Nine Months Ended June 30, 2017	Nine Months Ended June 30, 2016
OPERATING ACTIVITIES		
Net earnings (Viacom and noncontrolling interests)	$ 1,227	$ 1,210
Discontinued operations, net of tax	(3)	—
Net earnings from continuing operations	1,224	1,210
Reconciling items:		
Depreciation and amortization	167	166
Feature film and program amortization	3,475	3,253
Equity-based compensation	52	71
Equity in net earnings and distributions from investee companies	(11)	(81)
Gain on sale of EPIX	(285)	—
Deferred income taxes	(118)	470
Operating assets and liabilities, net of acquisitions:		
Receivables	(504)	(137)
Production and programming	(3,252)	(3,915)
Accounts payable and other current liabilities	(139)	(482)
Other, net	44	(155)
Net cash provided by operating activities	653	400
INVESTING ACTIVITIES		
Acquisitions and investments, net	(358)	(59)
Capital expenditures	(139)	(80)
Proceeds received from sale of EPIX	593	—
Proceeds received from grantor trusts	52	—
Sale of marketable securities	108	—
Net cash provided by/(used in) investing activities	256	(139)
FINANCING ACTIVITIES		
Borrowings	2,569	—
Debt repayments	(3,300)	(368)
Commercial paper	—	453
Purchase of treasury stock	—	(100)
Dividends paid	(239)	(476)
Excess tax benefits on equity-based compensation awards	1	—
Exercise of stock options	172	10
Other, net	(64)	(64)
Net cash flow used in financing activities	(861)	(545)
Effect of exchange rate changes on cash and cash equivalents	(2)	(30)
Net change in cash and cash equivalents	46	(314)
Cash and cash equivalents at beginning of period	379	506
Cash and cash equivalents at end of period	$ 425	$ 192

B. Corporate Governance

Viacom's corporate governance situation has improved dramatically over the past year or so. As most investors are aware, there has been a long drawn-out soap opera regarding the mental competence (or lack thereof) of Viacom founder Sumner Redstone, who is now 94 years old. In late 2016, Shari Redstone, daughter of Sumner, was able to seize control of Viacom's board of directors (replacing five incumbent board members with her own approved nominees[23]), which resulted in the resignation of former CEO Phillippe Dauman and the appointment of new CEO Bob Bakish (formerly in charge of Viacom's international media networks)[24]. With Shari Redstone and Bakish now firmly in control of the company, we believe that the distractions of the past few years are over with—and Viacom can now get back to focusing solely on producing great content, regaining lost relevance in the entertainment marketplace and rewarding shareholders for their patience.

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[23] The new directors are Buzzfeed Chairman and tech investor Kenneth Lerer, former Sony executive Nicole Seligman, former Discovery CEO Judith McHale, Bank of America alum Thomas J. May and former DreamWorks COO Ronald Nelson.

[24] See, e.g., the following news coverage:
http://fortune.com/2016/06/17/here-are-all-the-ways-viacom-has-become-a-hot-mess/;
http://www.expressnews.com/business/article/Redstone-family-trying-to-reclaim-control-of-8312086.php;
https://www.nytimes.com/2016/08/23/business/dealbook/lessons-from-the-viacom-dispute.html;
http://variety.com/2016/biz/news/philippe-dauman-tom-dooley-viacom-settlement-sumner-redstone-1201841061/;
http://www.businesswire.com/news/home/20161212006121/en/Viacom-Appoints-Bob-Bakish-CEO; and
http://variety.com/2017/tv/news/bob-bakish-viacom-ceo-2-1201962791/.

III. Risk Factors

Below are some key risk factors involved in an investment in Viacom shares (investors should also carefully review all of the risk factors set forth Viacom's SEC filings):

- *Success is Dependent upon Public Acceptance of Viacom's Brands, Programming, Motion Pictures and Other Entertainment Content, which is Difficult to Predict*: Consumer acceptance of Viacom brands, entertainment content and retail offerings is key to the success of Viacom's business and ability to generate revenues. The production and distribution of programming, motion pictures and other entertainment content is inherently risky because the revenues Viacom derives from various sources primarily depend on the public's acceptance of Viacom content, which is difficult to predict. Consumer acceptance of Viacom content is affected by Viacom's ability to maintain or develop strong brand awareness and target key audiences, the quality and acceptance of competing entertainment content and the availability of alternative forms of entertainment and leisure time activities, including online, mobile and other offerings. Audience tastes change frequently and it is a challenge to anticipate what offerings will be successful at any point in time.

- *Deficiencies in Audience Measurement on Various Platforms Adversely Impacts Viacom's Program Ratings and Adversely Affects Advertising and Affiliate Revenues*: Advertising sales are largely dependent on audience measurement, and the results of audience measurement techniques can vary for a variety of reasons, including the platforms on which viewing is measured and variations in the employed statistical sampling methods. While Nielsen's statistical sampling method is the primary measurement technique used in Viacom's television advertising sales, Viacom measures and monetizes our campaign reach and frequency on and across digital platforms based on other third-party data as well as first-party data using a variety of methods including the number of impressions served and demographics. In addition, multi-platform campaign verification remains in its infancy, and viewership on tablets, smartphones and other mobile devices, which continues to grow rapidly, still is not measured by any one consistently applied method. These variations and changes could have a significant effect on Viacom's advertising revenues.

