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Abstract

This thesis studies the takeover battle for Paramount Communications between Viacom and QVC. It gives a detailed analysis of Viacom's acquisition of Paramount Communication, its strategic and financial reasons as well as impacts. Today, Viacom is one of the world's leading media conglomerate, when comparing its revenues¹ for 2010 (\$9, 34 billion), revenue growth² (1%) and Return on Equity³ (18, 2%) with peers.

On the 3rd of February 2011 during the Financial Announcement for the year 2010, the President and CEO of the company, Philippe Dauman said:

*"We're off to a great start in fiscal 2011. The creative momentum in our major networks is building as we judiciously invest in original programming. This puts Viacom in the pole position in the race to capitalize on new opportunities for monetizing television content through emerging media here and around the world. We're excited about the potential for expanding our international businesses, and we know that our film studio is poised for a great year."*⁴

In my opinion Viacom overpaid for Paramount by more than \$2 billion. Viacom was willing to overpay more than QVC was willing to and that is why the company won the takeover battle. Even though Sumner Redstone, the CEO of Viacom, owned more than 75% of Viacom's cash flows of voting rights, the price of hubris exceeded \$1.5 billion. Even though, the company overpaid by more than \$2 billion, under the command of Redstone, Viacom had the best performance ever. The company produced during these 10 years such films as: "Saving Private Ryan", "Titanic", "Brave heart" and "Forrest Gump".

¹ www.viacom.com

² www.viacom.com

³ <http://finapps.forbes.com/>

⁴ <http://seekingalpha.com/>

1. Introduction

There is a simple principle in everything we do: grow or die. This rule is very adequate in the business field as well. Those companies which grow can take the market share from their competitors, increase profits and provide return to the shareholders. On the other hand, those companies, which stay at the same level and do not grow, lose market shares, customers and they destroy the shareholder value. Mergers and acquisitions play an important role in both cases: they enable strong and big companies to grow faster than the competitors and they provide enterprisers rewards. M&As ensure as well the weaker companies that they are irrelevant, worse and more quickly swallowed⁵.

“Mergers and acquisitions are vital part of any healthy economy and importantly, the primary way that companies are able to provide returns to owners and investors. This fact, combined with the potential for large returns, makes acquisition a highly attractive way for entrepreneurs and owners to capitalize on a value created in a company”⁶.

First of all the phrase mergers and acquisitions should be explained. As well a merger as an acquisition is a transaction. The first one combines two companies, leaving one surviving entity. The second one is the purchase by another company or individual. Both “deals” could fall under general heading of takeovers.⁷

It refers to the aspect of corporate finance, strategy and management dealing with the selling, buying and combining of companies, which can help, finance, or aid a growing company in a given industry grows faster without having to create another business entity. That is why it would be interesting to provide which impact one acquisition has on the whole industry.

In the beginning I would like to write about the entertainment industry. Later on I will give an overview of the three companies that were involved in the takeover battle: Paramount Communications Inc., Viacom International and QVC Network Inc.

⁵ Sherma, Hart (2006) 1

⁶ Sherma, Hart (2006) 1

⁷ Hirshleifer (1994)

Then, I will illustrate the need for a change. I will show Paramount Communication's financial performance as well as the financial performance of its main competitors (Time Warner, News Corporation, CBS and Walt Disney) and I will compare all companies. I will try to illustrate the bidding tactics of Viacom and QVC and the Paramount responses. Also, I will try to show the behavior of managers, boards of directors, and courts in the middle of a takeover battle. After that, I will evaluate if this takeover was the best solution for Paramount Communications. I will consider the alternatives that Paramount Communications had and I will try to evaluate these alternatives critically. I will propose some alternatives, which Paramount Communications could have chosen if it had not merged with Viacom.

Writing this paper is going to be very interesting and educational. Acquisitions themselves are intriguing. It is a way of cooperation between potential competitors, suppliers, producers or customers, who have decided to run a business together. This operation concentrates on the development and growth in a given market. We all know that after an acquisition and merger synergy occurs, this refers to a mutual financial or management benefit. The final outcome of the bidding war will show if the synergy occurred and I will try to show the amount by which each bidder was willing to over- or underpay.

2. Entertainment Industry

All three companies, that were involved in the takeover battle operated in the entertainment industry. Today entertainment industry is also known as show business and consists of a large number of sub-industries. Those sub-industries are: vaudeville, musical theatre, film, television and music. However, the main areas of this industry are: film and television and I am going to concentrate on this.

Television shows are produced for the cable and broadcast television networks. These television networks pay producers for the programming. The cable television network sells programming to the local cable television operators. In the late 80s and early 90s TCI and Time Warner were the leading local cable operators. Turning to the broadcast network, it sends programs to the related stations which broadcast the programming locally without charging. Television stations and networks earn money by charging for the commercials during the broadcast programs.

Second major area of the entertainment industry is film. Films are produced by the production companies. The largest film producers in the late 80s and early 90s were:

Columbia/TriStar, Twentieth Century Fox, Universal, Paramount, Warner Brothers and Walt Disney. Those companies were known not only for producing their own films but also for financing and distributing those films to the audiences. There were several steps in the distribution of the movies. Firstly, the distributor arranged with the cinema owners to exhibit the movie in the cinema. Cinema revenues accounted for almost 30% of the movie industry revenues⁸. Second step was recording the movies on the videocassettes and distributing them. This step was undertaken usually a couple of months after the movie had been shown in the theatre. This market accounted almost 40% of the movie industry revenues. Third step was broadcasting the movie on pay cable television and after that broadcasting it on network television. The last step was licensing the film to the local television syndicators.

The following table illustrates the annual film industry statistics for the period 1980-1993.

Table 1: Annual film industry statistics

Year	Total U.S. Box Office Revenues (millions)	Total U.S. Admissions (millions)	Motion Pictures Association of America Releases	Domestic Screens (thousands)	Major Distributors Filmed Entertain. Revenues (millions)	Major Distributors Filmed Entertain. Operating Income (millions)	Average Total Releasing Cost Per Film (millions)
1993	5154	1244	161	25.7	17417	1004	44.0
1992	4871	1173	150	25.1	15938	1288	42.3
1991	4803	1141	164	24.5	14208	948	38.2
1990	5022	1189	169	23.7	12676	1103	38.8
1989	5033	1263	169	23.1	11571	1130	32.7
1988	4458	1085	160	23.2	9121	1151	26.6
1987	4260	1089	129	23.6	8251	928	28.3
1986	3778	1017	139	22.8	6839	799	24.1
1985	3749	1056	153	21.1	6359	465	23.2
1984	4031	1199	167	20.2	5839	516	21.1
1983	3766	1197	190	18.9	5324	590	17.1

⁸ Vogel (1994)

1982	3453	1175	173	18.0	4548	565	16.8
1981	2966	1060	173	18.0	3749	301	15.7
1980	2749	1022	161	17.6	3997	489	13.7

Source: Paramount Communications Inc. – 1993, Steven N. Kaplan, University of Chicago

At that time (1980-2000) film costs had been increasing substantially but the number of the feature movies released had not changed. However, the risk on each movie had been reduced because of payoffs from sales and rentals of home videos. The other reason, why the risk had been reduced, is that there was a bigger demand for programming from the cable networks⁹.

In terms of total revenues the industry had performed a significant increase. Starting at \$2749 million in 1980 and reaching \$5154 million in 1993. One simple conclusion could be drawn from this fact: there was a demand for new movies and television shows. People wanted to watch more films and shows. This gave the production companies opportunity to produce more movies and earn more money. However, the average total releasing cost per film had increased dramatically in this period (1980- \$13.7 million and 1993- \$44.0 million) as well. The reason for that is simple: in the beginning of 1990 there was a fast development in the technology. Digital technology changed the nature of the film. Special effects had become more popular, editing and projection of the movies had changed. Unfortunately these high-tech solutions were very expensive, that is why the cost of releasing a movie had increased that rapidly.

3. Overview of the companies that were involved in the takeover battle

This part of my thesis presents 3 companies: Paramount Communications, Viacom International and QVC. All information about the companies is collected from the period before the takeover battle and the acquisition. I will start with the Paramount Communications, because this is the target company. Then, I will move on to the companies that waged the battle: Viacom International and QVC Network Inc.

⁹ Kaplan (1993)

3.1. Paramount Communications

In 1983, Martin Davis became the Chief Executive Officer of the Paramount Communications replacing Charles Bludhorn. At that time the company was known as Gulf & Western and operated in many business segments. In the following couple of years Davis sold most of the operating businesses and focused on the publishing and entertainment businesses.

Paramount Communications had two operating business segments: entertainment and publishing. The first segment provided 65% of total revenues and 62% of the operating profits. This business operated in motion picture production and distribution, television programming and prerecorded videocassettes. It maintained operations of motion picture theaters, independent television, regional theme parks, Madison Square Garden as well as in independent television stations and cable television networks. The second segment, which was publishing, included the publishing houses of Pocket Books, Prentice Hall, Simon & Schuster, Silver Burdett Ginn and Cumpster Curriculum Corporation. This segment also contained information operations such as manuals for accountants and other professionals as well as school text books. It provided 38% of Paramount's operating profits.

Between 1989 - 1993 Davis talked to many CEO's of the entertainment companies about mergers and acquisitions. Most of the talks were futile because he found the target companies too expensive. Firstly he flirted with the British publisher - Reed. Unfortunately, the \$4 billion merger fell through. Then, he wanted to buy 25% of a Dutch media company, called Elsevier. But this deal did not come into effect either. After that he started talks about potential mergers and acquisitions with record companies, such as: Bertelsmann, Geffen and PolyGram. Then the proposed partnership with Thorn-EMI, valued at \$4, 5 billion fell through as well. Afterwards Davis tried to merge with Sony, McGraw-Hill, Gannett, AT&T, and Matsushita. In 1989 Davis made a well- publicized hostile takeover offer for Time Inc. This takeover, which was valued at more than \$10 billion, did not end up successfully either. Davis explored mergers with major TV networks, such as CapCities/ABC, CBS and NBC as well. But all of the potential mergers or agreements either blew apart at the very last moment or fell on the regulatory hurdles. At that time Paramount Communications was left without strategic alliances¹⁰.

¹⁰ Steinbock (1995) 90

In 1993 Paramount Communication was the last studio that was in play. At that time Davis realized that his company no longer has to be the buyer. It could also be the seller.

In 1989 Paramount Communication had \$3.4 billion revenues and was one of the Hollywood's leading media and entertainment companies. It was compared to Disney (\$4.6 billion) and MCA-Universal (\$3.3 billion).

The following table shows, how Paramount's revenue, EBIT and EBIT margin have been changing between 1990 and 1993.

