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Entertainment, Cable & Media / Consumer

CBS Corp. (CBS) – Buy

CBS: 3Q10 Trends in ROIC

This report tracks CBS's capital allocation and efficiency trends for each of its major business segments through the Sept 30, 2010 quarter.

1. There is typically an 80-90% statistical correlation between forward-year ROICs and share prices in the media space. We estimate that CBS's ROIC will grow by about 100 basis points in FY11 (from 5.2% to 6.2%), despite the absence of political advertising revenue.
2. CBS gets an A grade at driving higher Cash from Operations and rapid deleveraging over the past six quarters.
3. CBS has turned into a FCF machine. Cash from Operations is up $1.4B y/y in the first 9 months of FY2010 and net debt is down $1.14B (17%) today vs 12 months ago.
4. In FY11, we project that CBS's EBITDA will rise by about $68M while CapX will rise by only $20M, implying marginal return on incremental capital of 240%. In fact, even if we look at *total* CapX in 2011E of $295mm vs the $68mm increase in EBITDA, CBS's marginal ROA is about 23%, well above its WACC of 9%.

We maintain our BUY rating on CBS and believe rising ROICs will continue to drive CBS's share price higher.

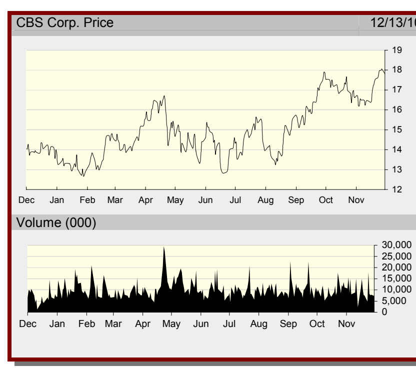
Company Update

Market Data	
Price (12/13/10)	$17.80
12-Month Price Target	$19.00
52-Week range	$18.05-12.67
Shares Out. (MM)	677.2
Market cap (MM)	$12,053.6
Avg. daily volume (000)	10,081.4
Financial Data	
Total Debt/Cap.	40.7%
Price/LTM Rev.	0.9x
Tangible BVPS	($8.13)
Net Cash Per Share	($7.87)

CBS Corporation owns CBS Broadcasting, the #1 broadcast network in the US. CBS also operates about 30 TV stations around the country and owns 50% of The CW Network.

	FY 12/31/09 A	FY 12/31/10 E		FY 12/31/11 E	
		Old	New	Old	New
Rev. (MM)	$13,014.6	$13,932.9	$13,932.9	$14,250.0	$14,250.0
Growth	*(38.0%)*	*7.1%*	*7.1%*	*2.3%*	*2.3%*
Op. Mar.	*7.7%*		13.3%		*14.2%*
EPS: 1Q	(0.05)	0.05	0.05A		
EPS: 2Q	0.09	0.25	0.25A		
EPS: 3Q	0.25	0.35	0.35A		
EPS: 4Q	0.25	0.42	0.42		
EPS: Year	0.51	1.08	1.08	1.28	1.28
Growth	*(64.9%)*	*111.1%*	*111.1%*	*17.9%*	*17.8%*
P/E Ratio	17.2x	16.4x	16.4x	13.9x	13.9x

Note: Pro forma earnings estimates displayed above do not include one-time items or any stock compensation expenses.



Disclosures applicable to this security: B.
Disclosure explanation on the inside back cover of this report.

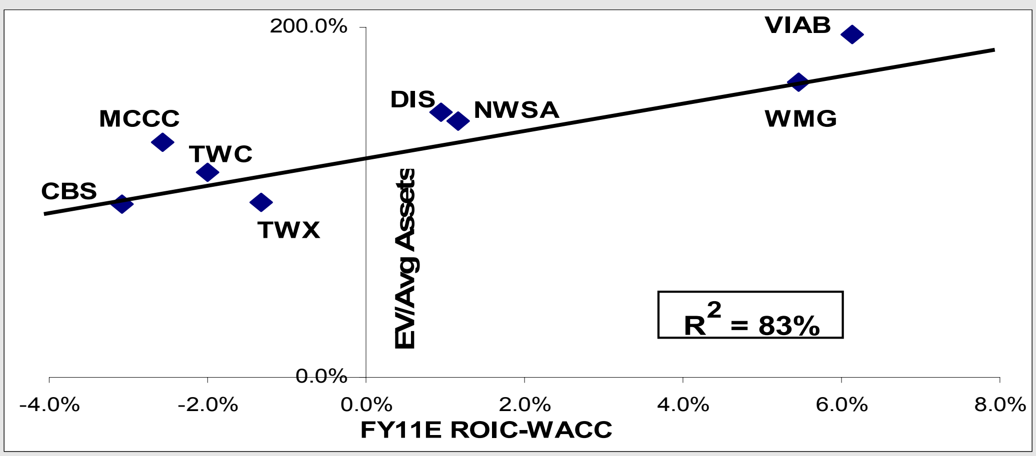
Why ROIC Matters in Media

Returns on invested capital (ROIC) in the media space are closely related to share price performance. In fact, there is typically more an 80-90% statistical correlation between U.S. entertainment company valuations and their year-forward estimated ROICs. Recently, the correlation hit 83%. This high a statistical correlation implies that shifts in ROIC are predictive of changes in total valuation and share prices. An important valuation implication of this high correlation is that a company is likely to stay on the line (ie, valuations should move up or down) as its ROIC outlook changes.

We estimate that CBS's ROIC will grow by about 100 basis points in FY11 (from 5.2% to 6.2%), despite the absence of political advertising revenue. CBS's WACC will remain at about 9.0%, according to our estimates.

Importantly, the slope of the entertainment regression line is typically very steep. Therefore, it is important to accurately assess ROIC trends for entertainment companies. Making mistakes is expensive for investors in cases where an entertainment company under-delivers expected ROICs and a boon to investors who accurately predict ROIC improvements. Figure 1 includes a recent statistical correlation between of FY11 forward-year returns on invested capital compared with valuations for the media stocks under our coverage.

Entertainment Companies: Correlation of Valuation to ROIC *Figure 1*



Source: Yahoo finance prices as of 10/12/10, Needham & Company, LLC. research.

What is ROIC?

Return on capital or ROIC is a measure of how efficiently a company uses capital to generate profits. There are three primary sources of capital: net income after taxes from running the businesses; equity capital (public sale of shares); and debt capital (public bond issuances and/or bank loans). Improving asset efficiency typically drives accelerating free cash flow that can be used for debt repayment, share repurchases, dividend increases and/or acquisitions (ie, acquiring new cash flow streams). ROIC analysis focuses attention on the balance sheet and cash flow statement, which are often predictive of income statement metrics.