- *Changes in Consumer Behavior Resulting from New Technologies and Distribution Platforms May Affect Viacom's Viewership and Profitability in Unpredictable Ways*: Technology and business models in the entertainment industry continue to evolve rapidly. Consumer behavior related to changes in content distribution and technological innovation affect Viacom's economic model and viewership in ways that are not entirely predictable. Consumers are increasingly viewing content on a time-delayed or on-demand basis from traditional distributors, from connected apps and websites and on a wide variety of screens, such as televisions, tablets, mobile phones and other devices. Time-shifting technologies that enable users to fast-forward or skip programming, including commercials, affect the attractiveness of Viacom's offerings to advertisers and could therefore adversely affect Viacom's revenues. Similarly, new advertising blocking technologies that enable consumers to circumvent online advertisements could also adversely affect Viacom's advertising revenues as they impact the attractiveness of Viacom's digital offerings to advertisers. In addition, the evolution of consumer preferences away from rental and purchase services towards subscription services may have an economic impact on Viacom's revenues that is not completely predictable. New technologies and distribution platforms are also having other effects on the marketplace. Some distributors have taken steps to limit Viacom's direct access to consumers or taken positions that they have more expansive rights than Viacom believe it has granted, which, if they prevail, could limit Viacom's revenue opportunities. All of these factors create uncertainty in the marketplace.

- *Viacom's Businesses Operate in Highly Competitive Industries*: Companies in the cable network, motion picture, digital and consumer product industries depend on audience acceptance of content, appeal to advertisers and solid distribution relationships. Competition for content, audiences, advertising and distribution is intense and comes from broadcast television, other cable networks (including Viacom's own), online and mobile properties, movie studios and independent film producers and distributors, consumer products companies and other entertainment outlets and platforms, as well as from search, social networks, program guides and "second screen" applications. Competition also comes from pirated content. Increased competition from additional entrants into the market for development and production of original programming, such as Netflix, Amazon and Hulu, increases Viacom's content costs as creating competing high quality, original content can require significant investment. Increased competition in the acquisition of programming may also lead to more complex negotiations over acquired rights to the content and the value of the rights we acquire or retain cannot be predicted with certainty in the future.

- *Advertising Market Conditions Could Cause Viacom's Revenues and Operating Results to Decline Significantly in Any Given Period or in Specific Markets*: Viacom derives substantial revenues from the sale of advertising on a variety of platforms, and a decline in advertising expenditures could have a significant adverse effect on Viacom's revenues and operating results in any given period. The strength of the advertising market can fluctuate in response to the economic prospects of specific advertisers or industries, advertisers' current spending priorities and the economy in general, and this may adversely affect Viacom's advertising revenues. Natural and other disasters, acts of terrorism, political uncertainty or hostilities could lead to a reduction in advertising expenditures as a result of disrupted programming and services, uninterrupted news coverage and economic uncertainty.

- *Theft of Viacom's Content, Including Digital Copyright Theft and Other Unauthorized Exhibitions of Viacom's Content, May Decrease Revenue Received from Viacom's Programming, Motion Pictures and Other Entertainment Content and Adversely Affect Viacom's Businesses and Profitability*: The success of Viacom's businesses depends in part on Viacom's ability to maintain and monetize Viacom's intellectual property rights in Viacom's entertainment content. Viacom is fundamentally a content company and theft of Viacom brands, motion pictures and home entertainment products, television programming, digital content and other intellectual property affects us and the value of Viacom's content. Copyright theft is particularly prevalent in many parts of the world that lack effective copyright and technical protective measures similar to those existing in the U.S. and Europe and/or that lack effective enforcement of such measures. Such foreign copyright theft often creates a supply of pirated content for major markets as well. The interpretation of copyright, piracy and other laws as applied to Viacom content, and Viacom's piracy detection and enforcement efforts, remain in flux, and some methods of copyright enforcement have encountered political opposition. The failure to appropriately enforce and/or the weakening of existing intellectual property laws could make it more difficult for us to adequately protect Viacom's intellectual property and negatively affect its value.