Table 2: Paramount's revenue, EBIT and EBIT Margin

	1990	1991	1992	1993
Entertainment	2,514.9	2,532.0	2,772.2	3,017.0
Publishing	1,354.1	1,363.4	1,492.7	1,624.6
Total revenue (mil)	3,869.0	3,895.4	4,264.9	4,641.6
EBIT (mil)	381.0	179.7	397.3	317.3
EBIT Margin	10%	7%	11%	9%

Source: balance sheets of Paramount Communications and Paramount Communications Inc. – 1993, Steven N. Kaplan, University of Chicago

There is a significant improve in the total revenues over the 4 years period. As well Entertainment Segment as Publishing Segment provided revenues, which were increasing from year to year. We see that Earnings before Interest and Tax and Earnings before Interest and Tax Margin did not improve. Moreover, it was even not stable over these years. Starting at \$381.0 million in 1990, decreasing to \$179.7 million in 1991, then increasing to \$397.3 million in 1992 and increasing not really significantly one more time in 1993 to \$317.3 million.

Earnings before interest and tax are calculated by taking total revenues less the cost of sales and the operating expenses¹¹. Cost of sales show costs, which are directly associated with the produced goods. It could be for example manufacturing costs. Operating expenses are costs related to the course of running the company. The reasons why EBIT and EBIT Margin was not stable and did not improve over this period were the cost of sales and operating expenses. In 1991 the drop in the EBIT was significant. It means that the costs related to the production of movies and TV shows increased dramatically. After this year it improved a lot, but in the last year there was an increase in the production costs and that is why it dropped again.

¹¹ Berk, DeMarzo (2007) 28

Right now I would like to turn to the two main companies, which were interested in acquiring Paramount Communications. The first one is Viacom International and the second is QVC Inc.

3.2. Viacom International Inc.

Viacom International Inc. was actually formed as a subsidiary of CBS. The reason for that was to manage returns of CBS programming. However, in 1970 the government made CBS to divest this subsidiary because of antitrust reasons. On June 9, 1987 Viacom was bought by Sumner Redstone for \$3.4 billion. It was a highly-leveraged deal, which overcame a management-led leveraged buyout bid. Under these circumstances Redstone had to raise his offer three times before acquiring the company.

For the next six years Redstone was trying to restructure Viacom's debt, shed the assets, which were not essential and focused on expanding MTV and Nickelodeon franchises worldwide. By 1993, Redstone decided that he has to focus on larger strategic issues. That is why he was thinking of acquiring Paramount Communications.

Viacom International was a communications and entertainment company that operated in four segments: Networks, Cable Television, Entertainment and Broadcasting¹². In the table below there is shown how much revenues and operating profits provided each segment of the company:

Table 3: Viacom's segments

Segment	Revenues	Operating Profits
Networks	56%	49%
Cable Television	22%	29%
Entertainment	13%	14%
Broadcasting	9%	8%

Source: Paramount Communications Inc. – 1993, Steven N. Kaplan, University of Chicago

The most profitable segment was the Networks segment, which provided 56% of the total revenues and 49% of the operating profits. On the other hand broadcasting segment provided only 9% of the revenues and 8% of the operating profits.

¹² Kaplan (1993)

The following table shows how the total revenues, EBIT and EBIT Margin have been changing in the period of 1990-1993. Total revenues are divided into segments.

Table 4: Viacom's revenues, EBIT and EBIT Margin

Year	1990	1991	1992	1993
Networks	895.8	958.5	1044.2	541.2
Cable Television	351.9	376.6	410.2	212.6
Entertainment	207.9	222.5	242.4	125.6
Broadcasting	144.0	154	167.9	87.0
Total revenue (mil)	1,599.6	1,711.6	1,864.7	966.4
EBIT (mil)	70.4	8.2	155.6	183.0
EBIT Margin	20%	7%	11%	9%

Source: Viacom's balance sheets and Paramount Communications Inc. -1993, Steven N. Kaplan, University of Chicago

There could be drawn a conclusion from the above table, which is similar to Paramount. We see that revenues were improving from year to year in every single segment. There is a significant decrease in the total revenues in the last year, but besides that year the company proves that it had a stable growth in the total sales. The decrease in total sales in the year 1993 could be explained only in one way. Redstone, CEO of Viacom, was focusing on strategic issues. Producing and selling movies and TV shows was not as important as looking for potential companies, which he could acquire or merge with. That is why the decrease in total revenues was so significant in the last year preceding the acquisition.

Turning to Earnings before Interest and Tax, we observe a significant decrease in both EBIT and EBIT Margin from year 1990 to 1991. It is related with increased operating expenses and cost of sales. Paramount had exactly the same drop in the EBIT and EBIT Margin in the year 1991. However, in 1992 EBIT increased from 8.2 to 155.6 and in 1993 it has been improved by 20%.

3.3. QVC Network Inc.

Turning to the second potential buyer, which was QVC Network Inc., it marketed a range of consumer products, such as electronics, cosmetics, toys, jewelry and housewares. It was done through shopping channels broadcast to cable television subscribers and satellite dish receivers. QVC reached nearly 59 million households. The most valuable asset of the company was its chairman and the Chief Executive Officer - Barry Diller. I would like to

devote some time to this person, because he is an essential figure in the Paramount-Viacom-QVC deal.

In 1974 Diller was named as chairman and CEO of Paramount Pictures. During the next few years Diller and his good friend Michael Eisner made the company one of the best performing studios in the 1970s and 1980s. Paramount Pictures was run by Diller until early 1980s. Then he was replaced by Martin Davis. Many people think that Paramount Pictures was run the best, when Davis was the chairman and the CEO of the company. Afterwards Diller moved to the Fox television network. Once again he proved that he was really good in what he was doing. He made the Fox the fourth television network in the world. After that he moved on to QVC, where he had significantly and really well moved the image of the company¹³.

Now, I would like to turn from people, who run QVC to the financial performance. As it was done before with Viacom and Paramount, I will present revenues, EBIT and EBIT Margin of the QVC in the following table:

Table 5: QVC's revenues, EBIT and EBIT Margin

	1/31 1991	1/31 1992	1/31 1993	7/31 1993
Revenues	776.0	921.8	1,070.6	535.7
EBIT	17.0	52.9	108.7	60.7
EBIT Margin	7%	9%	8%	6%

Source: Paramount Communications Inc. -1993, Steven N. Kaplan, University of Chicago

In QVC the tendency in total revenues is different comparing to Viacom. There is no significant decline in the total revenues in the beginning of 1993. QVC had a stable growth in total sales. Moreover, in the middle of 1993 the numbers suggested that there would be a slightly improvement in the total revenues by the end of the year.

Turning to EBIT and EBIT Margin we see a huge increase from \$52.9 million to \$108.7 million in year 1993. QVC did not face the same problem as Paramount and Viacom. Besides the fact of increasing cost of sales and operating expenses, the company managed to have an increase in EBIT in 1993. Barry Diller, CEO of QVC, was known for being a very good businessman and probably thanks to his knowledge and experience, QVC faced an increase in EBIT in all three years period preceding the takeover battle.

¹³ Steinbock (1995) 92

4. The Need for a Change

In this chapter of my thesis I would like to check if there was a need for a change in Paramount Communication. It is checked from the financial and strategic point of view.

4.1. Financial needs for the takeover

The figure below illustrates Paramount Communications' and its main competitors' financial performance during the three years preceding Viacom's takeover.

Table 6: Paramount Communications' and Peers Financial Performance 1990-1992¹⁴

Year	1990	1991	1992
Revenue Growth			
Paramount Communications	1%	9%	9%
Time Warner	4%	3%	7%
News Corp.	25%	-7%	5%
CBS	-6%	15%	1%
Median	6%	5%	5.5%
EBIT Margin			
Paramount Communications	10%	6%	11%
Time Warner	10%	10%	10%
News Corp.	15%	14%	16%
CBS	2%	9%	5%
Median	9%	10%	10%
ROE			
Paramount Communications	4%	8%	9%
Time Warner	6%	5%	5%
News Corp.	4%	8%	6%

¹⁴ Revenue Growth = (Sales(t1) – Sales (t0))/sales(t0)

EBIT Margin = EBIT(Tn)/Sales(Tn)

ROE= Net income available to common equity holders (Tn) / Book value Total common equity (Tn)

ROA = EBIT (Tn) / Total Assets (Tn)

CBS	na	na	na
Median	5%	7%	7%
ROA			
Paramount	5%	7%	8%
Communications			
Time Warner	5%	5%	6%
News Corp.	5%	6%	7%
CBS	na	na	na
Median	5%	6%	7%

Source: Balance sheets and „Triumph and Erosion in the American Media and Entertainment Industries, Dan Steinbock

In terms of revenue growth Paramount Communication had performed much better than its main competitors. Only in year 1990 Paramount Communications' revenue growth was below the median. However after this year we can observe a significant improve in the revenue growth. The EBIT margin could potentially unveil a difference in efficiency between Paramount and its peers. However, the EBIT margin is roughly in line with its peers and therefore gives no indication of an operating weakness at Paramount. Paramount's return on equity (ROE) was only a little bit higher than its peers' median and its return on assets (ROA) was only slightly better. As illustrated, on a company level, there was no strong indicator for a need of change in terms of revenue growth, efficiency or return. Paramount's financial performance did not reveal any particular operating weaknesses.

From the financial point of view there was no need for a change. But, besides the financial reasons, there are other reasons to acquire or merge as well.

4.2. Paramount's and Peers' Strategic Development 1980-1993

“Around the globe, folks just can't get enough of America“, wrote Fortune magazine in December 1990. „They may not want our hardware anymore- our cars, steel, or television sets. But when they want a jolt of popular culture – and they want more all the time – they increasingly turn to American software: our movies, music, TV programming, and home video,

*which together now accounted for an annual trade surplus of some \$8billion.*¹⁵

The mergers and acquisitions market is distinguished also by merger waves. A merger wave is: “a peak of heavy activity followed by quite troughs of few transactions”.¹⁶

The takeover waves are mostly seen during economic expansions. We can observe a takeover wave during contractions or correlates with bull markets very rarely. The managers are motivated to reshuffle assets through takeovers by the same economic and technological circumstances, which lead to bull markets. So, the conditions, which drive expansions, drive also peaks in merges and acquisitions activity.¹⁷

One of the main reasons for Paramount for a change was the fourth Mergers and Acquisitions Wave in America, which had started in the 80s. In the previous century, America experienced several mergers and acquisitions waves. The fourth wave had taken place from 1980 and lasted until 1990. At that time, the dollar value increased from \$33 billion to \$254 billion. The M&A industry was the third most active in the dollar value. There were undertaken nearly 2000 transactions which were worth more than \$89 billion¹⁸. From the top 100 deals of the 80s’, media and entertainment firms were mentioned in this ranking 11 times¹⁹.