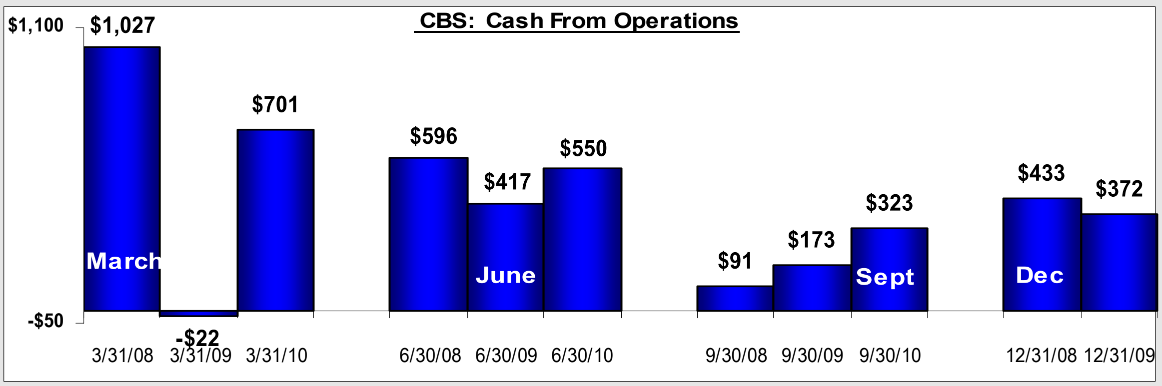
CBS: ROIC Summary & Conclusions

The clearest signposts of improving ROICs are rising FCF and deleveraging.

Cash From Operations Analysis:

- **9/30/10:** Cash from Opeartions rose $150M in 3Q10, a y/y increase of 87%.
- **LT Trends.** CBS's Cash from Operations has risen dramatically in each of the three quarters ended 9/30/10. CBS's Cash from Operations has been positive in 10 of the past 11 quarters, despite the worst advertising recession in 30 years. FCF trends have been strongly positive coming out of the recession. We expect this to continue in 4Q10 owing to strong political momentum.
- **Seasonality:** Highly seasonal with September the weakest FCF quarter of the year and March the biggest positive FCF quarter. 3Q10 strength (CBS's lowest FCF quarter) portends a strong 4Q10 and 1Q11.

CBS: Cash from Operations ($ in MMs) *Figure 2*

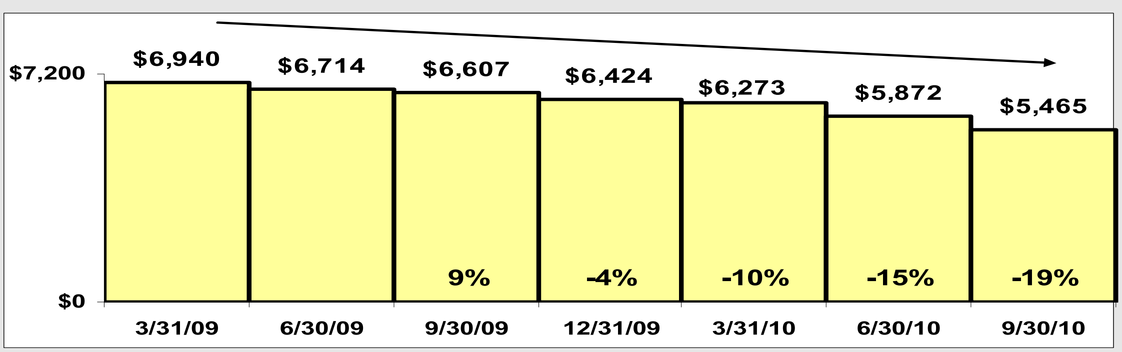


Source: Company reports, Needham & Company, LLC research.

Net Debt Analysis:

- **9/30/10:** Strong ROIC trends. Net Debt fell $407M in the 3 months ended 9/30/10, after being down $400mm in the 3 months ended 6/30/10.
- **LT Trends:** Debt declining steadily. CBS's net debt has fallen by $1.14B in the past 12 months (since 9/30/09). This consistent deleveraging implies stronger equity returns and higher ROICs.
- **Seasonality:** Debt repayment has NOT been seasonal. Analysis shows that CBS has had lower net debt in every quarter for the past 6 quarters.

CBS: Net Debt ($ in MMs) *Figure 3*

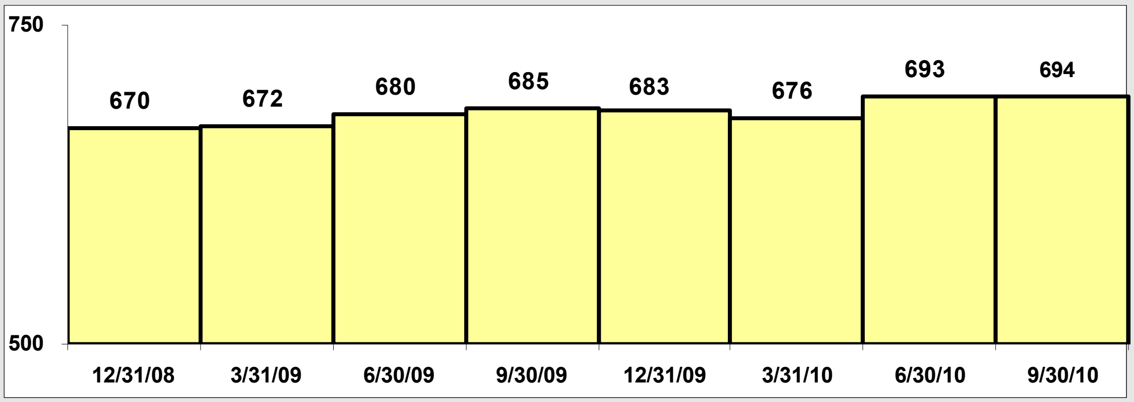


Source: Company reports, Needham & Company, LLC research.

CBS Average Shares Outstanding:

CBS's diluted share count has been creeping up over the past 6 months. In the most recent quarter, average diluted shares were up approximately 1M, after increasing by 17mm (2.5% q/q) in the June 2010 quarter. On Novemeber 4, 2010 CBS announced a $1.5 billion share repurchase program. We expect CBS to begin using its strong FCF to repurchase shares and so we expect this number to fall over the next several quarters.

