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The Ghost Of Sumner Past

- **Viacom** has come under pressure in recent days. Only this time it is not about ratings weakness at MTV or Nickelodeon or another loss in the studio segment. First, the company is being sued by a shareholder who is claiming that the company violated its fiduciary responsibility by paying executive chairman Sumner Redstone despite his poor health. Mr. Redstone owns 80% of National Amusements, which in turn controls roughly 80% of the voting stock in Viacom. His health and mental capacity have also been called into question by a former girlfriend, who has launched a suit against Mr. Redstone. Of course, she might have been motivated by a potential financial gain. CEO Philippe Dauman has insisted that in recent conversations Mr. Redstone has been attentive and engaged. Despite his cameo appearances on earnings calls prior to last year, we doubt that Mr. Redstone has had much influence on the day-to-day activities of the firm. Viacom is also the target of activist investor Eric Jackson of SpringOwl Asset Management, who just released a 99-page summary of why Viacom management should be replaced. *Among other requests, Mr. Jackson claims that management is overpaid, that it needs more executives with digital experience, that expenses need to be curtailed, and that combinations with AMC Networks and Alibaba should be explored.* We happen to agree with most of those assertions.
- These two events may move the stock prices, but probably will not have much of an impact on spreads in the near term. Yet they do illustrate the event risk surrounding Viacom. The uncertainty is obviously not beneficial for bondholders. However, if Viacom were to be sold or split up or recombined with CBS, the credit profile could easily improve. *Having said that, it is difficult to predict possible deals because of the dominant control of National Amusements.*
- Viacom has other issues that are more pressing currently. *For example, revenue has declined for three consecutive quarters, and in five of the last eight.* It has declined for four straight fiscal years, including the one just ended in September. Revenue in the Film unit is less than half of what it was five years ago. In the Media Networks segment, domestic advertising plunged 7% in the fiscal fourth quarter after falling 9% in the third quarter. The decreases were primarily a function of weaker ratings for some of its shows. Some of the ratings weakness is attributable to the fact that a significant portion of viewing is not being measured accurately since it is not live. Unfortunately for the company, this problem will persist until a better system is implemented, and that may not be very soon.
- Despite its many problems, Viacom typically generates excellent free cash flow, averaging nearly $2 billion annually over the last three years. Unfortunately, it has been extremely aggressive with share repurchases too, as they have far exceeded free cash flow over the past three years. *Consequently, the company had added a considerable amount of debt, and leverage has risen to 3x.* Viacom suspended stock buybacks midway through its last fiscal year, but management indicated that repurchases would begin again in the first quarter. The idea behind the suspended buybacks was to spend more on acquisitions. However, Viacom has not found attractive opportunities, and to management's credit, has not pursued poor deals. Spreads on the 2024 issue have widened to +312. With spreads that wide, it is hard to be too bearish. But considering the event risk, weak revenue prospects, potential contentious negotiations with Dish regarding renewal, and the possibility of hefty share repurchases that could lead to additional debt, we do not think now is the time to become bullish. **We are keeping our sell recommendation.**

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