There were a number of strategic developments in the media & entertainment industry during the ten years preceding Paramount’s acquisition. All companies including Paramount have had a significant focus on making its content available to the huge audience and on improving the movies. Warner Bros. bought Lorimar- Telepictures and became the world’s largest distributor of TV programming. Furthermore Sony purchased Columbia, because it wanted to use Columbia’s massive film and TV library. It was supposed to help Sony to push new forms of hardware. Digital technology changed the entertainment and media industry. Sony invested lots of money in the studio operations that increased its market share. Thanks to these investments, the following movies were produced: “Total recall”, “Misery”, “Terminator 2”, “and Prince of Tides”. Turning to another company- Walt Disney had a brilliant track record at that time as well. It produced such movies as: “Honey”, “Turner and Hooch”, “Father and the Bride”. Paramount was to

¹⁵ Huey (1990) 50-60

¹⁶ Berk, DeMarzo (2007) 891

¹⁷ Berk, DeMarzo (2007) 892

¹⁸ Steinbock (1995) 16

¹⁹ Sobel (1984)

follow this trend. By 1990 the company bought out top producers Don Simpson and Jerry Bruckheimer and produced “The hunt for Red October”, “Ghost” as well as “Addams Family”.

Special effects, new ways of editing and projection of the movies have affected the cost of production of the movies. Only the biggest companies with a huge capital and great producers were able to produce really good movies and TV shows. Therefore there was seen a need for a change for Paramount because of the merger and acquisition wave in the entertainment industry.

The company was in line with its peers in terms of strategic development regarding new technology and gradual streamlining of the business.

4.3. Other reasons for the takeover

An investment in the stock market is usually a zero-NPV investment. The question that comes with this statement is: Why the bidder is willing to pay a premium for a company that it wants to acquire and still meet the requirements that the transaction is a positive-NPV investment possibility? The answer is simple: Through the acquisition, the bidder is able to add the economic value, which could not be added by the individual investor. So in other words, the bidder is willing to pay the premium, because it is hoping for a large synergy.

4.3.1. Economies of scale and scope

“A firm is said to have economies of scale when its average cost falls as output increases. Economies of scope generalize the concept of economies of scale to the case of multiproduct firm. Economies of scale and scope are frequently used as an argument to defend a proposed merger. To assess the validity of the argument in each case, it is important to understand the sources of economies of scale, and assess whether they cannot be realized otherwise.

Economies of scale, realized through a merger, may be the result of coordination of the (formerly separate) firm’s investments in physical capital- called long-run economies of scale. Other realizations of economies

of scale may, however, come already in the short run (when physical capital is held fixed)”²⁰.

Thus, in Paramount Communication’s, QVC’s and Viacom’s case a reason for the acquisition was the synergy, which was to occur. A big firm can enjoy economics of scale or savings because of the high volume of the production, which is of course not available for a small firm. The more films the combined company would have produced, the lower the costs of the production of one film would have been.

Big companies can also benefit from economies of scope. By combining the distribution and marketing of different types of similar goods, the company can make significant savings.

In our case all of the companies, that were involved in the takeover battle operated in the same industry- entertainment industry. Thus, by the joint distribution and marketing of movies and TV shows produced, all companies could save money.

4.3.2. Vertical integration

“Vertical integration refers to the merger of two companies in the same industry that make products required at different stages of the production cycle.”²¹

A firm can conclude that it could improve its product if it had a direct control of the inputs, which are needed to make the goods. In the entertainment industry a vertical integration between two companies would be very beneficial for both firms, because usually the companies own all stages of the production process of TV shows and films. Starting with the development of the movie or TV show, through preproduction, production and post-production, even down to the distribution. If Paramount was put with another company under central control, management could ensure that both firms work toward a common company objective.

Vertical integration could lead to monopoly gains too. Merging or acquiring with a main rival helps a company to substantially reduce rivalry in the industry and therefore increase revenues. All three companies that are involved in the takeover battle operate in the same

²⁰ Ilzkovitz, Meiklejohn (2006) 89

²¹ Berk, DeMarzo (2007) 895

industry and they were competitors for each other. By merging with each other they could reduce the competition in the film industry and could create a huge world's leading media conglomerate.

However, society as a whole suffers from the monopoly strategies, so almost all countries have antitrust law, which extents these activities. So, monopoly gains are no longer good and beneficial reasons for a takeover, because of the antitrust laws.²²

4.3.3. Incremental growth

An extremely important method of growing is growing through merger or acquisition. An incremental growth, which could occur through combining Paramount with QVC or Viacom, is an example of a soft synergy. It is really difficult to predict how much faster Paramount could grow after merging with Viacom and QVC. However, if Paramount wanted to achieve an incremental growth, it seemed to be wiser to have a takeover with Viacom. Viacom could add Networks and Cable Operators and thanks to that Paramount could show its movies in MTV. From the other hand, merger with QVC will not give Paramount such opportunities.

4.3.4. Managerial motives to merge

It is extremely difficult to quantify a soft synergy. Better management, which could appear after combining with Viacom or QVC, is an example of a soft synergy too. In this case Paramount would profit more from the takeover with QVC. Barry Diller, CEO of QVC, was the most valuable asset in the company. A QVC-Paramount combination would be a very content-driven combination.

5. Consideration of Alternatives

When Martin Davis, who was the CEO of Paramount Communication, realized that his company could be not only the buyer but also the seller, he met with Ted Turner and talked about a potential merger of Paramount and Turner Broadcasting. It was not the only opportunity, he had. In April 1993 he started negotiating with Viacom's chairman- Sumner

²² Sudarsanam (2003) 38

Redstone. At the same time he was talking to John Malone, who was the CEO of the cable and media giant Tele-Communications Inc. (TCI). The talks were about a quasi-merger - TCI was supposed to acquire 17% of Paramount Communication. In May 1993 there were several merger possibilities for Paramount. The Board of Directors had the following options: TCI, Turner and Viacom²³.

5.1. Paramount-Viacom

In July 1993, Paramount and Viacom signed confidentiality statements but unfortunately the talks collapsed. Few months later, in September 1993 Davis agreed to this merger. Redstone, the owner and CEO of the Viacom Company, was to acquire Paramount Company for \$8.2 billion (\$69.14 a share). That was supposed to be a stock and cash deal. The following table shows the pro forma combination of the Paramount Viacom takeover, if Viacom had had acquired Paramount on the 14th of September 1993.

Table 7: Pro Forma Combination- Paramount-Viacom Combination

	Paramount (million)	Viacom (million)	Combined (million)	Overlap (million)
Entertainment	2,021	233	2,254	233
Networks	187	1,143	1,330	187
Cable TV	0	421	421	0
Broadcasting	216	175	391	175
Live Entertainment	634	0	634	0
Publishing	1,667	0	1,667	0
Total	4,725	1,972	6,697	595

Source: Merrill Lynch Analyst Report, September 14, 1993

The combined company would have 6 following segments: Entertainment, Networks, Cable TV, Broadcasting, Live Entertainment and Publishing. By comparing the overlap between the companies' segments, it becomes clear, that the overlap is \$595 million, which is equal to about 8% overlap. Viacom's owner- Redstone- knew that there would appear real synergies among the assets of Paramount and Viacom. These synergies would occur,

²³ Steinbock (1995) 253

because both Paramount and Viacom had businesses, which were complementary to each other. Another reason for the synergies was the fact that both of these firms were well known. Paramount-Viacom combination would have no rivals in the national TV distribution. It would possess all together 7 cable televisions and 12 broadcast stations. It would be also the world's leading cable programmer, thanks to having networks such as Nickelodeon and MTV and it would be the major Hollywood studio as well. But this combination could bring together something more: creative talent, managerial resources, intellectual property and trademarks of Viacom and Paramount. Another advantage of this acquisition would be the cost reduction, because both of the companies operated in the same business. There would occur economies of scale too. The more films they would have had produced, the lower the costs of the production of one film would have had been. Redstone strongly believed that there were opportunities for increased revenues from this combination. Firstly, it would occur from cross-promotion and utilization of the both companies' well-known brand names. He meant using Viacom's Showtime, Nickelodeon brands to increase Paramount's live entertainment segment. Secondly, he thought that increased revenues would come from the utilization of distribution capabilities of each firm to distribute products of the other. A good example could be: distributing Paramount's theatrical motion picture library on a new or already existing cable network, which was owned by Viacom²⁴.

This combination would definitely bring synergies and the companies would benefit from technological and other developments in the distribution and form of entertainment programming. The last but not least advantage from the Paramount-Viacom acquisition would be the fact that both companies wanted to pursue international business strategies. It would result in an intensely enhanced international existence.

5.2. Paramount-QVC

About a week after Viacom's bid, QVC announced a \$9.5 billion (\$80-a-share) hostile bid for Paramount. QVC had two main shareholders at that time - Comcast and Liberty Media-TCI. Each of those two shareholders put up \$500 million to back the QVC's offer. Paramount had exactly, what QVC was looking for: film library, movie studios, publishing house, and TV programs and sports teams. There were several advantages, which would

²⁴ Kaplan (1993)

appear, if Paramount merged with QVC. These advantages were different from those of Paramount-Viacom combination.

As it was mentioned before, the most valuable asset of QVC was its CEO Barry Diller. A QVC-Paramount combination would be more content-driven comparing to Paramount-Viacom combination. It was expected that Diller would probably change the way Paramount did business. Observers said that Diller would probably have sold the theme parks and TV stations and he would have concentrated on programming. At the same time it was expected from Diller to enhance flow of Paramount films completed at lower costs. There were rumors that Diller wanted to start a new television network.²⁵ The QVC-Paramount combination would probably bring new television channels and fifth television network. This merger would help TCI to satisfy its customers, who were willing to watch high-visibility programs.

The following table (Table 8) shows the pro forma combination of the hypothetical Paramount - QVC acquisition and the overlap between the different segments of these two companies.

Table 8: Pro Forma Combination- Paramount-QVC Combination

	Paramount (million)	QVC (million)	Combined (million)	Overlap (million)
Entertainment	2,021	0	2,021	0
Networks	187	1,200	1,387	187
Cable TV	0	0	0	0
Broadcasting	216	0	216	0
Live Entertainment	634	0	634	0
Publishing	1,667	0	1,667	0
Total	4,725	1,200	5,925	187

Source: Merrill Lynch Analyst Report, September 14, 1993

It becomes clear that the hard synergy, which could occur from the combination Paramount-QVC, was much smaller than from the combination Paramount-Viacom. Overlap of \$187 million, which makes about 4%, is smaller than the overlap in Viacom,

²⁵ Wall Street Journal, October 20, 1993

which was 8%. But, as it was mentioned earlier, from Paramount-QVC merger, there was expected not had synergy, but soft synergy, especially managerial improvement.