***CBS Average Diluted Shares Outstanding** (MMs)* *Figure 4*

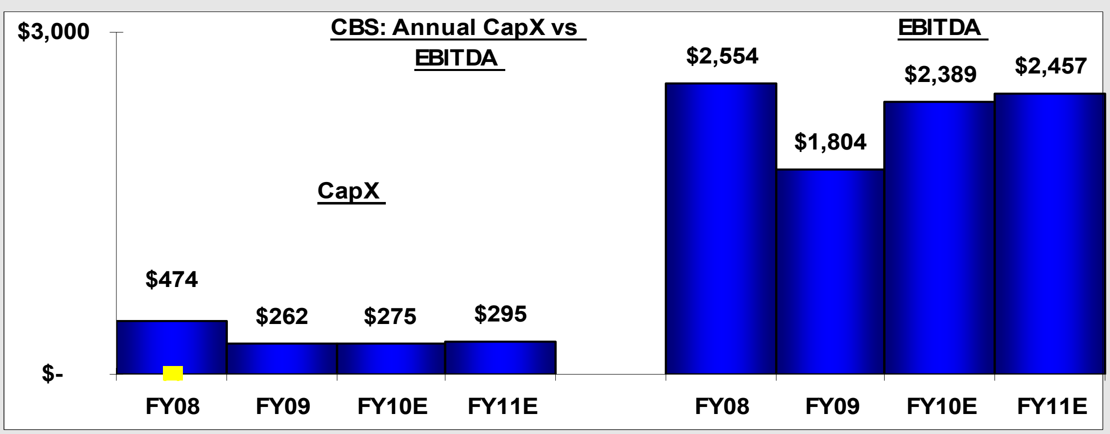


Source: Company reports, Needham & Company, LLC research.

CapX vs EBITDA Trends:

CBS has a strong FCF profile. For example, in FY11, we project that EBITDA will rise by about $68M while total CapX is only $295mm, implying 23% ROAs. In FY11, incremental $20mm of capital spending should drive incremental $68mm of EBITDA, which implies a marginal incremental ROIC of 240%.

***CBS: CapX vs EBITDA, FY08-FY11E** ($ in MMs)* *Figure 5*

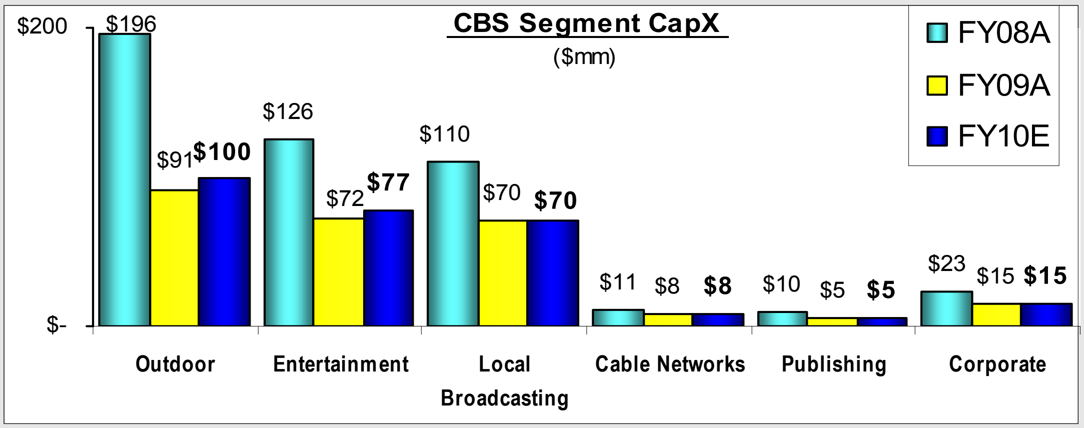


Source: Company reports, Needham & Company, LLC research.

Segment Capital Spending Trends:

- **FY10E:** Driven by a deep advertising recession, every segment at CBS had dramatically lower CapX in FY09 vs FY08 and CBS's CapX didn't rise much in FY10E even though its earnings improved dramatically. This suggests rapidly accelerating ROICs.
- **LT Trends.** Very favorable ROIC trends. Capital intensity is structurally falling and now there is **NO** CBS division that is a big capital user. Outdoor went through a capital spending cycle while building out the London Underground, but now that it is completed, capital efficiency should structurally improve.

Comparative Segment Capital Spending Trends *($ in MMs)* *Figure 6*

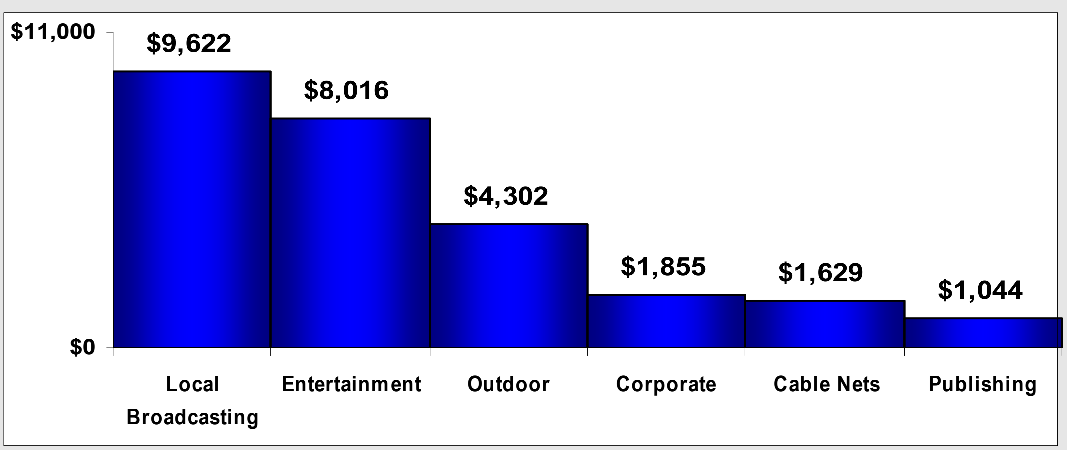


Source: Company reports, Needham & Company, LLC research.

Total Assets Analysis:

The largest asset base in the CBS empire is contained in Local Broadcasting at $9.6B, followed by Entertainment at $8B, followed by Outdoor at $4.3B,Corporate at $1.9B, Cable Networks at $1.6B and Publishing at $1.0B of assets. We discuss capital efficiency trends for each of these segments, in order of their asset size, in the pages that follow.

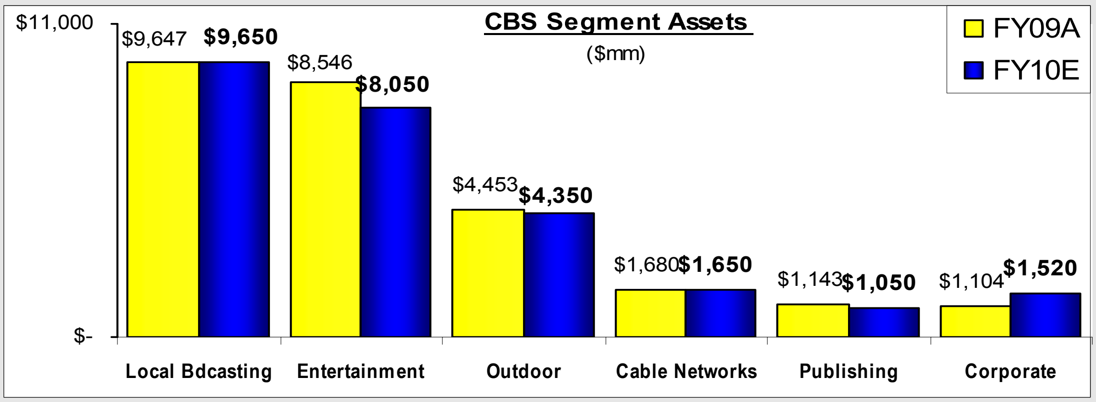
Total Assets by Segment at 9/30/10 *($ in MMs)* *Figure 7*



Source: Company reports, Needham & Company, LLC research.

