12/9/2021

Investment Report

By: Christian Turiello

VIACOMCBS

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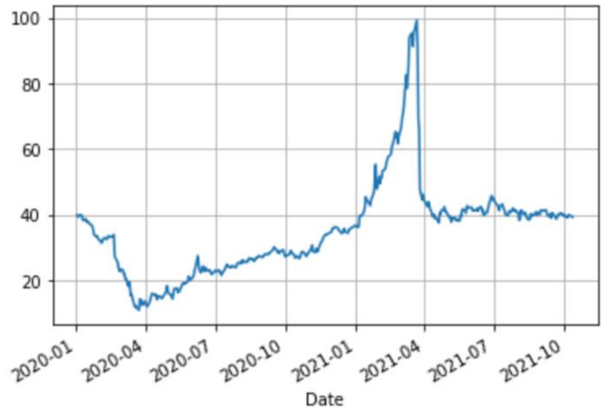
VIACOMCBS

Investment Summary & Thesis

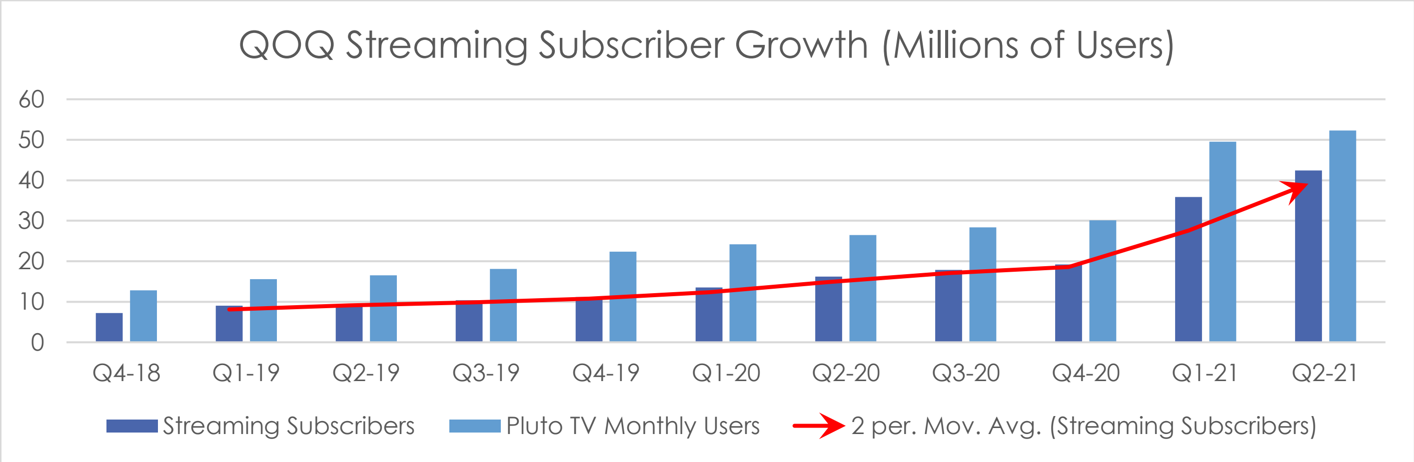
Trade Recommendation

- Buy ViacomCBS (VIAC) shares
- Target price: $59.08
    - Upside (12/08): 88.27%



Key Drivers

- Growth in streaming subscribers
    - Pluto TV: 66.8% growth YoY (13.6% QoQ)
    - Premium (Paramount + and Showtime): 90.55% growth YoY (17.5% QoQ)

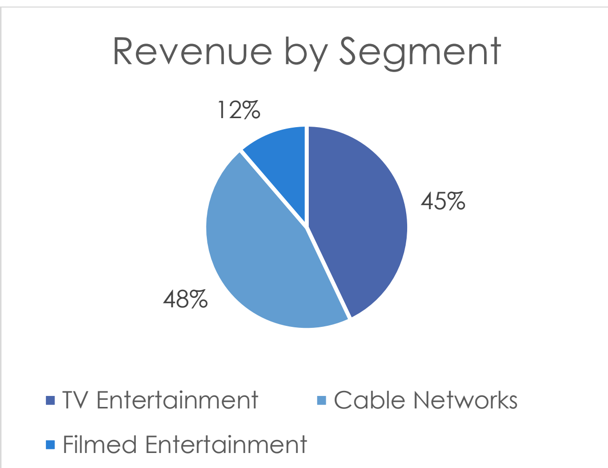


- Investments in new content
    - Management has stressed the importance in creating new forms of content to attract customers in the competitive video entertainment market
    - Planned investment of over $5 billion in new content
- Expansion of sports offerings
    - ViacomCBS has quietly acquired the rights to the Serie A (Italy's top soccer league) as well as the Champion's League competition, in which the final alone attracts over 3.5 million viewers in the United States.
    - Expansion of NFL rights in the US maintains the company's position as one of the only providers of NFL broadcasting, attracting cord-cutters to subscribe to Paramount+
    - New opportunities to expand sports offerings will become available within the next few years, including the most popular soccer league in the world, the British Premier League

Business Description

ViacomCBS was founded in December 2019 through the merger of Viacom and CBS corporation. The two entities split up in 2006 and recombined with the intention of focusing on a direct-to-consumer strategy. Operating as an entertainment and media conglomerate, ViacomCBS produces and distributes multiple forms of premium and free content for consumers. Combined, the company has a 22% market share of the US TV audience as well as over 40 million premium streaming subscribers. The company has over 22,000 employees, organized into three major segments.