6. The Hostile Battle

Right now I would like to concentrate on the hostile takeover battle between QVC and Viacom.

Redstone wanted to kill two birds with one stone – bring down John Malone, the CEO of Telecommunications Inc. (as it was mentioned before TCI was one of the two main shareholders of QVC) and win Paramount²⁶.

Paramount's management did not meet with QVC, although they were authorized by the Board of Directors to do that. They were waiting for a new offer from Viacom. However, Viacom concentrated on the TCI's case.

"In the American cable industry, one man has... seized monopoly power. Using bullyboy tactics and strong-arming of competitors, suppliers and customers, that man has inflicted injury on Virtually every American consumer of cable services and technologies. That man is John C. Malone."²⁷ This is what Redstone said in Viacom's antitrust suit against TCI. He actually hoped to bring down John C. Malone, his main competitor. He also hoped that he could get Paramount. In fact, the competitor relationship between QVC and Viacom renew the talks with Viacom. Viacom was ready to acquire Paramount, but Davis – Paramount's CEO- was suspicious about the Viacom's sufficient financial assets, that is why, he wanted to see the "proof of financing". Otherwise he was not willing to have any talks with Viacom.

Few days later, in the end of September 1993 Viacom got \$600 million from Blockbuster to win the bid. In October 1993, Viacom obtained additional \$1.2 billion commitment from Nynex, which was a telephone company that served five New England states as well as New York state, from 1984 through 1997. The company also operated cable television and telephone services in the United Kingdom. The reason why Viacom got that money was very simple. Nynex wanted Viacom to win the battle. The companies sweetened the bid by adding additional money. But it was not the end of the battle. Meanwhile Bell Atlantic announced it would buy TCI and Liberty. This deal gave a financial muscle to the QVC's offer. Furthermore, Advance Publications, newspaper and magazine publisher,

²⁶ Steinbock (1995) 253

²⁷ Wall Street Journal, September 27, 1993

and Cox Enterprises, a newspaper and cable television company, said that they would back the QVC's bid with \$500 million each.

What happened in the meantime was unexpected. On the October 21st QVC announced a hostile tender offer. It was willing to get 51% of Paramount at the price of \$80 a share and \$1.43 for every remaining share of Paramount. Paramount and QVC had not had to wait long for the Viacom's respond. Three days later, Viacom offered a \$80-a-share cash bid for 51% of Paramount. Viacom was offering its stock for the remaining 49%²⁸.

The takeover battle moved at that time to the courts. On the October, 28th QVC put forward a motion in Delaware Chancery Court looking for preliminary injunction to stop the merger between Paramount and Viacom. The company wanted to use the "poison pill" takeover defenses, which would support Viacom. QVC was of the opinion that the Paramount's Board performed improperly, because it did not exercise the Revlon duties and it allowed defensive measures to grant Viacom. The defensive measures were for instance: termination fees, lucrative stock options and lock up options²⁹.

After that, the time has come for Viacom's answer. It raised its offer from \$80 to \$85-a-share for 51% of Paramount. The company stayed with the offer of buying the remainder with the stock.

When Viacom raised its bit, QVC raised the cash part of its bid as well. The total value of the cash part was worth \$90 a share. At that time new companies decided to support the bid. BellSouth Corp agreed to invest \$1.5 billion in QVC to back its bid. At the same time Liberty Media agreed to sell its stake to QVC under the condition it won control of Paramount. However, Paramount's Board of Directors recommended their shareholders to reject QVC's \$90-a-share bid.

By mid-November, there were some arguments in the Delaware Chancery Court on the QVC's motion for a preliminary injunction. Court's decision was to grant the QVC the preliminary instruction blocking Paramount's "poison pill plan"³⁰ (there will be a little bit more about the poison pill in the next paragraph) and stroked down "lock up" options, which were worth \$500 million. On the 9th of December the Delaware Supreme Court stranded by the Chancery Court decision and set the stage for an auction process of

²⁸ Steinbock (1995) 254

²⁹ Gaughan, 2002

³⁰ Wall Street Journal, November 24, 1993

Paramount. Paramount had to withdraw its support for the Viacom bid and at that time the auction process started³¹.

I would like to concentrate now on the Paramount's poison pill plan. If there is a hostile takeover and a company is a target, it is obvious that managers are often faced with the choices, which are not really comfortable. Hostile takeover have one main benefit for the shareholders. It allows them to get substantial financial gains. However, it has a main disadvantage for the managers as well. It usually results in losing jobs by the managers. That is why they often try to protect their own interest at the great expense of stockholders. One of the ways, which helps the managers to protect themselves in a hostile takeover, is a poison pill³².

“Firms sometimes create poison pills, which are triggered by hostile takeovers. The objective is to make it difficult and costly to acquire control. A flip over right offers a simple example. In a flip over right, existing stockholders get the right to buy shares in the firm at a price well above the current stock price. As long as the existing management runs the firm; this right is not worth very much. If a hostile acquirer takes over the firm, though, stockholders are given the right to buy additional shares at a price much lower than the current stock price. The acquirer, having weighed in this additional cost, may very well decide against the acquisition”³³.

Managers of Paramount prepared during the hostile battle a poison pill plan, which was unfortunately blocked by the Delaware Supreme Court.

6.1. Not exercised Revlon duties and the defensive measures such as lock up options and termination fees

One of the most important sets of directives and rules in the mergers and acquisition case law is known as the “Revlon duties”. Two cases: Paramount Communication Inc. vs. QVC Network Inc. and Revlon Inc. vs. MacAndrews and Forbes Holdings helped to establish these directives.

³¹ Gaughan (2002) 108

³² Damodaran (2008) 18

³³ Damodaran (2008) 18

“The essential premise of the Revlon duties is that in the context of a sale of a company, the board has a duty to maximize value of the company for the benefit of the shareholders. In a sense, this is contrary to the boards’ day-to-day obligations, as the board is now faced with an immediate decision to maximize the shareholder value rather than a long-term strategic process to deliver shareholder value. The board’s responsibility shifts from preserving the corporation for long-term benefit to maximizing the value of the company in the sale to the shareholders’ benefit”³⁴.

In Delaware Supreme Court’s opinion, since the Paramount Board of Directors had decided to sell control, they were obliged to search for the best option to their shareholders. This obligation contained the responsibility to evaluate critically both the Viacom and the QVC offer. This critical evaluation’s purpose was to determine, if the QVC tender offer was conditional. It also investigated if the offers could have been improved and if yes under which circumstances. The purpose of this investigation was to determine if all important information was available for consideration of the Paramount’s Board of Directors and if there were realistic possibilities of actions of the Board of Directors. The last thing that was investigated was to determine if the directors had enough time to consider the materials carefully³⁵.

The takeover defenses are very useful tactics in the takeover battles. It helps the Board of Directors to get a higher price. But also in a hostile takeover it gives the board time to find a “friendly buyer” or other reasonable solution. There are several defensive tactics that were used in Paramount-Viacom-QVC battle: termination fees, lock-up options and lucrative stock options.

„Unknown less than 15 years ago, termination fees (otherwise called kill fees) are now a commonplace component of merger and takeover agreements. Such fees typically require target firms to pay a monetary consideration to bidders if a merger or takeover agreement is broken.“³⁶.

³⁴ Hunt (2009) 514

³⁵ Welch, Turezyn, Saunders (2009) 48

³⁶ Khalil, Magnan, Andre (2005)

Viacom wanted a termination fee because it spent time, energy and its name in this acquisition war. But the time and reputation invested in the takeover battle were not the only reasons why the company demanded termination fee. The second reason was a fact, that a termination fee makes the bid much more expensive for the other bidders. If there was a new bidder, it had to pay Viacom the termination fee.

Another defensive tactic used in the battle was a lock-up option:

*“Lock-up options are provisions drafted to favor an acquirer with whom the target company has signed a defensive agreement. They give the acquirer the right to purchase stock or assets of the target under certain circumstances. The goal of a lock-up is to discourage third party offers, in particular hostile third parties”.*³⁷

The main objective of this defensive tactic was to disfavor QVC. A lock-up option makes a hostile bid very hard.

6.2. Auction Process

Around the mid of December Paramount could not support Viacom anymore and it opened an auction. The company set up the bid system and called for bids by the 20th December deadline. By the 20th of December both Paramount and QVC submitted their bids to Paramount. QVC's bid was higher and that is why Paramount's Board of Directors recommended merging with QVC. QVC was willing to pay \$92 a share in cash for Paramount's 51% and the rest in stock. However, Paramount gave some additional days to Viacom to increase its bid. In the beginning of January Viacom announced that it wanted to merge with the Blockbuster in an \$8.4 billion deal. “Viacom-Blockbuster” offered \$105 in cash for 50.1% of Paramount's stock. The rest was supposed to be purchased with Viacom's stock. Viacom valued the total offer at \$79.25 a share. The Viacom-Blockbuster synergies were seen only on the balance sheet. The main reason for that was the fact, that the video retailer had a debt-free financial structure. Blockbuster was at that time an all-equity firm. Unfortunately, the operational synergies were not seen at all. Redstone (CEO of Viacom) needed this merger to win Paramount. Wayne Huizenga, Blockbuster's CEO, wanted to merge with Viacom because he had a hope to exit from the home video industry-

³⁷ Hunt (2009) 677

“industry bound to decline with electronic superhighways³⁸”. However, Paramount’s Board of Directors recommended its shareholders to reject the Viacom’s bid. At that time the QVC bid was still preferred³⁹.

6.3. Epilogue: the End of the Bidding War

On the 12th of January 1994, Paramount’s Board of Directors rejected Viacom’s \$9.3 billion takeover bid. About a week later Viacom raised its bid to \$107 a share and it added a financial instrument to secure the value of the securities fraction of its offer. So, on that day Viacom’s offer included \$107 per share in cash for 50.1% of Paramount’s shares and for the remaining 49, 9% Viacom increased its offer in a second-step merger to:

- “0.93065 shares of Viacom Class B Common Stock,
- 0.93065 CVRs⁴⁰,
- 0.5 Viacom Three-Year Warrants
- 0.3 Viacom Five-Year Warrants
- and \$17.50 in principal amount of Viacom Merger Debentures with an 8% coupon and 12 year maturity if the Blockbuster-Viacom merger was approved. If the merger was not approved, the debentures would be replaced with \$17.50 face value of Viacom preferred stock with a 5% dividend yield”⁴¹

Paramount’s Board of Directors found this offer really attractive and that is why it ended the merge pact with QVC, even though in meantime QVC increased its offer as well. QVC was offering \$104 per share in cash for 50.1% of Paramount’s shares and:

- “1.2361 shares of QVC Common Stock,
- 0.2386 shares of New QVC Merger Preferred Stock,
- and 0.32 ten-year warrants for each remaining Paramount share in a second step merger”⁴¹.