Total Assets Trends:
In 4Q09, CBS changed its reporting segments to the ones we see today. This required a reallocation of segment assets. As a result, the "same-store" assets by segment for CBS are available for only the past 4 quarters plus the quarter ended 12/31/08. If we look at Total Assets on a same-store basis for each of CBS's segments at the end of the past two fiscal years, they have been relatively constant, with the exception of Entertainment which reallocated some of its assets to the Corporate segment. We expect current asset levels to remain steady throughout FY11E, assuming no significant acquisitions.

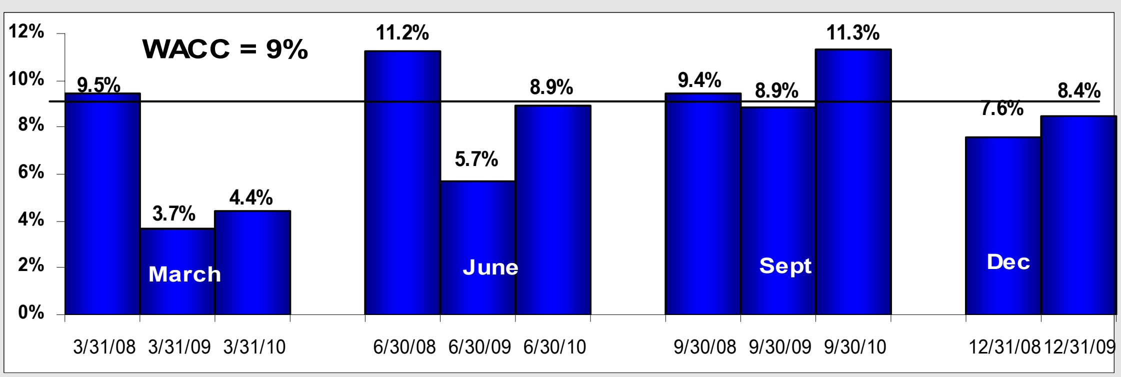
Asset Trends by Segment *($ in MMs)* *Figure 8*



Source: Company reports, Needham & Company, LLC research.

CBS ROA Trends:
CBS's ROA's (defined as EBITDA/Assets) in the first 9 months of FY 2010 are much higher than the similar period in FY 2009. ROAs. CBS's WACC is approximately 9% and CBS's ROAs have surpassed that level only four times in the past 11 quarters, but this might in part relate to the asset allocation of its spin-off from Viacom. If CBS was over-allocated assets in the spin-off, CBS would show extraordinarily low ROAs and Viacom would show high ROAs. We note that share prices tie closely to ***trends in ROIC,*** not the actual level of ROICs.

CBS ROA Trends *Figure 9*



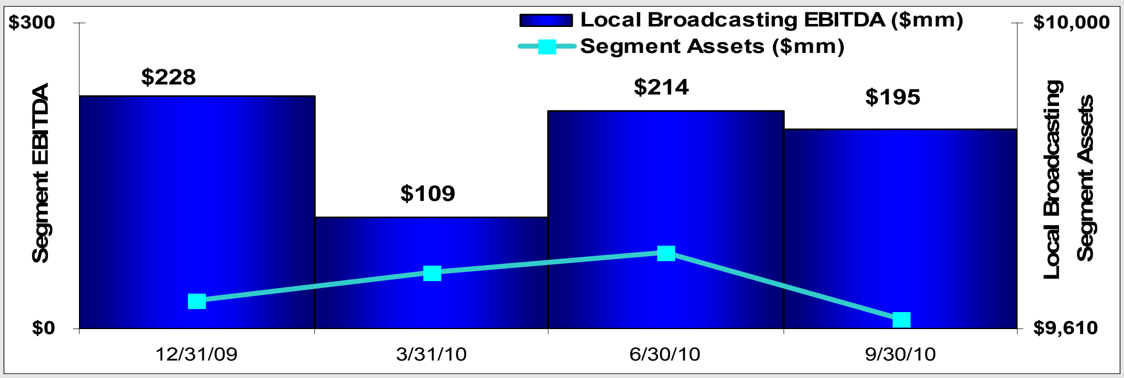
Source: Company reports, Needham & Company, LLC research.

Segment Capital Efficiency Trends

Local Broadcasting ROA Analysis:

- **Assets.** This segment has the largest asset base in the CBS empire. Local Broadcasting segment assets had been essentally flat at approximately $9.7B for each of the 3 quarters ending 6/30/10, but fell to $9.6B for the quarter ending 9/30/10. We expect this trend to continue, and to accelerate if CBS decides to divest more radio stations.
- **EBITDA.** The first 9 months of FY 2010 shows a sharp rebound of EBITDA to pre-recession levels and we expect this to improve in 4Q10 owing to strong political advertising., FY11 should be aided by >15% higher current scatter advertising prices plus 6-8% upfront price increases. .

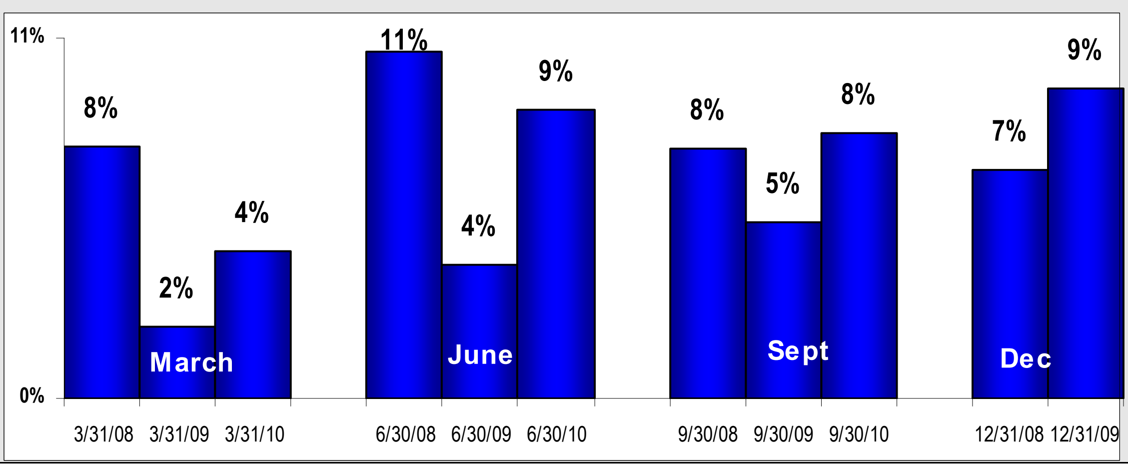
***Local Broadcasting: EBITDA vs Asset Trends** ($ in MMs)* *Figure 10*



Source: Company reports, Needham & Company, LLC research.