TV Entertainment | Cable Networks | Filmed Entertainment



ViacomCBS is split up into three major segments; each deriving revenue from advertising, streaming, and licensing. Advertising revenue comes in the form of the purchase of commercial time and digital advertising space from large corporations/businesses on owned cable networks and to specific demographics through the TV entertainment segment. Licensing revenue comes from being paid by competitors to use owned content on different cable networks/streaming services. Streaming revenues come in the form of premium subscriptions to the company's owned direct-to-consumer content platforms. Additionally, theatrical revenue comes from sales of filmed entertainment in cinema settings

ViacomCBS operates one of the 'big three' cable networks, CBS, which offers regularly scheduled programming including local/national news and major sports events. In addition to their major cable offering, the company offers a wide variety of cable networks across several demographics including children, young adults, and African Americans. Premium cable content products allow consumers access to premium shows and movies as well as Pay per view sports content. The company's streaming offerings represent the push toward direct to consumer, in which owned content is leveraged and included in one platform at a monthly rate.

Management & Corporate Governance

Chief Executive Officer

Robert M. Bakish

Chief Financial Officer

Naveen Chopra

Chief Content Officer / Head of CBS

George Cheeks

Chief Technology Officer

Phil Wiser

C-Suite

The current executive leadership of ViacomCBS consists of former executives from the preexisting entities and other highly experienced entertainment industry veterans. Recently, the company has added a number of technology executives with the intention of producing high quality direct to consumer streaming platforms. Other C-Suite executives include:

- Katherine Gill-Charest, Chief Accounting Officer
- Nancy Phillips, Chief People Officer
- Jo Ann Ross, Chief Advertising Revenue Officer
- Jose Tolosa, Chief Transformation Officer

Board of Directors

The Board of Directors for ViacomCBS consists of a diverse group of 13 entertainment, financial, law, and political veterans with immense experience in business. The members of the board are expected to actively evaluate the company and its general direction in order to ensure success from its management team. The board is expected to meet at least six times per year for the members to fulfill their obligations. Viacom looks for successful individuals with a lot of achievement in their respective industry using data driven and analytical judgment. The board of ViacomCBS is expected to remain completely independent to judge management decisions fairly and efficiently. Members of the board are able to participate in various committees related to operating the company and nominating new members.

Governance Committees

- Audit Committee
- Compensation Committee
- Nominating and Governance Committee

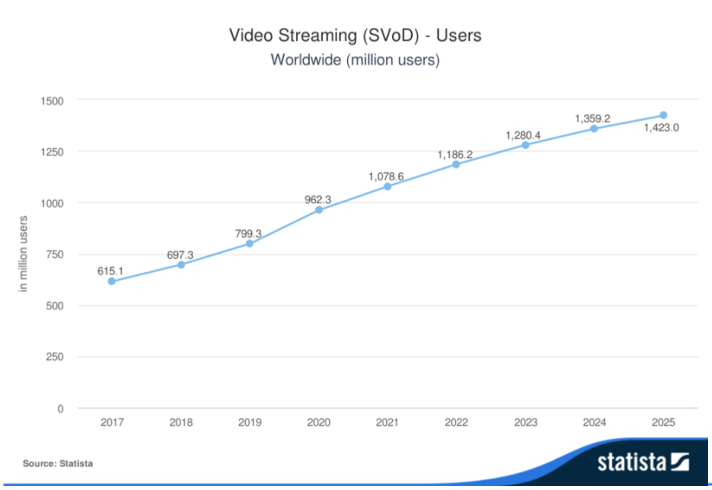
Video Entertainment Industry Overview

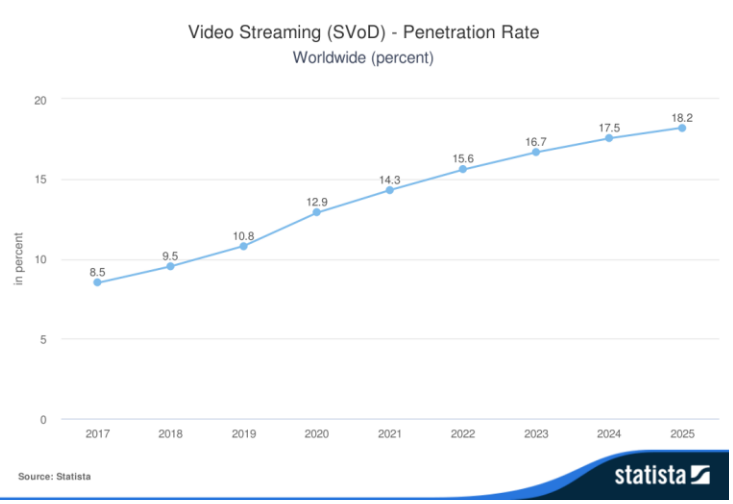
The entertainment industry consists of highly capitalized and diversified firms with strong financials and brand recognition. For the broadcasting and video entertainment sector specifically, strict regulations on ownership and what can be distributed leads to high barriers to entry. Recent changes in consumer preferences, aided by mass technologization due to the Covid 19 pandemic, have begun to change the way people consume media.