Paramount’s Board of Directors recommended the Viacom’s offer to its shareholders⁴². On 13th of February QVC’s CEO, Diller, said that he is not willing to alter his bid for Paramount, thus on the 15th of February Viacom could claim victory. On that day Diller said:

³⁸ Steinbock (1995) 254

³⁹ Noglows, Robins (1994) 1 - 71

⁴⁰ The Contingent Valuation Rights

⁴¹ Hietala, Kaplan, Robinson (2003) 22

⁴² New York Times, January 19, 1994

“They won. We lost. Next.”

Finally, Viacom bought Paramount for \$10 billion. It was approximately \$2 billion more than the original offer. The whole takeover battle lasted 5 months⁴³.

On the day when Viacom won the takeover battle, so on the 15th of February 1994, Viacom's B share's value decreased to \$28.00, Viacom's A share's value fall to \$34.125. QVC share price increased to \$50.25 per share and Paramount was traded at \$77.00 per share⁴⁴.

The combined company was run by Sumner Redstone. The new CEO of the Viacom-Paramount was Frank J. Biondi, who has been Sumner's right-hand man for a long time. When the acquisition was finalized, Redstone had control over the 75% of the votes. He overtook with Frank J. Biondi the whole control over the combined company, which meant that Paramount's chairman, Martin Davis and his second-in-command, Stanley Jaffe, were out.

In the beginning of March Jonathan Dolgen was named to run the movie and television division of Paramount. Dolgen was earlier a president of Sony Motion Pictures Group, but when Redstone made him the offer to run the division, he accepted it immediately. Dolgen was known of being a really good businessman and steely negotiator.

Viacom paid for Paramount almost \$2 billion more, than it was agreed in September 1993, when the companies started the negotiations. That is why it was expected from Viacom to shed certain of the Paramount's assets. In this way it could raise some cash, which it spent, while buying Paramount. Indeed, in late April, Viacom announced that it was willing to sell several units in its information and software department. Redstone shed the following assets: the Madison Square Garden was shed to Charles Dolan's Cablevision and Simon & Schuster's educational publishing units were shed to Pearson Plc. Both deals were valued to almost \$4 billion.

The value of the Viacom's share was falling down and that is “why the prospects clouded for the acquisition of Blockbuster”⁴⁵. In the beginning of May 1994 Harry Huzenga, who was the man, who grew Blockbuster Video sent information to its shareholder and said: “Could be no assurance the board could recommend a transaction with Viacom”. Huizenga was at that time acting like an investor and not like a decisive player. Through this action

⁴³ Wall Street Journal, February 16th, 1994; Landler, DeGeorge, Business Week, February 28th, 1994

⁴⁴ Kaplan (1993) 22

⁴⁵ Steinbock (1995) 256

his stockholders became worried about the Viacom investment and they started thinking that Blockbuster might have lost more than it could have gained.⁴⁶

Viacom started new investments, when it acquired Paramount. “The company joined Nynex in exploring video-on-demand possibilities for the vast Viacom and Paramount film and TV libraries”. It began developing multiplayer video games and started creating interactive versions of Viacom’s cable television, such as VH-1, MTV, and Nickelodeon⁴⁷. Even if Viacom’s initial transaction with Blockbuster was not going to happen as it was planned, it did not threaten the takeover of Paramount- that was complicated by “block bummer” deal.

Redstone was a really good CEO and he knew how to run a business. He turned Viacom’s expenditures into real profit. Under the command of Redstone, Paramount had the best performance ever. It produced during these 10 years such films as: “Saving Private Ryan”, “Titanic”, “Brave heart” and “Forrest Gump”.

7. Viacom’s shareholders opinion about the acquisition with Paramount

QVC and Viacom were leading the bidding war for more than 5 months. Starting in September 1993 and ending on the 15th of February, when Viacom’s final bid was accepted. Right now I would like to concentrate on the investors’ point of view of the acquisition. On the day, when Viacom announced the bid for the first time, the company’s share dropped by 6.8 per cent and the Standard and Poor’s Index dropped by 0.4 per cent. Viacom’s shares were affected by the change in the market index as follows⁴⁸:

*Expected return on Viacom = $\alpha + \beta * \text{return on market} = 0.01 + 0.78 * \text{return on market}$*

As we see, the alfa is equal to 0.01. This numer could be interpreted as follows: Viacom’s shares increased on average by 0.01 per cent per day, when the market index was unchaned. Turning to the beta, we see that it was equal to 0.78, which means that whenever the market index increased by one per cent, it leaded to an additional 0.78 per cent

⁴⁶ Business Week, May 9, 1994; Bart, May 9-15, 1994

⁴⁷ Brown (1994)

⁴⁸ Brealey, Myers, Myers (2000) 80

Viacom's return. On the day, when Viacom made its bid for Paramount, the market decreased by 0.4 percent. So, the expected return on Viacom was equal to:

$$\text{Expected return on Viacom} = 0.01 + 0.78 * (-0.4) = -0.3 \text{ per cent.}$$

Now, we can calculate the abnormal return on the Viacom's share, which is equal to -6.5%.

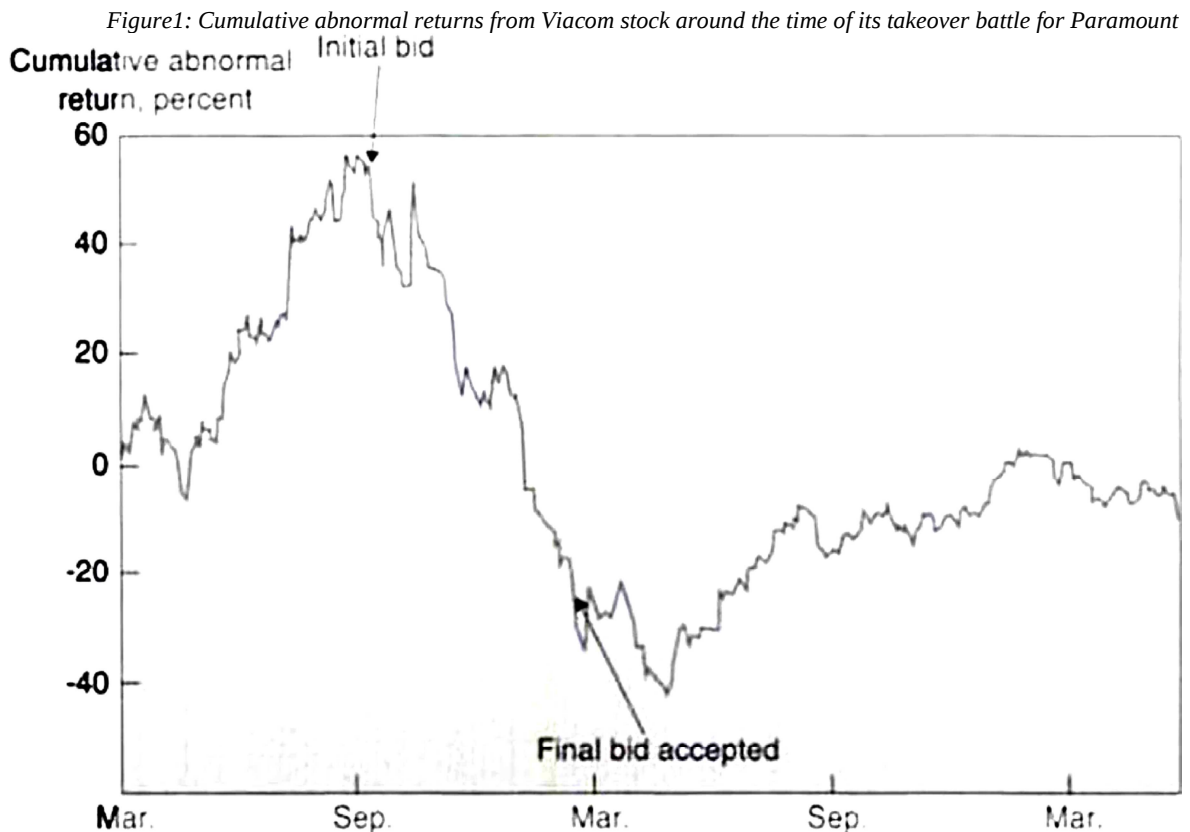
$$\text{Abnormal return} = \text{actual return} - \text{expected return} = -6.8 - (-0.3) = -6.5\%$$

Just before the bid Viacom was worth around \$7.9 billion. We can easily calculate that the abnormal decrease in the value of the company's shares was equal to:

$$0.065 * 7.9 \text{ billion, which is equal to } \$515 \text{ million.}$$

If we accumulate the daily abnormal returns, we can observe Viacom's stock performance over a longer period. If Viacom's abnormal return was on one day equal to +5 per cent and on the next day its abnormal return was equal to +6 per cent, the company's cumulative abnormal return would be equal to 11.3% ($1.05 * 1.06 - 1 = 0.113$).

The following graph shows the cumulative abnormal performance of Viacom's stock during the period 1993-1995. There was marked in the graph the day, when Viacom made the initial bid for Paramount and the day, when it actually won the takeover battle.



Source: *Financing and risk management*, Richard A. Brealey, Stewart C. Myers, Stewart Myers, Brattle Group

The abnormal return for the period between the initial bid and the acquisition was - 50%. We can easily calculate that Viacom's stock value dropped to \$4 billion during this period. It is obvious, that when Viacom's value decreased almost by 50%, Paramount's shareholders were not really happy with the Viacom's stock, which was offered to them. Another thing is, that if Viacom really wanted to win Paramount it had to increase the amount of cash on the offer. Also, the company had to guarantee that it would repurchase the stock from Paramount's investors if it decreased below a specified price.

We should notice here one very important thing. The market's response to the bid, should have suggested managers, that the shareholders were not happy with the proposed acquisition and that they found it as a very poor deal. We see in the graph, that Viacom's price was falling during this period significantly, which means that management had clear and loud messages, that investors did not want this acquisition. Of course, we could assume, that management had additional information, which shareholders did not have, and that is why there was an information asymmetry, but usually the stock price performance

gives the information about the shareholders' point of view. In our case, the investors did not want to acquire with Paramount⁴⁹.

8. Paramount Valuation as a standalone company using the DCF Model

“The DCF valuation can be described as a mathematical concept which seeks to estimate the present value of an entity or the whole company by discounting expected future free cash flow streams by an appropriate discount rate reflecting the expectations of the market. It has been introduced by Nobel Prize winners Merton Miller and Franco Modigliani in 1961.”⁵⁰

In the work of Rappaport (1998) we can find the definition of the entity model of the DCF Valuation: “The total economic value (corporate value) of an entity such as a company or business unit is the sum of the values of its debt and its equity....Corporate value consists of two basic components: the present value of FCF from operations during the forecast period, and the residual or continual value, which represents the present value of the business attributable to the period beyond the forecast period.”⁵¹

8.1. Capital Structure

The capital structure applies to the way a company finances its assets through some combination of equity, debt or hybrid securities. In other words the capital structure of the company is the composition of the company's liabilities.