The Local Broadcasting segment has had highly volatile ROAs, ranging from 2% to 11% over the past 11 quarters. ROAs began improving in the December quarter of 2009 and ROAs have been predictably double 2009 levels in 2010 year-to-date driven by revenue and EBITDA growth, coupled with falling asset intensity.

Local Broadcasting: ROA Trends *Figure 11*

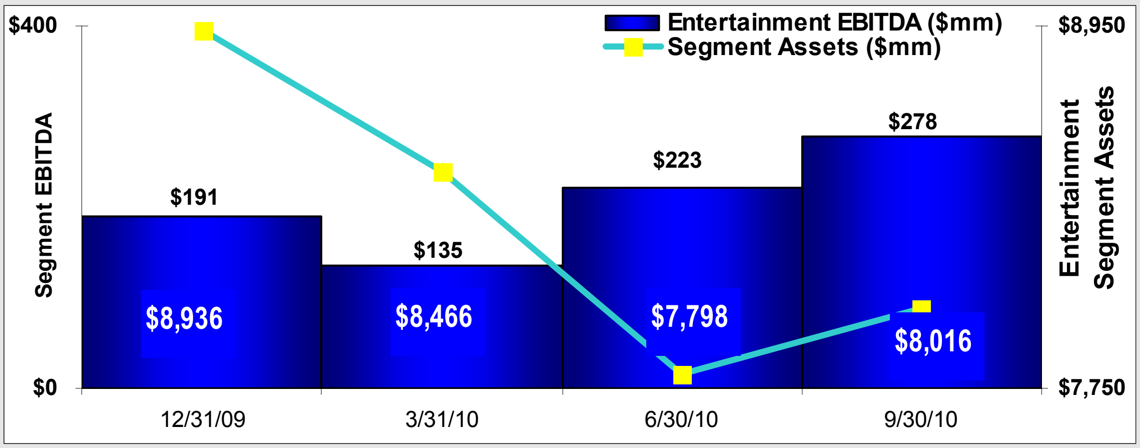


Source: Company reports, Needham & Company, LLC research.

Entertainment ROA Analysis:

- **<u>Assets:</u>** This segment has the second largest asset base within CBS. Assets have been declining rapidly, down $1.1B over the two quarters ended 6/30/10, but increased $218M for the quarter ended 9/30/10. Falling assets is a positive trend that helps drive higher ROAs, so we view the recent increase in assets with trepidation and will watch this trend closely for the December quarter.
- **<u>EBITDA</u>** to date in FY10 has been growing in each quarter. Results have been hampered by mediocre movie EBITDA being more than offset by higher TV syndication revenue.

Entertainments: EBITDA vs Asset Trends ($ in MMs) *Figure 12*



Source: Company reports, Needham & Company, LLC research.

Seasonally, CBS's ROAs in the June and September quarters are typically the highest at 10-15%. This business is the least tied to the advertising cycle, so CBS reported a lower September ROA in FY10 than FY09. This is a hit-driven business. CBS has an excellent track record in TV, but it's track record in films is mixed.

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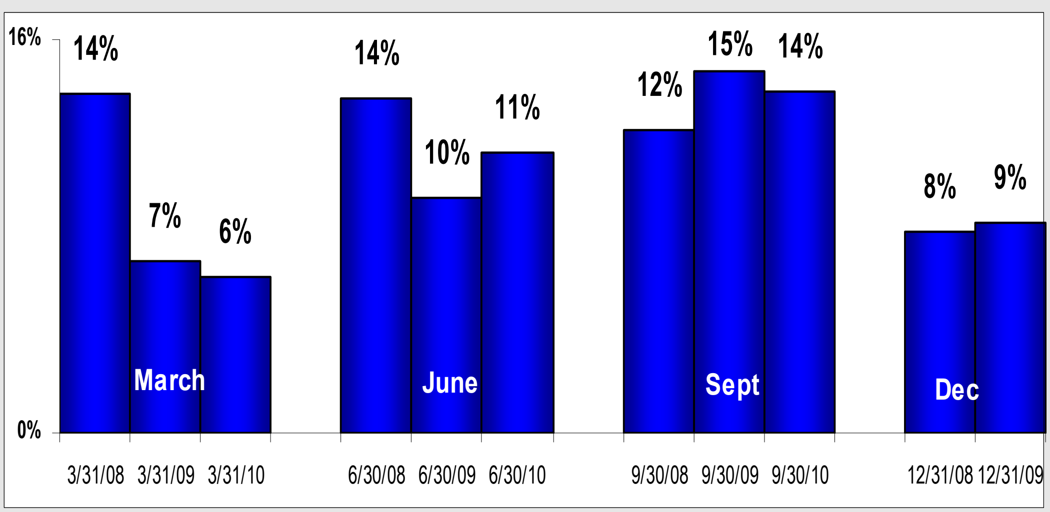
Entertainment: ROA Trends *Figure 13*

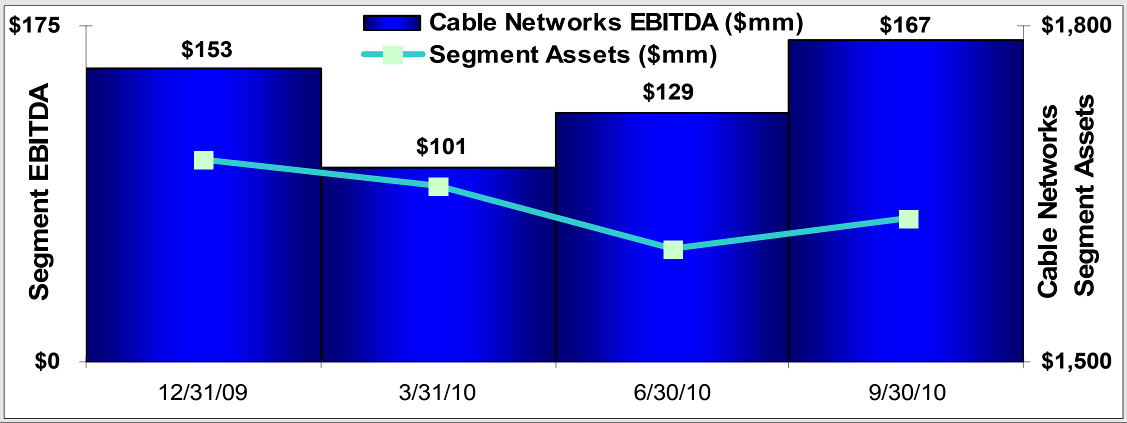


Source: Company reports, Needham & Company, LLC research.