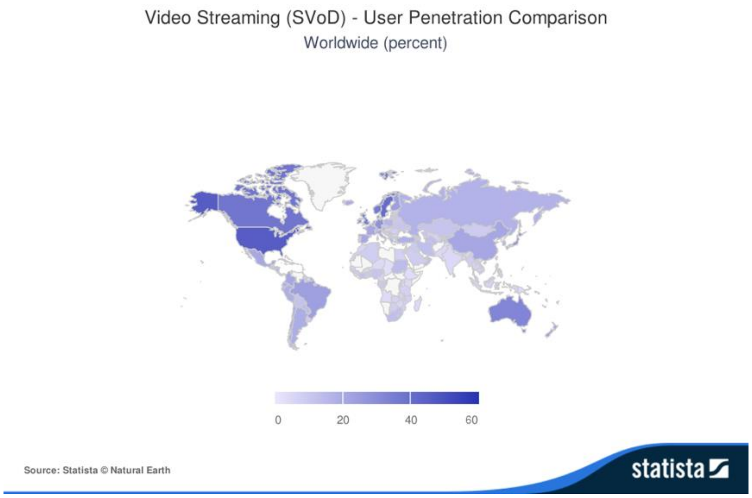
Segment	Projected Market Size (2021)	Projected Market Size (2026)	Expected Growth Rate
Cable Networks	$ 95.09 Billion	$96.6 Billion	0.30%
Television Broadcasting	$ 62.81 Billion	$65.4 Billion	0.80%
Filmed Entertainment	$ 17.35 Billion	$21.4 Billion	4.30%
Video Streaming	$ 51.4 Billion	$149.34 Billion	23.78%

The changes in consumer preferences are reflected in expected industry sizes and growth rates among the video entertainment subsectors. Over the next 5 years, traditional forms of media consumption are not expected to grow significantly, however, direct to consumer consumption using streaming platforms are expected to grow at a CAGR of 23.78% after more than doubling from the three years prior.

Trends and Untapped Markets







In 2021, global streaming subscribers will surpass 1 billion, with only 14.3% global market penetration. Even in the most developed markets, market penetration stands below 45%, presenting significant opportunity to expand world-wide. As more economies develop, demand in less developed nations will also increase as they adopt new forms of technology allowing for direct-to-consumer media consumption. Video streaming will grow in line with rapid digitalization and cord cutting efforts across all demographics.

M&A Boom and Industry Consolidation

To take advantage of the massive opportunity around video streaming, competitors are beginning to differentiate themselves and their direct-to-consumer strategies to position themselves to take significant market share in this relatively nascent sector. Differentiation in the video entertainment industry comes in the form of investment in original content creation and through the acquisition of content rights through M&A deals. New media platforms need to have a high quantity of high quality content to attract consumers. This has led to a wave of consolidation within the sector from companies attempting to strengthen their content offerings. These offerings range from live sports to movies and TV shows, each attracting a wide set of demographics.

Recent blockbuster deals include:

amazon.com → $8.5 Billion → Metro Goldwyn Mayer

Disney → $71.3 Billion → 21ST CENTURY FOX

AT&T WarnerMedia → $130 Billion → Discovery

Competitive Positioning

ViacomCBS has a unique position within the video entertainment industry. Operating one of the three major US broadcasting networks, as well as having the rights to and owning a strong set of sports rights and premium content differentiates the company from its competition. In an environment in which content determines success, ViacomCBS is well positioned to attract customers through diversified content on a single platform. The company's most recent product offering, Paramount+, gives the consumer the ability to not only watch video on demand, but to watch live television on CBS networks and have access to premium live sports content. Through the company's new focus on direct to consumer, ViacomCBS can achieve a competitive advantage by leveraging their already strong library of content and investing into new offerings, particularly sports, which will attract traditional cable subscribers to cut the cord.

Strategic Acquisitions and Partnerships

Exclusive rights to Europe's premier club soccer competitions

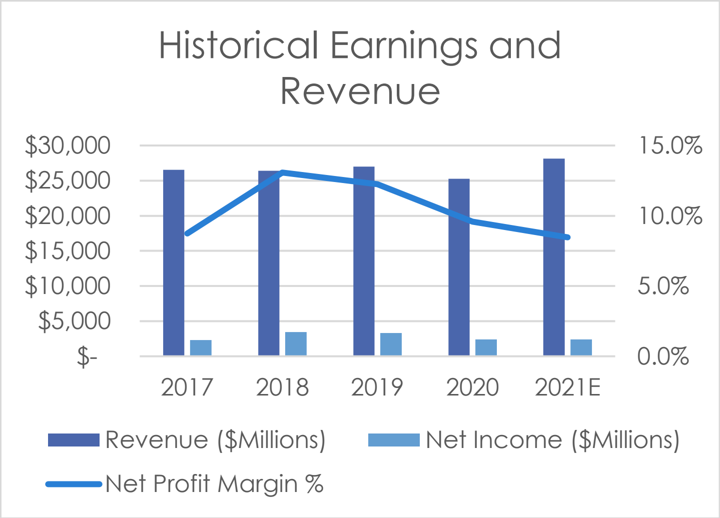
Exclusive rights to Europe's 4th largest soccer league