In Paramount's case the total debt in 1993 was calculated from the long term financial debt (\$1.002, 9 million) and the current maturities of the long term debt (\$10, 1 million). So the total debt is equal to \$1.013million.

The equity was calculated as a market capitalization, by using the following formula:

$$\text{Equity} = \text{Market Capitalization} = \text{Share price} \times \text{Number of Shares Outstanding}$$

⁴⁹ Brealey, Myers, Myers (2000)

⁵⁰ Brealey, Myers, Myers (2000)

⁵¹ Schoen, (2007) 11

To calculate the market value of equity the number of outstanding shares is multiplied by the share price. The total number of shares outstanding was at that time 120 million. We can easily calculate the total market value of equity, which was worth:

$$\text{Market Value of Equity} = \$55,5^{52} \times 120.000.000 = \$6.660.000.000$$

Having the value of equity and the value of debt, we can easily calculate the current debt-to-equity ratio and the debt-to-value ratio for Paramount in 1993.

$$D/E = 1.013/6.660 \text{ million} = 15\%$$

$$D/V = 1.013/(6.660+1.013) \text{ million} = 13\%$$

However, while using the WACC method, Paramount's debt-to-equity ratio has to be constant. It means that Paramount adjusts its leverage to carry on a constant debt-to-equity ratio in terms of market values. This policy implies that the risk of the company's debt and equity and its weighted average cost of capital will not change because of the leverage fluctuations. It also shows the amount of debt the company will employ when it undertakes a new project or investment.⁵³

The optimal capital structure will be determined by an industry peer group comparison. When computing the optimal capital structure of the industry, there will be growth, return and asset of the companies compared. If these factors are quite similar across the peer group, market forces will push the companies in the industry toward an effective and optimal capital structure.⁵⁴

Paramount's debt-to-equity ratio and the debt to value ratio seem to be a little bit lower comparing to the whole industry. Davis, Paramount's CEO, was responsible for the low debt-to-equity and debt-to-value ratios. When he was the CEO of the company, Paramount had lots of excess cash and very little debt. This has a number of benefits but also drawbacks. Lower geared companies have lower probability of bankruptcy, but also financial distress is lower, and the advantage from debt overcomes the cost. The companies' shares have lower volatility of equity returns since lower interest on the debt must be paid before paying returns to the shareholders. But, since the interest rate paid on

⁵² Closing price on August 30th, 1993

⁵³ Berk, DeMarzo (2007) 900

⁵⁴ Koller (2010)

debt financing is tax deductible, debt is much cheaper than the equity. So, a company usually will borrow because of the valuable interest tax shield.

Since, Paramount's debt-to-equity and debt-to-value ratios are a little bit lower comparing to the other companies in the industry; we can easily assume a constant debt-to-equity ratio for the industry at 25%. Constant means that it intends to maintain a similar ratio for the foreseeable future.

8.2. Weighted Average Cost of Capital

According to Jonathan Berg and Peter DeMarzo Weighted Average Cost of Capital is described as:

“The average of a firm's equity and after tax cost of capital, weighted by the fraction of the firm's enterprise value that corresponds to equity and debt, respectively”⁵⁵

In other words, WACC is the cost of capital, which is the weighted average of the costs of different components (equity and debt) used for the financing of a firm. To calculate WACC, the following formula will be used:

$$WACC = K_e * \frac{E}{E + D} + K_d * (1 - t) * \frac{D}{E + D}$$

Cost of equity (K_e) is the required rate of return by shareholders on their investments for the risk they face. To calculate cost of equity for Paramount the Capital Asset Pricing Model is used:

$$K_e = r_f + \beta(r_m - r_f)$$

Cost of debt (K_d) is the required rate of return by debt holders on their investments (i.e. cost of borrowing funds). It should be noted that cost of equity should be greater than cost of debt, as shareholders face greater risks. The formula for cost of debt is:

$$K_d = r_f + \text{Company Default Spread} + \text{Country Default Spread}.$$

⁵⁵ Berk, DeMarzo (2007) G-18

8.2.1. Risk Free Rate

The risk free rate (r_f) represents the rate of return earned by investing in the risk-free asset. Although in reality everybody knows there are no risk free investments, it can be approximated by taking the yield on short dated government bonds. This can be equated to the yield on short dated US T-Bonds. The geometric average of the T-bond returns over past 60 years is 5.68%⁵⁶.

8.2.2. Risk Premium

The risk premium ($r_m - r_f$) represents the excess of market returns over the returns of risk-free assets. It is calculated based upon S&P 500's return with added dividend yield minus risk free rate based on annual returns for the years: 1960-1994⁵⁷.

Table 9: Annual returns for the years: 1960-1994

Year	Earnings Yield (%)	Dividend Yield (%)
1960	5,34	3,41
1961	4,71	2,85
1962	5,81	3,4
1963	5,51	3,13
1964	5,62	3,05
1965	5,73	3,06
1966	6,74	3,59
1967	5,66	3,09
1968	5,51	2,93
1969	6,63	3,52
1970	5,98	3,46
1971	5,46	3,1
1972	5,23	2,7
1973	8,16	3,7
1974	13,64	5,43
1975	8,55	4,14
1976	9,07	3,93
1977	11,43	5,11
1978	12,11	5,39

⁵⁶ Federal Reserve Bank

⁵⁷ <http://pages.stern.nyu.edu/>

1979	13,48	5,53
1980	11,04	4,74
1981	12,39	5,57
1982	9,83	4,93
1983	8,06	4,32
1984	10,07	4,68
1985	7,42	3,88
1986	5,96	3,38
1987	6,49	3,71
1988	8,69	3,68
1989	6,88	3,32
1990	6,86	3,74
1991	4,63	3,11
1992	4,79	2,9
1993	5,77	2,72
1994	6,91	2,91
SUM	266,16	132,11
SUM/Number of years	7,60	3,77

Source: http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/spearn.htm

$$R_m = 7,60 + 3,77 = 11,37$$

In our case market risk is equal to 11.37. And since risk free rate is equal to 5.68% the risk premium, is 5.69%.

8.2.3. Beta

The beta (β) measures the sensitivity of returns on the security to changes in systematic factors. Paramount's levered beta is equal to 1⁵⁸. To calculate WACC correctly, this beta has to be unlevered and then re-levered again. A firm's asset beta is equal to the weighted average of its debt beta and equity beta:

$$\beta_A = \frac{E}{E + D} \beta_E + \frac{D}{E + D} \beta_D$$

The unlevered (asset) beta measures the market risk of the company's underlying assets. That is why it could be used to value the cost of capital for comparable projects or investments. If a company changes its capital structure but it does not change its projects or investments, its asset beta remains unchanged. However, we have to be aware, that

⁵⁸ Kaplan (1993)

company's equity beta will alter to show the consequence of the capital structure change on its risk⁵⁹. If the current D/E ratio is 0 then $\beta_E = 1 = \beta_U$.

Hence, the cost of equity is equal to:

$$K_e = K_u = 5.68\% + 1 * 5.69\% = 11.37\%$$

However, to calculate WACC properly, we have to calculate the new equity beta, since the debt to equity ratio has changed and it is not equal to zero. The new equity beta will be calculated using the following formula:

$$\beta_E = \beta_U + \frac{D}{E}(\beta_U - \beta_D)$$

Two cases will be considered: for the debt equity ratio equals to 25% and 35%. Suppose that Paramount's debt-to-equity ratio is 0.25 and it has an equity beta of 1 and a debt beta of zero. Company's equity beta after re-leveraging is equal to:

$$\beta_E = \beta_U + \frac{D}{E}(\beta_U - \beta_D) = 1 + 0.25 * (1-0) = 1.25$$

If there is an assumption that the debt-to-equity ratio changes to 0.35 the new equity beta is equal to:

$$\beta_E = \beta_U + \frac{D}{E}(\beta_U - \beta_D) = 1 + 0.35 * (1 - 0) = 1.35$$

We can see that Paramount's equity beta increases with the leverage. Also cost of equity increases, when beta increases:

$$K_e = 5.68\% + 1.25 * 5.69\% = 12.79\%$$

$$K_e = 5.68\% + 1.35 * 5.69\% = 13.36\%$$

While determining the cost of equity, we observe that beta has a significant effect. The higher the beta, the higher the cost of equity.

⁵⁹ The relationship between leverage and equity betas was developed by R. Hamada in "The effect of the Firm's Capital Structure on the Systematic Risk of Common Stocks", Journal of Finance 27 (2) (1972): 435-452 and by M. Rubinstein in "A Mean-Variance Synthesis of Corporate Finance Theory", Journal of Finance 28(1) (1973): 167-181.

Turning to the cost of debt, we easily calculate that if the company's debt-to-equity ratio is equal to 25%, the company default spread is equal to 1.37%⁶⁰ and its rating is AA. The country default spread for the United States of America was zero⁶¹; hence cost of debt is equal to:

$$K_d = 5,68\% + 1,37\% = 7,05\%$$

However, if the debt-to-equity ratio increases, company's default spread increases as well and at the same time its rating decreases. The following table shows, which impact has the capital structure on the cost of debt:

Table10: Impact of the debt-to-equity ratio on the cost of debt

D/E	Credit Rating	Cost of Debt
25%	AA	7,05%
43%	A	7,24%
67%	BBB	7,59%
100%	BB	9,00%
150%	B	10,75%

The higher the debt-to-equity ratio, the lower the credit rating and the higher the cost of debt.

8.2.4. Tax

Tax- the following table shows the historical tax rate for the years 1990-1993. The average tax over this period was taken to calculate WACC.

Table11: Tax rate for the period: 1990-1993

Year	1990	1991	1992	1993	Average
Historical tax rate	32%	37%	31%	34%	34%

Since we have the cost of equity, cost of debt and we know the capital structure of Paramount, we can calculate weighted average cost of capital.