Cable Networks ROA Analysis:

- **Assets.** This segment has the third largest asset base within CBS. Assets had been trending down, which was helping to drive ROAs up, but assets rose $28M, 1.7%, in the most recent quarter. We expect CBS to maintain a consistent level of assets in this segment throughout FY11.
- **EBITDA.** Results in this segment have been far more steady than CBS's purely ad-driven segments owing to the subscriber fee portion of the revenue stream. Because Showtime has no advertising and the sports networks get a disproportionate amount of their revenue from sub fees, the EBITDA in this segment is one of CBS's least cyclical and most predictable.

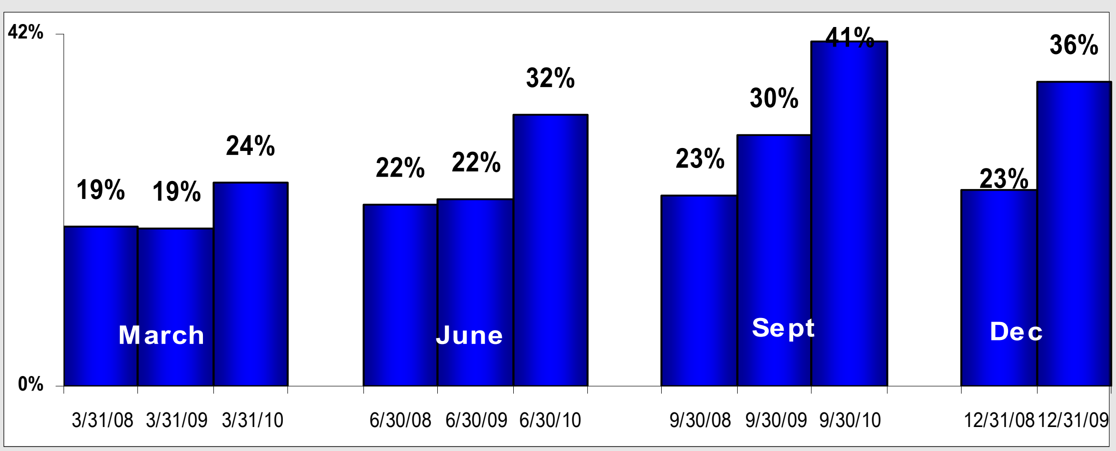
Cable Networks: EBITDA vs Asset Trends ($ in MMs) *Figure 14*



Source: Company reports, Needham & Company, LLC research.

At 19-41%, the Cable Networks division has the highest ROAs of all of CBS's segments. The most recent 5 quarters have each reported strong y/y growth compared with the prior year period, and we expect this strong trajectory to continue for the foreseeable future.

Cable Networks: ROA Trends *Figure 15*

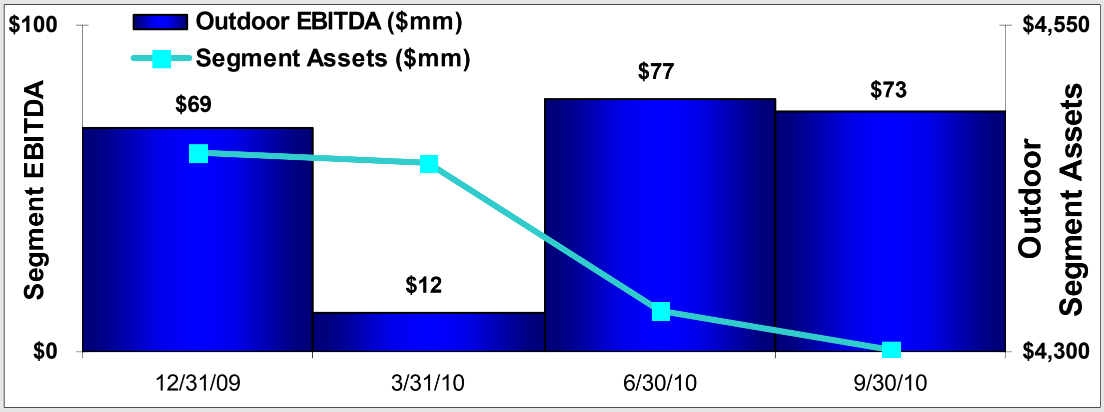


Source: Company reports, Needham & Company, LLC research.

Outdoor ROA Analysis:

- **Assets:** Assets in this segment fell by $29M to $4.3B in the September quarter after falling $114mm (3%) to $4.3B in the June quarter of 2010 and remaining stable for the prior two quarters. We expect asset levels to remain relatively stable in this segment going forward.
- **EBITDA.** EBITDA has been stable at about $70mm, other than in 1Q10. We expect this segment to benefit from a strengthening local advertising environment so EBITDA and ROA's should improve in FY11.

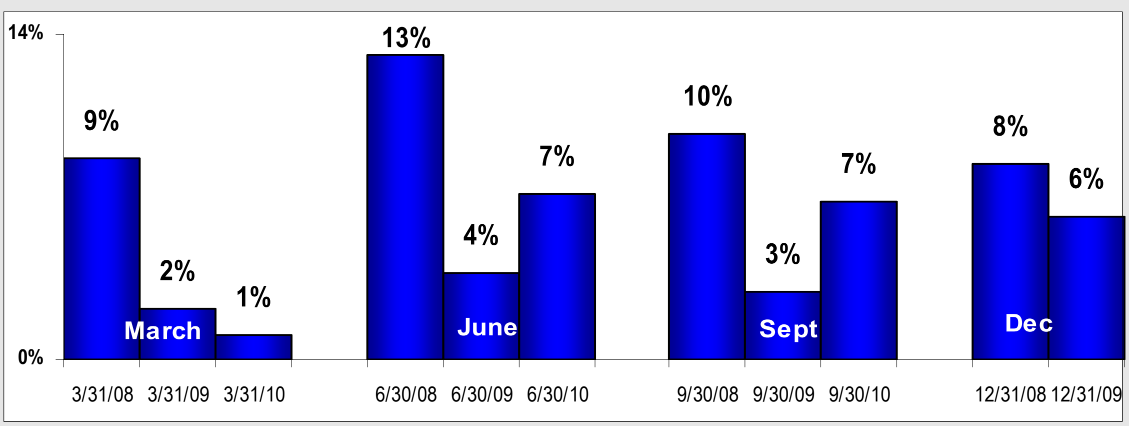
Outdoor: EBITDA vs Asset Trends ($ in MMs) *Figure 16*



Source: Company reports, Needham & Company, LLC research.

Only the most recent two quarters show improvement in Outdoor ROAs. Trends in ROAs in Outdoor are *more negative* than CBS's other ad-driven segments because: 1) the international operations lose money (due to the London Underground contract); 2) Outdoor had a later cycle, lagging CBS's other ad-driven segments by at least two quarters; and 3) 35% of CBS Outdoor is transit contracts with escalator clauses where costs go up every year regardless of the economy. Because of the downturn, when CBS recently renewed its Washington DC contract it did not include this escalator clause. The new NY transit contract also has no escalator clause.