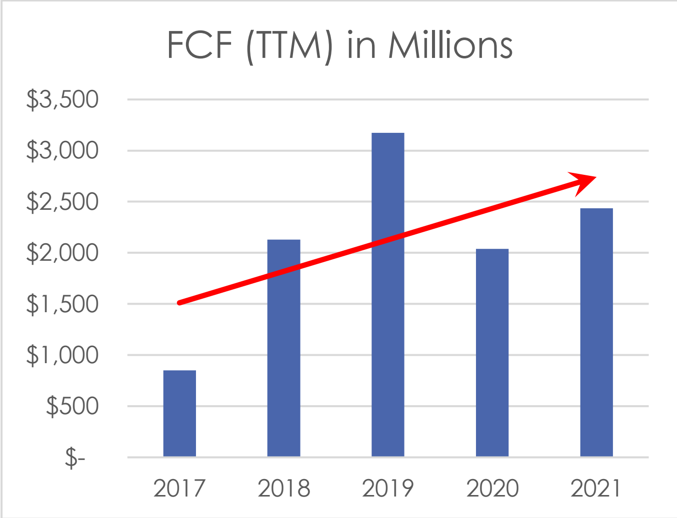
Exclusive rights to produce new content for one of the most successful shows of all time

MIRAMAX FILMS

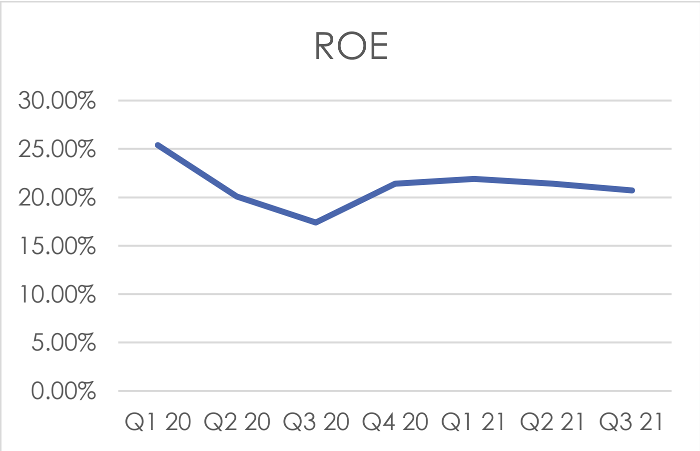
Joint venture expanding movie and TV show offerings