In the following table all of the above information was cumulated: unleveraged beta, leveraged beta, cost of equity, cost of debt, credit rating and WACC. As it was said earlier

⁶⁰ Calculated through Damodaran spreadsheet

⁶¹ <http://pages.stern.nyu.edu/>

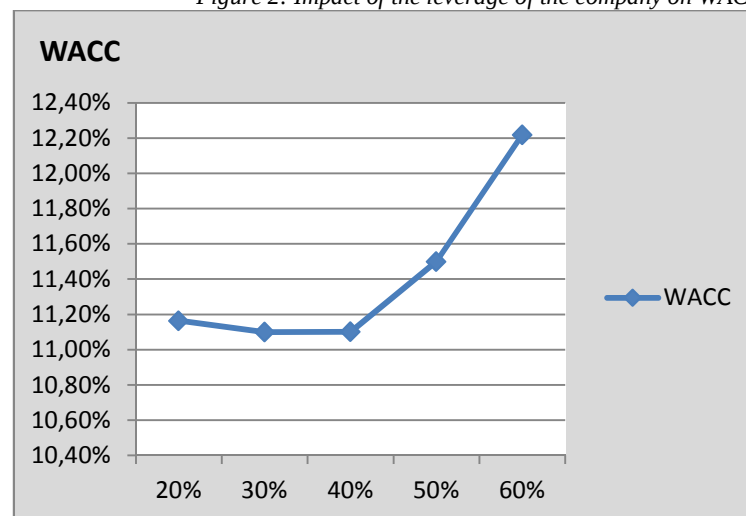
the higher the debt-to-value and debt-to-equity ratios the higher the cost of equity and cost of debt. Second observation is, that the higher the leverage the lower the credit rating.

Table12: Impact of the debt-to-equity ratio on WACC

D/(D+E)	E/(D+E)	D/E	β_e	$\beta_{a-unlev.}$	$\beta_{e-relev.}$	Cost of Equity	Rating	Cost of Debt	WACC
20%	80%	25%	1,00	1,00	1,25	12,79%	AA	7,05%	11,16%
30%	70%	43%	1,00	1,00	1,43	13,81%	A	7,24%	11,10%
40%	60%	67%	1,00	1,00	1,67	15,16%	BBB	7,59%	11,10%
50%	50%	100%	1,00	1,00	2,00	17,06%	BB	9,00%	11,50%
60%	40%	150%	1,00	1,00	2,50	19,91%	B	10,75%	12,22%

The following graph illustrates how the WACC changes, when the leverage of the company increases. There is a small decrease in WACC when the company changes its debt-to-value ratio from 20% to 30%. WACC stays at the same level, when the company changes its debt-to-value ratio from 30% to 40%. However, an increase from 40% to 50% and to 60% has got a significant impact on WACC, which is equal to 11,50% and 12,22% respectively.

Figure 2: Impact of the leverage of the company on WACC



There was an assumption made that the industry debt-to-equity ratio is 25%. For this ratio, the WACC is equal to 11, 16%. This number percentage will be used for the valuation as a discount rate.

8.3. Value of the Firm

Because Paramount was at that time in the process of changing, the best way to value the company is using the FCFF model. This approach provides the most accurate estimates of value. The present value of the Paramount as a stand-alone company will be calculated using the following model:⁶²

$$Value\ of\ Firm = \sum_{t=1}^{t=n} \frac{FCFF_t}{(1 + WACC)^t} + \frac{\frac{FCFF_{n+1}}{WACC - g_n}}{(1 + WACC)^n}$$

Where:

FCFF- Free Cash Flow to the Firm

WACC- Weighted Average Cost of Capital

g-growth rate

8.3.1. Free Cash Flow to the Firm

The following table shows Paramount's Cash Flow forecast as a stand-alone company for the period 1994-1998. Earnings before Interest and Tax (EBIT) were calculated by subtracting cost of goods sold, depreciation, selling expenses and administrative expenses from revenues (sales). Free cash flow to the firm has been calculated by using earnings before interest and tax as a basis.

To calculate Free Cash Flow to the Firm the following formula was used:

$FCFF = EBIT \cdot (1 - \text{tax rate}) + \text{Depreciation} - \text{Capital Expenditures} - \text{Change in Working Capital}.$

Table 13: Free Cash Flow Calculation for the years: 1994-1998

Year	1994	1995	1996	1997	1998
Sales	4 905,00	5 264,30	5 648,60	6 060,00	6 500,70
EBITDA	660,60	737,00	790,80	848,40	910,10
Depreciation	-162,00	-172,00	-184,00	-196,00	-209,00
EBIT	498,60	565,00	606,80	652,40	701,10
Tax 34%	-169,52	-192,10	-206,31	-221,82	-238,37
EBIT(1-t)	329,08	372,90	400,49	430,58	462,73

⁶² Damodaran (1996) 242

Operating CF	491,08	544,90	584,49	626,58	671,73
Capex	-160,10	-177,30	-176,70	-202,90	-216,60
Δ in working capital	-45,60	-62,10	-66,50	-71,20	-76,20
Asset sale		900,00			
FCFF	285,38	1 205,50	341,29	352,48	378,93
FCFF/Discount rate	256,73	975,60	248,47	230,86	223,26

If we assume, that Paramount reached a steady state after 1998 and it started growing at a stable growth rate at $g_n = 0,05$, we can easily calculate terminal value, which is equal to:

$$\frac{\frac{FCFF_{n+1}}{WACC - g_n}}{(1 + WACC)^n} = \frac{\frac{397,88}{0,1116 - 0,05}}{(1 + 0,1116)^5} = 3805,65 \text{ million}$$

The value of the firm is then the present value of the expected free cash flows to the firm and the present value of the terminal value:

PV of FCFF (1-5) = 1.934,92 million

PV of Terminal Value= 3.805,65 million

Value of Firm= 5.740,57 million

Enterprise value is defined as a sum of equity value and net debt, where net debt is the difference between debt and equivalents and cash. Cash and short term investments are equal to 1.007,1 million and total debt is equal to 1.013 million. Thus, net debt is 5, 9 million.

By subtracting net debt from the value of the firm we get the value of equity, which in Paramount's case is \$5.734, 57 million.

Equity Value (million)	\$5.734,67
Number of shares (million)	\$120
Equity per share	\$47,79

From the valuation that was made it becomes clear that Paramount's value of the equity per share is equal to \$47, 79.

9. Value of Paramount to Viacom

The amount of money paid for a target company should be equal to the target's market capitalization before the bid and the premium paid in the takeover. The market capitalization before the bid is usually seen as the stand-alone market price of the target. Thus, from the bidder's point of view, the acquisition is a positive-NPV investment only when the premium the company pays is not higher than the synergy created. Even though the premium that is paid is a specified number, the synergy is not- shareholders may be skeptical of the bidder's estimate of their great size. The acquirer's stock price response to the announcement of the takeover is a very helpful way to determine shareholder's assessments of whether the acquirer under- or overpaid for the target company. In chapter 7, I have shown Viacom's shareholders opinion about the acquisition with Paramount. It became clear that from the investor's point of view, the synergy created did not exceed the premium that Viacom was willing to pay for Paramount⁶³.

To value the hard synergy for the combined Paramount-Viacom company I will have to make new assumptions. Due to changed unlevered and re-levered beta, the WACC for the company is equal to 10, 52%. The following table shows the estimated EBITDA synergies from the merger: Paramount-Viacom:

Table 14: Est. EBITDA synergies w/Paramount for the years: 1994-1998

	1994	1995	1996	1997	1998
Estimated EBITDA synergies: Paramount -Viacom merger	134	150	171	216	223
Discount rate $(1+WACC)^t$	121,25	122,80	126,67	144,77	135,24
= \$ 650,73 million					

The present value of the synergy for the period: 1994-1998 is \$650, 73 million. If I assume that the merged company's growth rate is 5% (the same growth rate was assumed for the companies, when they were operating separately), then the present value of all synergies is equal to: \$3223, 20 million. The following table presents the synergy calculation, which was to be created by merging with Viacom.

⁶³ Berk, DeMarzo (2007) 901

Table 15: Synergy calculation with the growth rate=5%

Growth rate	5%
Synergies year 6	\$ 234, 15
Terminal value of synergies in year 5	\$ 4.241, 85
Present value of terminal value of synergies	\$ 2.572, 47
Present value of all synergies	\$ 3.223, 20
Synergy per share	\$ 26, 86

The synergy per share is \$26, 86. To calculate the total value of Paramount share to Viacom I had to add the synergy per share (\$26,86) and the price of the equity per share (\$47,79). This sum is equal to \$74,65 and it means that Paramount's stock is worth to Viacom at least \$74,65. I get this price with the assumption that the growth rate does not change.

However, this estimation of synergy seems to be too high. Paramount's EBITDA in 1998 was to be \$910,10 million and Viacom's estimated EBITDA synergies with Paramount was to be \$223,00 million, which is 25%. This number is not highly probable and real. Even the fact that the above synergy calculation seems to be overrated I would like to see, what would happen if the merger created much faster growth too. The table below shows the calculation of the synergy with the assumption that the combined company has a growth rate at 6%.

Table 16: Synergy calculation with the growth rate=6%

Growth rate	6%
Synergies year 6	\$ 236,38
Terminal value of synergies in year 5	\$ 5 229,65
Present value of terminal value of synergies	\$ 3 171,52
Present value of all synergies	\$ 6 993, 77
Synergy per share	\$ 58,28

When comparing both of the above tables, we can observe a huge increase in the synergy made by the increased growth rate. The increased growth rate from 5% to 6% made the synergy worth \$58, 28 per share. Of course this situation is even less probable than the

previous. According to this calculation Paramount's stock would be worth to Viacom at least \$106, 07, which is way too much.

According to the first calculation Paramount was worth to Viacom at least \$74, 65. This price seemed to be too high. But the second valuation is even less realistic and the assumption that the merged company would be growing at 6% is too optimistic.

10. Value of Paramount to QVC

As it was concluded in chapter 5, Paramount and QVC did not have much overlap to cut costs. Hard synergy, which could occur from the combination Paramount-QVC, was much smaller than from the combination Paramount-Viacom. Merger Paramount-QVC was supposed to bring soft synergy, especially managerial improvement.

Hard synergy from the merger Paramount-QVC will be calculated by taking the half of the estimated EBITDA synergies from merger Viacom-Paramount. It is probably very optimistic assumption, because there was not much overlap to cut costs from Paramount-QVC combination. The following table shows the estimated discounted synergies at WACC (10,11%).

Table 17: Est. EBITDA synergies w/Paramount for the years: 1994-1998

	1994	1995	1996	1997	1998
Estimated EBITDA synergies: Paramount -QVC merger	67	75	85,5	108	111,5
Discount rate $(1+WACC)^t$	60,85	61,86	64,05	73,47	68,89
= \$329,12 million					

Present value of the synergy for the period: 1994-1998 is \$329, 12 million. The following table shows the valuation of the synergy per share, with the assumption that the merged company would be growing at 5%.