Outdoor: ROA Trends *Figure 17*

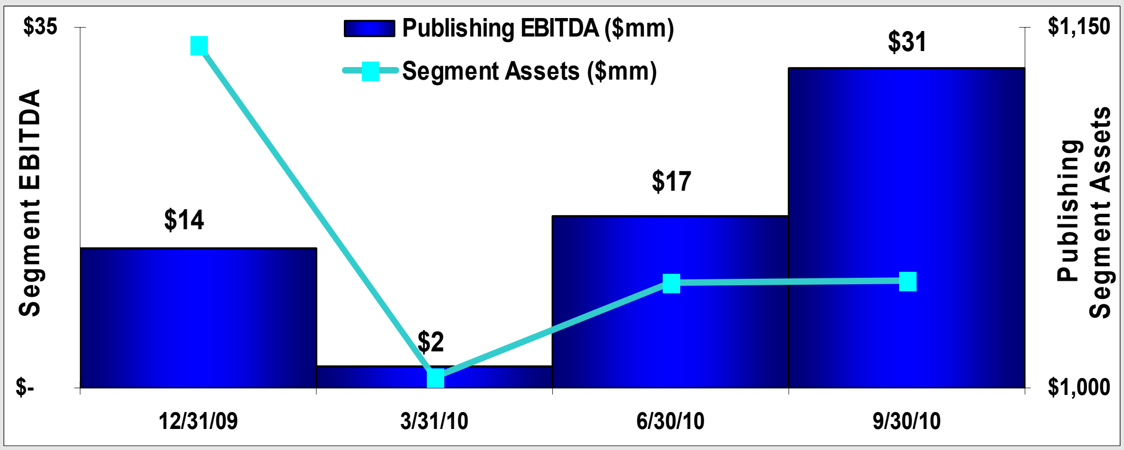


Source: Company reports, Needham & Company, LLC research.

Publishing ROA Analysis:

- **<u>Assets:</u>** Publishing segment assets have been stable at about $1.0B for the past 9 months, which is down about 9% from the December quarter of 2009. Assets in this segment are relatively small so changes have minimal impact on overall CBS ROAs.
- **<u>EBITDA.</u>** EBITDA has doubled Q/Q as the economy has strengthened. We expect this strength to continue going into FY11.

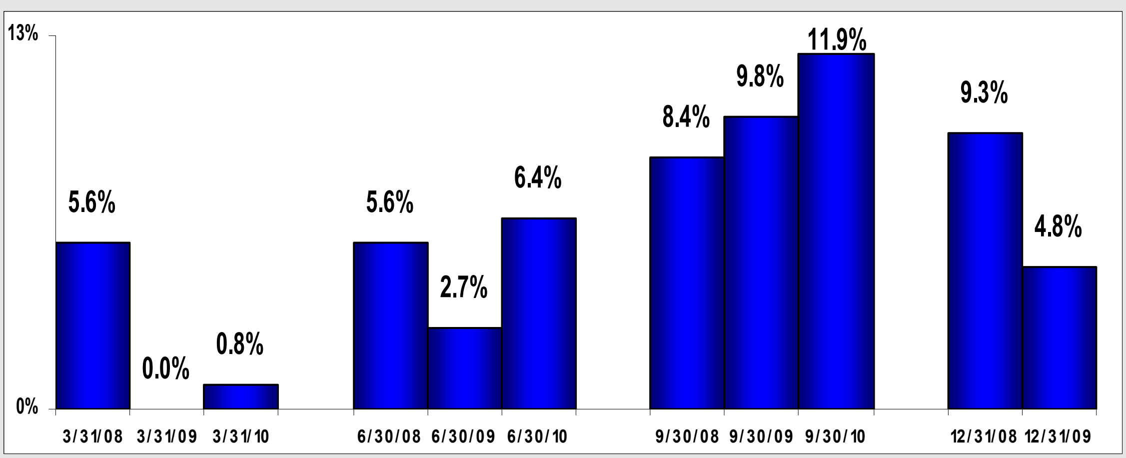
***Publishing: EBITDA vs Asset Trends** ($ in MMs)* *Figure 18*



Source: Company reports, Needham & Company, LLC research.

Publishing is a hit driven business and its success in any quarter is dependent on the mix of titles released during the quarter. Seasonally, the September quarter is strongest in this segment, while March is weakest. It appears from the first 9 months of FY10 that ROAs are coming out of a low period in 2009, mirroring many of CBS's ad-driven business results. We expect this positive y/y ROA trend to continue in 4Q10.

Publishing: ROA Trends *Figure 19*

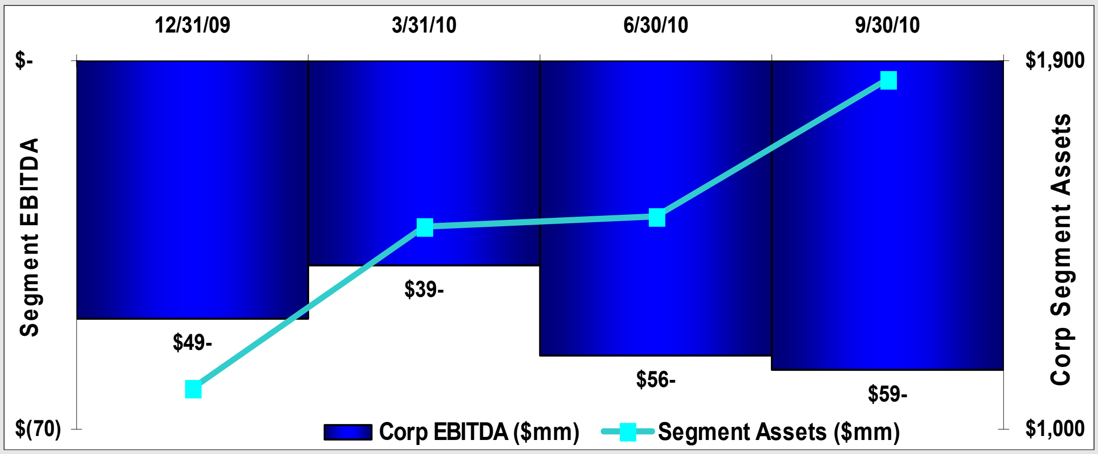


Source: Company reports, Needham & Company, LLC research.

Corporate ROA Analysis:

- **<u>Assets:</u>** Corporate segment assets have risen by $755M to $1.86B in the past 9 months. Assets in this segment are relatively small so changes have minimal impact on overall CBS ROAs.
- **<u>EBITDA</u>** in this segment is always negative as corporate is a cost center. These costs have been very stable over the past 12 months. We do believe that income on cash balances is included in this segment's EBITDA, which partly masks the true cost of the corporate center.