- *Increased Costs for Programming, Motion Pictures and Other Rights, and Judgments Viacom Makes on the Potential Performance of Viacom Content, May Adversely Affect Viacom's Profits and Balance Sheet*: In Viacom's Media Networks segment, Viacom has historically produced a significant amount of original programming and other content and continue to invest significantly in this area. The Filmed Entertainment segment's core business involves the production, marketing and distribution of motion pictures, the costs of which are significant. Viacom also acquires programming, motion pictures and television series, as well as a variety of digital content and other ancillary rights such as consumer and home entertainment product offerings from other companies, and Viacom pays license fees, royalties and/or contingent compensation in connection with these acquired rights. Viacom's investments in original and acquired programming are significant and involve complex negotiations with numerous third parties. These costs may not be recouped when the content is broadcast or distributed and higher costs may lead to decreased profitability or potential write-downs. Further, rapid changes in consumer behavior have increased the risk associated with all kinds of programming. The accounting for the expenses incurred in connection with Viacom programming, motion pictures and other content requires that Viacom makes judgments about the potential success and useful life of the program or motion picture. If Viacom's estimates prove to be incorrect, it may result in the accelerated recognition of the expense and/or write down of the value of the asset. For example, Viacom estimates the ultimate revenues of a motion picture before it is released based on a number of factors, and the company then update its estimate of ultimate revenues, including following a film's initial domestic theatrical release, based on expected future and actual results. If Viacom reduces its estimate of ultimate revenues, it may result in the accelerations of capitalized film cost amortization. Similarly, if Viacom determines it is no longer advantageous to air a program on Viacom's media networks, the company would accelerate the amortization of the program costs.

- *<u>The Loss of Affiliation Agreements, Renewal on Less Favorable Terms or Adverse Interpretations Could Cause Viacom's Revenues to Decline in Any Given Period or in Specific Markets</u>*: Viacom is dependent upon its agreements with cable television, direct-to-home satellite television and telecommunications operators, subscription and advertising supported video-on-demand services, and other distributors of Viacom programming and program services. The company has agreements in place with the major cable and satellite distributors and several SVOD and other OTT content distributors, but there can be no assurance that these agreements will be renewed in the future on terms, including pricing, acceptable to Viacom, or at all. While many consumers have a choice of distributors from which to access Viacom content, the loss of carriage on the most widely available cable and satellite programming tiers could reduce the distribution of Viacom's programming and program services and decrease the potential audience for Viacom's programs, thereby negatively affecting Viacom's growth prospects and revenues from both advertising and affiliate fees. Further, the loss of favorable packaging and positioning opportunities with any distributor could reduce revenues from subscriber fees. In addition, as these affiliate agreements have grown in complexity, the number of disputes regarding the interpretation, and even validity, of the agreements has grown, resulting in greater uncertainty and, from time to time, litigation seeking to circumscribe enforcement of Viacom's rights or to seek damages under competition and other laws.

- *<u>Consolidation among Cable, Satellite and Telecommunications Service Providers Has Had, and Could Continue to Have, an Adverse Effect on Viacom's Revenue and Profitability</u>*: Consolidation among cable and satellite distributors and telecommunications service providers has given the largest operators considerable leverage and market power in their relationships with programmers. Viacom currently has agreements in place with the major U.S. cable and satellite operators and this consolidation has affected, and could continue to affect, Viacom's ability to maximize the value of Viacom content through those distributors. In addition, many of the countries and territories in which Viacom distributes its networks also have a small number of dominant distributors. Continued consolidation within the industry could reduce the number of distributors that carry Viacom programming, subject Viacom's affiliate revenues to greater volume discounts, and further increase the negotiating leverage of the cable and satellite television system operators, which could have an adverse effect on Viacom's financial condition or results of operations.

- *<u>The Development of Alternative Offerings for Consumers Has Had, and Could Continue to Have, an Adverse Effect on Viacom's Viewership, Revenue and Profitability</u>*: In response to perceived consumer demand, distributors of programming and program services are continuing to develop alternative offerings for consumers. These alternative packages of networks are generally smaller than the traditional cable package, and some allow the consumer to customize its package of networks to a certain extent. To the extent these alternative packages are widely accepted by consumers in lieu of traditional cable packages, Viacom could experience a decline in subscribers to certain of its networks, which could lead to lower affiliate and advertising revenues.

IV. Conclusion

Although judging by its current depressed stock price, Viacom seems down and out, things may not be as dire as investors now believe. The narrative surrounding the demise of cable television as the principal medium for watching TV appears to be premature at best (and totally wrong at worst), leading us to believe that Viacom does not face an inevitable secular decline in its businesses. (Even if viewers continue to migrate to OTT packages, Viacom can win in this area too, since its content should remain in demand.)

With a new CEO and refreshed Board of Directors under the control of Shari Redstone, as well as iconic assets such as MTV, Nickelodeon, BET, Comedy Central, CMT and Paramount Pictures, we instead see a company in the early stages of a turnaround—and the best time for an investor to buy into a turnaround is before success is priced into the stock. Viewing the company's valuation from several separate perspectives (namely, EV/subscriber, EV/EBITDA, sum-of-the-parts and FCF/share multiple), we obtain a fair value for VIAB of $58/share, or 125% above the current market price, representing an enticing 31% IRR for a three-year hold period.

Indeed, our thesis boils down to the following: content remains king. Long Viacom.

V. Disclaimer

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