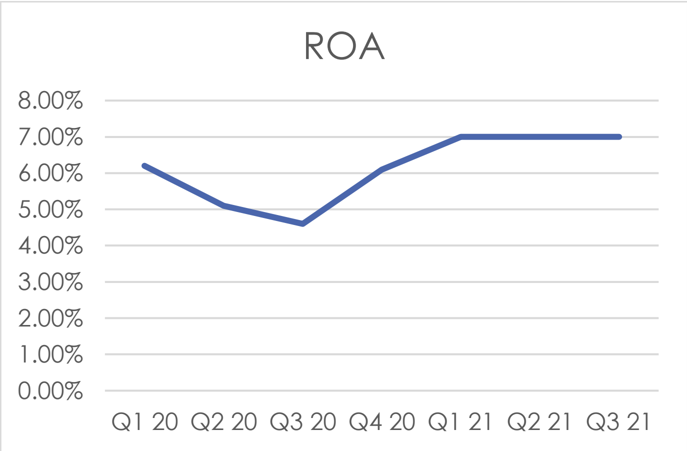
Financial Analysis



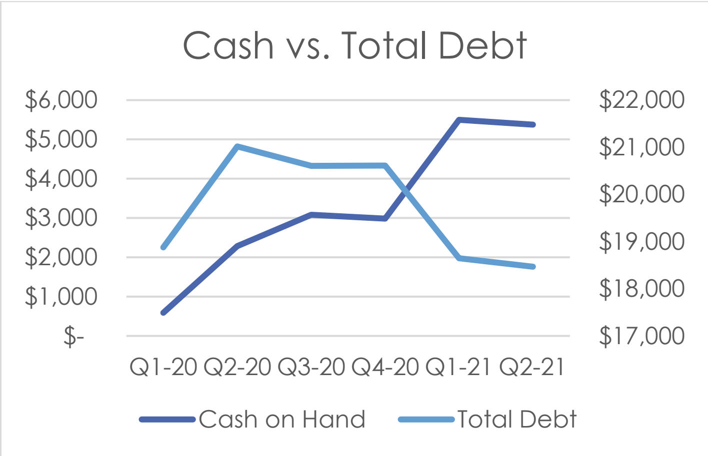


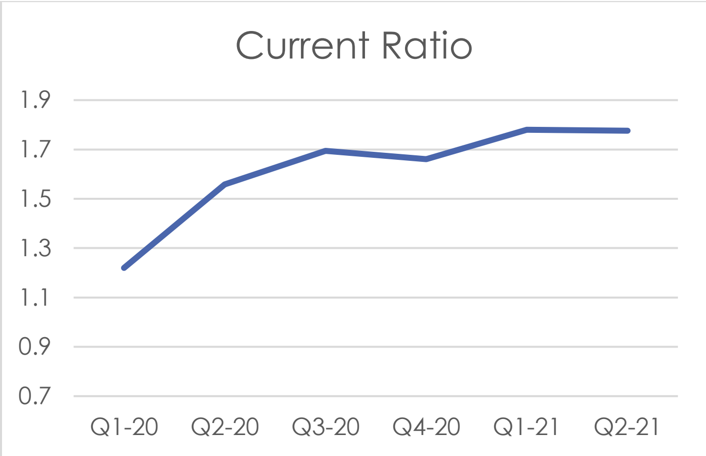
Because Viacom and CBS merged in late 2019, the financial information used is consolidated from historical records of the two companies. The combined companies have consistently generated over $25 billion in revenues as well as generated profits. FCF numbers have been much more volatile, however, the FCF has been trending upwards over recent years on a consolidated basis.



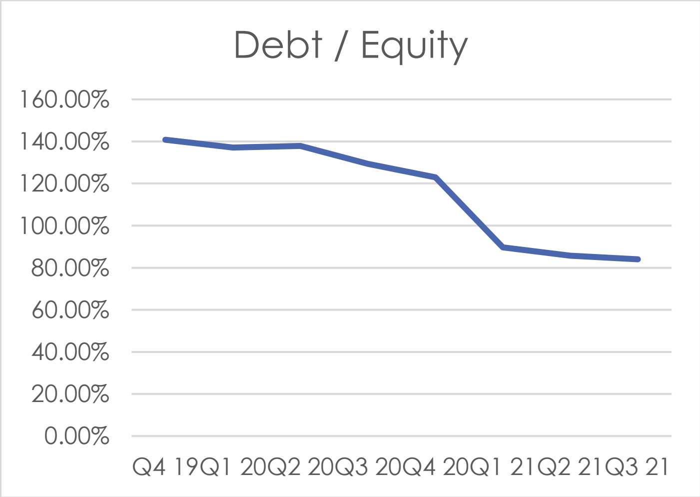


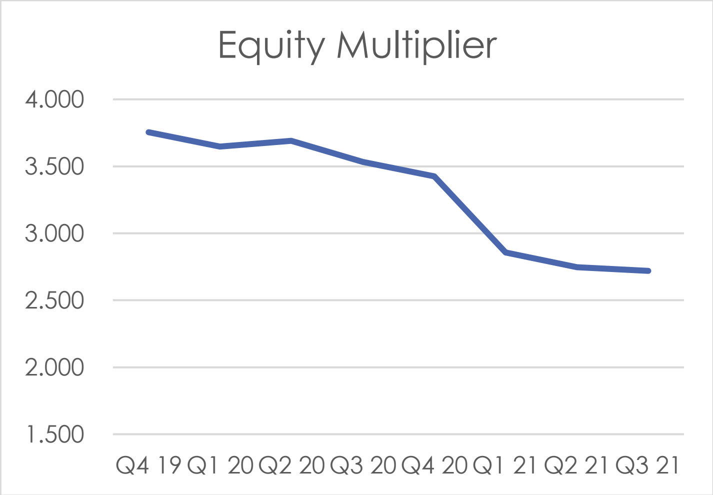
The company has maintained consistent returns since the the merger completed in late 2019. While realizing significant cost savings, the synergies from the merger have yet to show in the financial statements as the savings come in the form of longer term spending. However, both the return on equity and return on assets have maintained consistent levels, even with increases in both assets and equity over the last year. As the companies continue to integrate their operations, they will experience growth in profits should their direct to consumer strategy be successful.