Table 18: Synergy calculation with the growth rate=5%

Growth rate	5%
Synergies year 6	\$ 117,08
Terminal value of synergies in year 5	\$ 2.291,10
Present value of terminal value of synergies	\$ 1.415,50
Present value of all	\$ 1.744,61

synergies	
Synergy per share	\$ 14,54

Hard synergy per share is worth \$14, 54 and this is not surprising that it is less than in Viacom's case. It was obvious from the beginning that the Paramount-Viacom merger creates more hard synergy than Paramount-QVC. Every additional one per cent of extra growth is worth \$3-4 per share (synergy per share increases from \$14, 54 to \$17,41, due to change in growth rate from 5% to 6%). But in QVC's case it is not about hard synergy-it is about Barry Diller and his managerial opportunities. Soft synergy is very difficult to value, and since one merger creates more hard synergy while the other creates more soft synergy it is not easy to say which merger would be more valuable. From the financial point of view it becomes clear that the merger with Viacom made more sense for Paramount, because of the hard synergy created. But from the strategic point of view it was more reasonable to merge with QVC.

11. Comparison of the initial and final bids: determining the overpayment

Right now, when I know what Paramount's price was and how much it was worth to Viacom and QVC I should answer the question: how much should Viacom or QVC offer to pay for Paramount? And how should be the offer structured?

Beacuse Viacom started the negotiations with Paramount it was in the position, where it could bid either high or low. A "bear hug" is known in M&A as a high initial bid. It refers to the expresion of affection, which destroys all resistance. This strategy discourages potential competitors and forces the target's Board of Directors to accept the bid. The biggest disadvantage of the "bear hug" is that it "gives value to target shareholders that might have been retained by the bidder with a lower-priced opening bid."⁶⁴ This approach is applicable when the bidder is afraid of the other competitors or does not want to have a long takeover battle and is impatient.

The second opportunity that Viacom had was to bid low. This approach has a benefit of saving the gains from the acquisition for the bidder. But the iggest disadvantage of this strategy is that it attracts the competing bidders. It is highly probable that it invites also the traget company to reveal an internal restructuring. This strategy is longer than the "bear

⁶⁴ Bruner (2004)

hug” it makes bidder more risky. This approach makes sense, when the bidder is very confident that it can win the takeover battle and if there is only few competitors.

Summing the above information, Viacom, as the first bidder in the battle could not bid less than Paramount was worth. It also had to offer a premium over the market price for the synergy that was to be created. If Redston, the CEO of Viacom, was impatient and had not time it would have offered more from the very beginning. But this not have happened and thus QVC came into the game with its hostile takeover.

Viacom’s final bid included \$107 per share in cash for 50.1% of Paramount’s shares and for the remaining 49, 9%:

- “0.93065 shares of Viacom Class B Common Stock,
- 0.93065 CVRs⁶⁵,
- 0.5 Viacom Three-Year Warrants
- 0.3 Viacom Five-Year Warrants
- and \$17.50 in principal amount of Viacom Merger Debentures with an 8% coupon and 12 year maturity if the Blockbuster-Viacom merger was approved. If the merger was not approved, the debentures would be replaced with \$17.50 face value of Viacom preferred stock with a 5% dividend yield”³

The following table compares the initial and final offer. The value of Viacom’s final offer assumes that the Blockbuster merger takes place. In the Viacom’s offer the warrant values are based on volatilities of 35% and the CVR values are based on volatilities of 45%. Viacom’s final offer was valued to \$83.32 if the merger with Blockbuster was approved, if it was not approved the offer was valued to \$81.49⁶⁶.

Table 19: Viacom’s initial and final offer

Viacom's initial offer, September 12, 1993				
\$9.10 in cash				\$9.10
0.1 shares of Viacom A				\$6.60
0.9 shares of Viacom B				\$53.44
Total				\$69.14
Viacom's final offer, February 3, 1994				
Security	Value	Ratio	Amount	Per Share
Cash	107	0.501	1	\$53.61
Subordinated Debt	0.96	0.499	17.5	\$8.41
CVR	8.33	0.499	0.931	\$3.87

65 The Contingent Valuation Rights

66 Lazard Freres presentation to Paramount Board in Paramount Communications 13E3, May 25, 1994

Warrant - 3 year	3.28	0.499	0.5	\$0.82
Warrant - 5 year	5.48	0.499	0.3	\$0.82
Common	34	0.499	0.931	\$15.79
Total				\$83.32

Sources: Lazard Freres presentation to Paramount Board in Paramount Communications 13E3, May 25, 1994.

This table shows QVC's initial and final offer:

Table 20: QVC's initial and final offer

QVC's offer, September 20, 1993				
\$30.00 in cash				\$30.00
0.893 QVC shares				\$50.01
Total				\$80.01
QVC's final offer: February 3, 1994				
Cash	104	0.501	1	\$52.1
Preferred	31.53	0.499	0.239	\$3.76
Warrant ⁶⁷ - 10 year	15.97	0.499	0.32	\$2.55
Common	45.875	0.499	1.236	\$28.3
Total				\$86.71

Sources: Lazard Freres presentation to Paramount Board in Paramount Communications 13E3, May 25, 1994.

The average Paramount's price in September 1993 was \$55.5. In my opinion Viacom should not offer less than \$65 for Paramount. This price includes a 15% premium over the current price. Viacom's initial offer was \$69.14 while QVC's offer was \$80.01. Because of the fact, that QVC made a hostile takeover offer for Paramount, Viacom had to increase its initial offer several times to win the battle. Viacom's final offer was \$83.32. It is almost \$20 more comparing to the price it could have offered as an initial price. If Viacom's offer was \$65 per share, the whole deal would be worth:

120 million * \$65 = \$7.800 million.

Because of the fact, that the initial offer raised several times in the end Viacom's offer was valued to \$83.32 and the whole deal was worth:

120 million * \$83.32 = \$9.998,4 million

⁶⁷ QVC's value of warrant is based on a volatility of 25%

The difference between these two numbers is the amount, by which Viacom has overpaid. In my opinion Viacom overpaid for Paramount by more than \$2 billion.

12. Conclusion

When studying Paramount's financial performance relative to its peers in the three years previous to the acquisition there was at first no real indicator of a need for a change. However, when studying Paramount's and peers' strategic development it became apparent that the company had to follow the moves that were made in the media & entertainment industry. Due to the fact, that Paramount was at that time the last studio, that was left without any strategic alliances, the acquisition with either QVC or Viacom made sense mainly from the strategic point of view. Especially when considering that QVC and Viacom were in reality the only realistic acquisition candidates.

Turning to both candidates: QVC and Viacom, it was really difficult to say which merger was better for Paramount. QVC was offering lots of soft synergy; especially it was giving rise to new business opportunities and better management. From the other hand Viacom was offering incremental growth and economies of scale and scope. Actually, each company was offering something that Paramount was looking for and that was valuable.

Finally, as previously shown, the actual transaction of acquiring Paramount by Viacom, was definitely not value enhancing for Viacom's shareholders and according to my estimates Viacom overpaid for Paramount by more than \$2 billion. Even if I consider all synergies that were to be created, I still think that Viacom could have bought Paramount for a more attractive price, if it had bit a little bit more in the beginning of the takeover battle. This strategy would have probably discouraged QVC and other potential competitors and would have forced Paramount's Board of Directors to accept the bid.

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PERSONAL DETAILS

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Nationality	Polish

EDUCATION

Jan. 2010 – July 2011	UNIVERSITY OF VIENNA , AUSTRIA Business Administration: Corporate Finance and Controlling /01.2010-05.2010 Exchange Programme - UNIVERSITY OF OTTAWA, CANADA/
Oct. 2005 – Jan. 2010	UNIVERSITY OF VIENNA, AUSTRIA Business Administration: Management /01.2009-06.2009 Exchange Programme - CITY UNIVERSITY LONDON, ENGLAND/
Oct. 2004 – Feb. 2004	UNIVERSITY PREPARATION PROGRAM OF THE GRAZ UNIVERSITIES, AUSTRIA

EMPLOYMENT HISTORY

Aug. 2011 – now	ITI Neovision Sp. z o. o., Warszawa, Poland • Participation in the process of budgeting; • Preparation of consolidate created business plans to overall business forecast including comparison of the actual forecasts vs. official plans;
July 2010 – Dec. 2010	LKW Walter in Wiener Neudorf, Austria • Coordination and organization of transportation; • Calculation of prices and conditions; • Communication with international partners;
Sept. 2009 – June 2010	Internship in TAX-NET S. A. in Katowice, Poland • Valuation of the company; • Valuation of the company's potential mergers and acquisitions; • Preparation of the competitor analysis and market analysis;

July 2008 – Aug. 2008	Internship in the Embassy of the Republic of Poland in Washington D.C., USA • Planning, coordination and organization of the events in the Embassy
July 2007 – Aug. 2007	Internship in BDO in Katowice, Poland
July 2006 – Aug. 2006	Internship in DATEV eG in Nürnberg, Germany

LANGUAGES

Polish	native
German	fluent (Universitäts-Sprachprüfung aus Deutsch)
English	fluent (Toefl, SAT)
Spanish	basic

ADDITIONAL QUALIFICATIONS

MS Office (Word, Excel, PowerPoint)
 SQL
 CIMA (passed Fundamentals of Management Accounting, Fundamentals of Financial Accounting, Fundamentals of Business Mathematics, Fundamentals of Business Economics, Fundamentals of Ethics, Corporate Governance and Law)
 Driver's license

INTERESTS

Fencing, reading, traveling

Die vorliegende Arbeit untersucht den Übernahmekampf um Paramount Communications zwischen Viacom und QVC. Es gibt eine detaillierte Analyse von der Übernahme, ihre strategischen und finanziellen Gründen sowie Auswirkungen. Heute gehört Viacom zu den weltweit führenden Medienkonzern. Das Unternehmen hatte einen Umsatz in der Höhe von \$9,34 Mrd. (2010), das Umsatzwachstum 1% und Return on Equity 18, 2%. Am 3. Februar 2011 während der Finanz-Mitteilung für das Jahr 2010, sagte Philippe Dauman – der Präsidenten und CEO des Unternehmens:

“We're off to a great start in fiscal 2011. The creative momentum in our major networks is building as we judiciously invest in original programming. This puts Viacom in the pole position in the race to capitalize on new opportunities for monetizing television content through emerging media here and around the world. We're excited about the potential for expanding our international businesses, and we know that our film studio is poised for a great year.”⁶⁸

Meiner Meinung nach hat Viacom für Paramount von mehr als 2 Milliarden Dollar überbezahlt. Viacom war bereit, mehr als QVC zu zahlen und deshalb hat Viacom den Kampf gewonnen. Auch wenn Sumner Redstone, der CEO von Viacom, besaß mehr als 75% der Viacom Cash-Flows der Stimmrechte, überschritt der Preis der Hybris 1,5 Milliarden Dollar. Obwohl Viacom um mehr als 2 Milliarden Dollar überbezahlt hat, unter dem Kommando von Redstone, hatte das Unternehmen die beste Filme aller Zeiten produziert: "Saving Private Ryan", "Titanic", "Brave Heart" und "Forrest Gump“.

⁶⁸ <http://seekingalpha.com/>