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Huge Write-Downs at Viacom, Clear Channel May Spell Trouble

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… The multibillion dollar charges taken recently by conglomerates Viacom and Clear Channel Communications on assets they bought in the late 1990s signal potential earnings troubles ahead, according to a New York investment banker. This is because these companies have their stocks valued on revenue and asset growth, rather than earnings, said R.W. Wentworth's Thomas Au, giving these companies too much incentive to grow by acquisition regardless of the cost. He said the write-offs for Viacom and Clear Channel two weeks ago - $18.4 billion and $4.7 billion, respectively - were a clear admission by corporate managements that their business models are outmoded.

Write-downs are reductions in the value of assets carried on corporations' balance sheets. The largest write-down in history was the $54 billion charge Time Warner took in 2001 after its 2000 merger with America Online.

Viacom's, Clear Channel's, and Time Warner's recent write-downs were in an area called "goodwill," which is the value assigned to an asset, such as a radio station, above its stated book value.

For radio or television stations, this can mean the valuation given to intangible things such as consumer and advertiser loyalty. The charges do not affect company earnings, but they reduce the value for which the assets can be sold. As a result, should Viacom or Clear Channel decide to sell radio stations, it would likely be for a loss.

R.W. Wentworth's Mr. Au, who helps corporations raise capital, said Viacom and Time Warner had sold Wall Street analysts and investment bankers on a business model that failed to take into account fundamental human behavior. He said Viacom and Time Warner built their empires on the argument that once the high fixed charges incurred in expanding cable systems or buying television stations were swallowed, their ability to sell consumers Internet access, pay-per-view events, or to cross promote music or movies would create revenue that would go straight to the bottom line. However, said Mr. Au, the companies forgot that they were ultimately service businesses, and that customers usually do not use more than one service at a time. Thus, a cable customer might get cable-based Internet service, but he won't be watching cable TV and listening to a radio station at the same time. Moreover, given the local monopolies afforded cable, network, and radio stations, every upgrade to a higher-margin service frequently comes at the expense of another corporate division, as opposed to a competitor. So far, he said radio is the clear loser, as $10.9 billion of Viacom's write-down and Clear Channel's $4.7 billion attest to.

"These companies have locked themselves into an either/or trap, where every dollar they make comes at the expense of one of their own divisions," he said. This cannibalization, as Mr. Au calls it, will force entertainment companies into single digit profit growth for the foreseeable future.

Another issue to consider is the opaque valuation process behind these write-downs, according to Rate-Financials President Victor Germack. Mr. Germack, who analyzes and rates the quality of financial disclosures in corporate filings for institutional investors, said balance sheet write downs are the last area where corporate management decisions have to be taken at face value. “Once management has decided an asset is impaired, they can decide on an acceptable charge, and simply order up an impairment study from an investment bank or accounting firm to confirm that figure,” he said.

The problem being, as he sees it, is that investment banks and accounting firms often have little motivation to be independent from a profitable client. “If you think you'll see arguments from a company over an analyst’s stock recommendation, what kind of argument will you get when you tell them their $3 billion write-down should really be an $8 billion charge?” The bank or accounting firm that does that will kill off millions of dollars worth of potential future underwriting or auditing fees, he said.

Mr. Germack said an important first step to guaranteeing an accurate write-down would be for analysts to start demanding a discussion of what the contents of the impairment reports are. “As it stands now, they are content with brief, scripted management spin, which fails to get at why they bought the wrong thing or paid the wrong price,” he said.

“Eventually, I would like to see companies forced to disclose the full report, which might show us if anyone is being honest about the problems.”