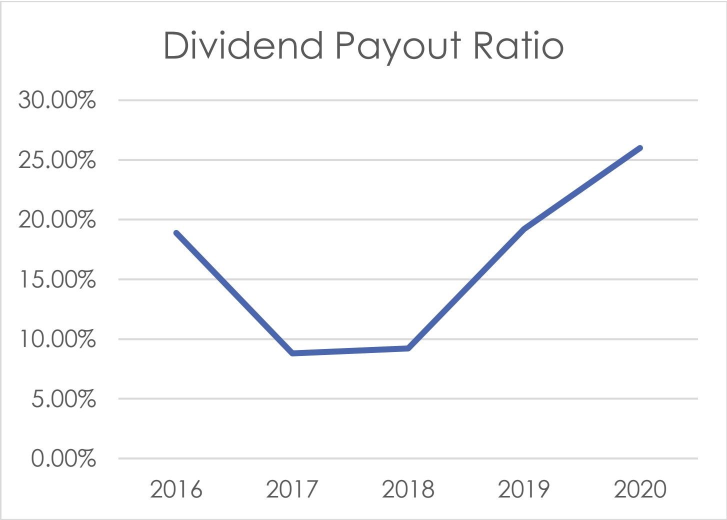


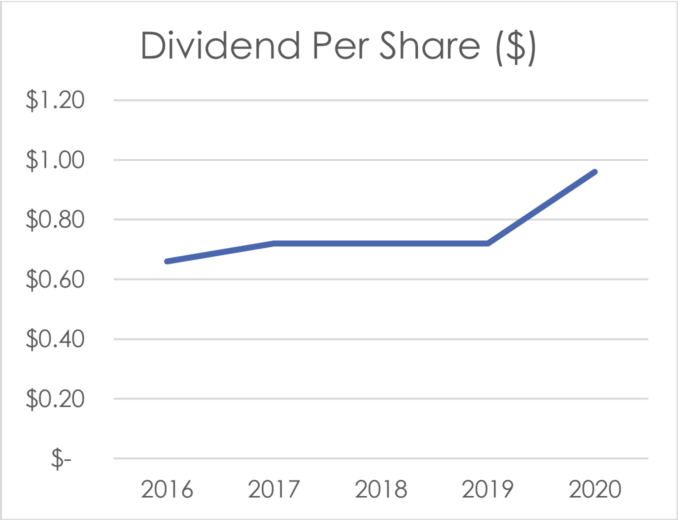
Since the merger, increasing liquidity and lowering debt created from the transaction has been a focus of management in order to invest in the business transformation towards direct to consumer. The company has raised cash through selling preferred equity, selling assets, as well as well as reaping benefits from the synergies created in the merger. This has led to ample amounts of cash to either purhcase new assets or invest in creating new content in house. ViacomCBS currently has $547 million in assets held for sale and a deal to sell their publishing subsidiary that will provide a huge amount of capital to support expansion.



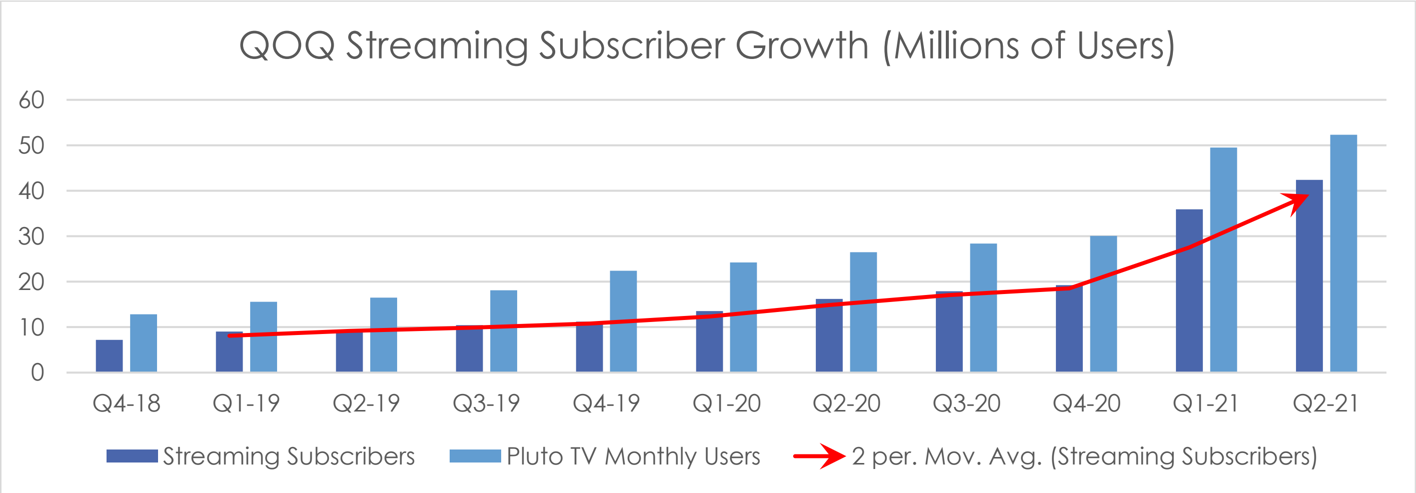


Because of the combined management's desire to make the company's stock an investment grade asset, the company has taken measures to decrease the amount of leverage taken on by the firm. In addition to paying down debt, the company has taken advantage of irregular market conditions by raising capital through the sale of both common and preferred equity at premiums more than double the current stock price. These actions have led to a short-term reduction in leverage ratios including debt/equity, as well as the equity multiplier, defined as the firm's total assets divided by shareholder's equity. By decreasing leverage, the company hopes their capital structure will become more attractive to investors.





Before the merger, the separated companies each had different dividend payment strategies. After the merger, the new management has made a clear commitment to maintaining and growing an attractive dividend. This is reflected by an increase in the dividend after the merger and a subsequent increase in the dividend payout ratio. Currently, the company pays a dividend of $0.96 per year, indicating a 2.70% dividend yield.



Due to the increased focus on a direct-to-consumer strategy, information regarding subscriber/active user counts on both ViacomCBS's premium and free platforms become a valuable metric in gauging the success of the strategy. Additionally, these metrics allow for the company's financial results to become more predictable, as the premium platforms have consistent monthly payments associated with them. Since the year before the merger, the company's free content platform (PlutoTV) has grown at a rate of 66.8% YoY (13.6% QoQ) and the premium platforms (Paramount + and Showtime) have grown at a rate of 90.55% YoY (17.5% QoQ), alluding to significant early success in the direct-to-consumer strategy.

Company Name	Market Cap ($)	P/B	P/E	EV/EBITDA	P/CF	Div Yield	WACC(%)
ViacomCBS Inc	$ 23,027,856,398	1.11	9.46	7.33	7.20	2.7%	7.7%
Fox Corp	$ 21,054,298,574	2.03	13.13	8.57	12.24	1.2%	6.0%
Walt Disney Co	$ 319,832,451,986	3.58	35.40	47.60	76.51	0.0%	7.8%
Discovery Inc	$ 13,529,542,531	1.19	8.68	3.82	5.36	0.0%	5.6%
Netflix Inc	$ 239,486,754,481	18.71	50.62	15.98	58.28	0.0%	6.5%
Comcast Corp	$ 240,026,383,413	2.58	14.95	10.13	9.19	1.8%	5.9%
Charter Communications Inc	$ 128,162,737,758	7.38	23.02	11.00	9.22	0.0%	5.6%
Altice USA Inc	$ 18,043,902,805	(7.22)	9.46	7.83	2.52	0.0%	4.2%
Grupo Televisa SAB	$ 4,591,757,607	1.16	33.13	6.02	15.58	0.8%	12.4%
Low	$ 4,591,757,607	(7.22)	8.68	3.82	2.52	0.0%	4.2%
High	$ 319,832,451,986	18.71	50.62	47.60	76.51	2.7%	12.4%
Average	$ 111,972,853,950	3.39	21.98	13.14	21.79	0.7%	6.9%

When comparing ViacomCBS to a set of related companies in terms of financial ratios based on value as well as cost of capital, the firm seems incredibly undervalued. The firm's P/E, P/B, EV/EBITDA, P/CF are all below industry averages, indicating the stock is trading at a discount relative to its peers. Additionally, the company's dividend yield is the highest among the competitors. While some of the companies listed do not provide exactly the same services as ViacomCBS, its closest competitor Fox Corp is more expensive in terms of financial ratios. The company's cost of capital, measured in terms of weighted average cost of capital (WACC), is higher than the average of its closest peers, and is lower than the largest competitor, Walt Disney Co.

Based on the names of ViacomCBS' closest peers, the market seems to reward companies who either specialize in a direct-to-consumer strategy or have begun the transformation toward that strategy. If the market continues to price these companies this way, ViacomCBS will benefit with their highly focused direct-to-consumer strategy.

Valuation

Dividend Discount Model

Dividend Discount Model	2-Stage
Stage 1 Growth Rate	10.06%
Number of Years in Stage 1	10
Stage 2 Growth Rate	5.00%
Growth Path	Linear
Cost of Equity Capital	8.78%
Dividends per share, LTM	$0.96

	k / terminal g	3.50%	4.00%	4.50%	5.00%	5.50%	6.00%	6.50%
	7.28%	$37.76	$42.10	$48.02	$56.52	$69.81	$93.47	
	7.78%	$33.18	$36.37	$40.54	$46.21	$54.37	$67.11	$89.80
	8.28%	$29.56	$31.99	$35.05	$39.05	$44.49	$52.31	$64.53
	8.78%	$26.64	$28.52	$30.85	$33.79	$37.62	$42.84	$50.35
	9.28%	$24.22	$25.71	$27.52	$29.75	$32.58	$36.26	$41.27
	9.78%	$22.19	$23.40	$24.83	$26.57	$28.71	$31.42	$34.95
	10.28%	$20.46	$21.45	$22.61	$23.99	$25.65	$27.71	$30.31
Average	$38.43							

For the dividend discount model, the two-stage growth method was used to reflect a period of growth as a result of the merger between Viacom and CBS and then plateauing growth into perpetuity. For the first stage, a 10.06% growth rate was used, reflecting the 5-year CAGR of dividends for the company. This growth will continue for 10 years, eventually decreasing to a 5% growth rate reflecting declining growth because of the company's increased market penetration. This 5% growth rate into perpetuity was used to represent a rate higher than average economic growth due to management's vocal commitment to maintaining and growing the dividend and making ViacomCBS an attractive, investment-grade security.

FCF Model

Free Cash Flow Model	3-Stage
Stage 1 Growth Rate	10.73%
Number of Years in Stage 1	3
Stage 2 Growth Rate	7.00%
Number of Years in Stage 2	5
Stage 3 Growth Rate	3.00%
Growth Path	Linear
Free Cash Flow, LTM	$2,436.00

Total Debt ($ millions)	$26,609.00
Cash ($ millions)	$4,823.00
Shares Outstanding (millions)	647.42
Weighted Average Cost of Capital (%)	8.50%

	k / terminal g	1.50%	2.00%	2.50%	3.00%	3.50%	4.00%	4.50%
	7.00%	$64.44	$71.71	$80.59	$91.70	$105.98	$125.02	$151.68
	7.50%	$55.73	$61.59	$68.63	$77.23	$87.98	$101.80	$120.23
	8.00%	$48.37	$53.17	$58.85	$65.66	$73.98	$84.39	$97.77
	8.50%	$42.06	$46.05	$50.70	$56.20	$62.79	$70.85	$80.93
	9.00%	$36.61	$39.95	$43.81	$48.32	$53.64	$60.02	$67.83
	9.50%	$31.84	$34.67	$37.91	$41.65	$46.01	$51.17	$57.35
	10.00%	$27.64	$30.06	$32.81	$35.94	$39.56	$43.79	$48.78
Average	$62.56							

For the free cash flow model, a three-stage growth model was used to reflect declining medium-term growth as a result of changing consumer preferences involving the company's cable broadcasting division. The first stage used a 10.73% growth rate to represent the average free cash flow growth for the company over the last 5 years. This growth will continue for 3 years, until growth slightly declines due to market pressures involving the company's legacy cable operations. This decline will be offset by increasing demand from the successful implementation of the direct-to-consumer content strategy. This growth will continue for 5 years, until growth plateaus into perpetuity, growing at a higher than average, but conservative rate (3%).

FCFE Model

Free Cash Flow to Equity Model	3-Stage
Stage 1 Growth Rate	10.73%
Number of Years in Stage 1	3
Stage 2 Growth Rate	7.00%
Number of Years in Stage 2	5
Stage 3 Growth Rate	3.00%
Growth Path	Linear
Cost of Equity Capital	8.78%
Free Cash Flow to Equity, LTM	$1,998.21

For FCF and FCFE models only:	
Net new debt ($ millions)	$403.00
Interest on debt ($ millions)	$1,013.00
Shares Outstanding (millions)	647.42
Corporate tax rate (%)	17.00%

	k / terminal g	1.50%	2.00%	2.50%	3.00%	3.50%	4.00%	4.50%
	7.28%	$78.23	$83.51	$89.89	$97.76	$107.71	$120.70	$138.36
	7.78%	$71.74	$76.04	$81.14	$87.32	$94.94	$104.57	$117.14
	8.28%	$66.21	$69.76	$73.92	$78.86	$84.84	$92.21	$101.54
	8.78%	$61.45	$64.41	$67.84	$71.87	$76.66	$82.45	$89.59
	9.28%	$57.31	$59.80	$62.67	$65.99	$69.89	$74.53	$80.13
	9.78%	$53.66	$55.79	$58.21	$60.99	$64.21	$67.98	$72.47
	10.28%	$50.44	$52.27	$54.33	$56.67	$59.36	$62.48	$66.14
Average	$76.24							

For the free cash flow to equity model, like the FCF model, a three-stage growth method was used in order to reflect changes in growth over time due to changes in consumer preferences. The first stage growth rate is 10.73% representing the 5-year FCF growth rate for the company lasting for 3 years. FCF growth will then decline to 7% for 5 more years and then continue at 3% into perpetuity. Because the company has paid down a significant amount of debt in the last year, the 3-year average net new debt value was used to calculate FCF to equity. If the actual net new debt number were to be used, the FCF to equity would be negative, causing the model to fail in finding a valuation. The tax rate used represents the most recent fiscal year's annual tax rate.

Valuation – Target Price

DDM	$	38.43
FCF	$	62.56
FCFE	$	76.24
Average (Target Price)	**$**	**59.08**

Investment Risks

Short Term Risk – Failure to capitalize on business synergies

Upon announcement of the merger between Viacom and CBS, the companies claimed that the combination would lead to over $500 million in annual cost savings through synergies. In the short term, the company may overestimate the benefits of the merger and it may take more time for the cost savings to begin taking effect. This could be due to a myriad of different reasons, such as failure to intertwine company cultures, failure to meet the deadlines of the lofty goals in which the combined entity has set, as well as market forces such as the Covid pandemic. The company, however, recently stated that the cost savings expected from the merger are likely to increase from a $500 million goal to over $750 million in annual cost savings.

Medium Term Risk – Competitive Risk

With the rapid adoption of direct-to-consumer content platforms by incumbent entertainment industry giants as well as the existence of current platforms such as Netflix and Prime Video, ViacomCBS has significant risk in terms of how much competition they will face in their digitalization strategy. This risk forces the company to find different ways to differentiate their product from other new and existing content platforms. ViacomCBS is differentiating their premium direct-to-consumer platform through the investment in exclusive sports offerings as well as including some of their live TV properties on the platform. These additions, along with the commitment to investing significant capital into content expansion, will reduce the risk of competition, as their product offerings are unique from the traditional platforms such as Netflix, which only includes on-demand content.

Long Term Risk – Risk of changes in consumer preferences/behavior

The long-term risk in which the company will need to navigate is the potential changes in consumer preferences and behavior. As seen through the pandemic, a large number of consumers have adopted direct-to-consumer platforms as their primary form of content consumption. This will have an adverse effect of some of the company's broadcasting business but will benefit other segments. In the longer term, however, the company must create content that follows what consumers want and that will keep them engaged for longer periods of time. To circumvent this risk, the company's initial strategy for content investment includes leveraging already successful intellectual property and using it as a means to draw in new customers. For instance, Paramount is planning on making multiple spin off shows of their most successful TV show, Yellowstone. Additionally, the company rebooted one of its most famous shows, ICarly, appealing to the younger demographic's nostalgia.

Sources

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