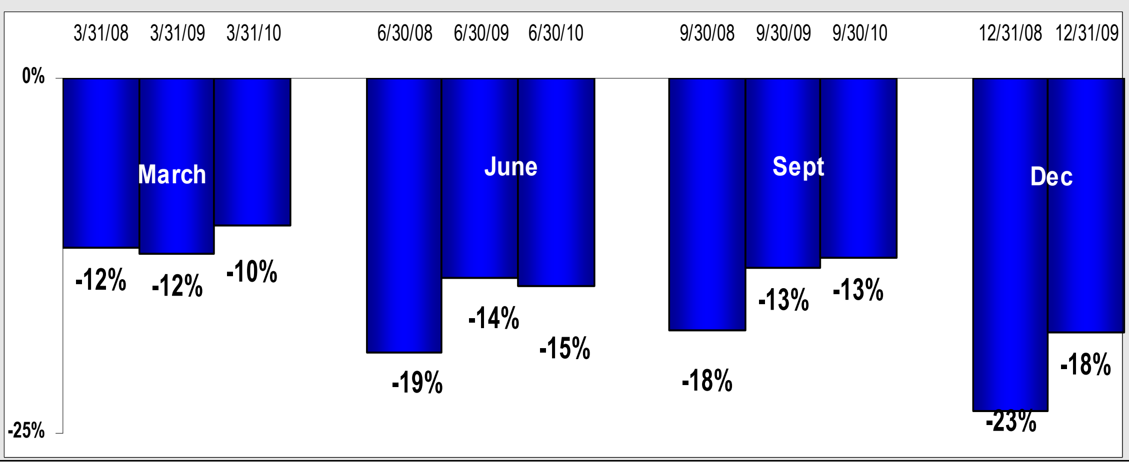
Corporate: EBITDA vs Asset Trends ($ in MMs) *Figure 20*



Source: Company reports, Needham & Company, LLC research.

Corporate results are always negative, but appear seasonal which surprises us. December is typically the weakest ROA quarter and March is the strongest for the corporate segment. We note that nine months of the year have pretty similar ROAs and that March is the outlier with stronger ROAs.

Publishing: ROA Trends *Figure 21*



Source: Company reports, Needham & Company, LLC research.

TARGET PRICE & RISKS

Our 12-month target price of $19 is based on a DCF model. We use a WACC of 9% and a long-term nominal GDP growth rate of 2%. The standard DCF is widely used on Wall Street because it is a rigorous bottom-up valuation of the enterprise based on discounting its long-term cash flows and removing the impact of non-cash accounting conventions. Our target price embeds a 10-year OIBDA growth rate of approximately 0.7% annually beginning in FY 2011 and represents an 8.1x multiple of forward year (2011E) OIBDA.

Risks to our target price include a weakening economy, advertising weakness, piracy of content online, the network-TV cycle, and ownership by Sumner Redstone through an A/B voting structure.

VALUATION

Our BUY rating is based on several forms of valuation, summarized in Table 1:

CBS: Valuation Summary & Conclusions — *Table 1*

2011E Valuation Multiples			Embedded Expectations Metrics		
1	EV/Sales	1.4	7	**Breakeven DCF** (Calculated as the 10-Yr EBITDA CAGR required to justify current share price)	0.2%
2	EV/OIBDA	7.9			
3	P/E	13.9			
4	FCF/Share	$1.94			
5	EV/FCF	15.0			
6	FCF Yield	11%			

Source: Needham & Company, LLC research.

1. The **"Breakeven DCF"** valuation methodology uses the current share price to calculate the market's growth expectations for the enterprise, including capital efficiency trends. This valuation methodology concludes that CBS must achieve a 10-year OIBDA compound annual growth rate of approximately 0.2% to justify its current share price.
2. CBS's EV/EBITDA trading multiple is approximately 7.9x 2011E.
3. Our Free Cash Flow analysis shows that CBS is currently valued at about 15x 2011E Free Cash flow and has an 11% free cash flow yield, making it one of the least expensive companies we cover.

Table 2

CBS: Quarterly Income Statement Projections, 2010E

$ and shares in millions, except per share data

	3/31/10A	6/30/10A	9/30/10A	12/31/10E	2010E	Year/Year Change Q1	Q2	Q3	Q4	2010E
REVENUE										
Entertainment	$2,082	$1,672	$1,617	$1,979	$7,349	15%	10%	-12%	9%	5%
Cable Networks	$368	$369	$370	$371	$1,478	8%	12%	12%	7%	10%
Publishing	$152	$190	$218	$216	$775	-6%	5%	-6%	-2%	-2%
Local Broadcasting	$606	$678	$677	$755	$2,716	19%	17%	15%	11%	15%
Outdoor	$392	$456	$460	$503	$1,811	3%	5%	8%	4%	5%
Eliminations	($68)	($34)	($44)	($50)	($196)	35%	3%	-19%	5%	6%
Total Revenue	**$3,531**	**$3,331**	**$3,298**	**$3,774**	**$13,933**	12%	11%	-2%	8%	7%
OIBDA, incl. SBC										
Entertainment	$145	$223	$278	$257	$903	-4%	7%	-14%	35%	3%
Cable Networks	$101	$129	$171	$163	$564	21%	33%	33%	7%	1024%
Publishing	$4	$17	$31	$30	$82	NM	64%	10%	122%	-84%
Local Broadcasting	$134	$214	$195	$306	$849	148%	103%	49%	NM	403%
Outdoor	$32	$79	$77	$101	$289	24%	NM	NM	47%	71%
Segment OIBDA	$416	$662	$752	$858	$2,686	32%	42%	17%	31%	30%
Corp. & Intersegment Elims	($39)	($56)	($59)	($40)	($193)	36%	61%	69%	-19%	
Residual Costs of Disc. Ops.	($26)	($26)	($26)	($26)	($104)	-26%	-27%	223%	26%	-12%
Impairment Charges/Other	$1	($1)	$0	$0	$0					
Total OIBDA	**$351**	**$579**	**$667**	**$792**	**$2,389**	41%	50%	17%	103%	50%
Less Restructuring Charge	($57)									
Operating Income										
Entertainment	$104	$181	$237	$216	$738	-3%	10%	-15%	47%	5%
Cable Networks	$95	$124	$165	$157	$541	23%	36%	35%	7%	24%
Publishing	$2	$15	$30	$27	$74	NM	83%	11%	NM	74%
Local Broadcasting	$110	$190	$171	$281	$750	244%	127%	NM	38%	78%
Outdoor	($31)	$14	$16	$36	$34	-20%	NM	NM	NM	-136%
Segment Op Income	**$280**	**$523**	**$618**	**$718**	**$2,138**	59%	61%	23%	40%	42%
Corp, Interseg. Elim.	($44)	($61)	($64)	($40)	($209)	32%	55%	62%	-26%	26%
Residual Costs of Disc. Ops.	($26)	($26)	($26)	($26)	($103)	-28%	-27%	113%	-26%	-12%
Impairment Charges, Other	($57)	($1)	$83	$0	$25					
Op Income	$153	$435	$611	$652	$1,852	43%	80%	46%	168%	85%
Net Interest Expense	($137)	($133)	($128)	($120)	($517)	5%	0%	-4%	-13%	-4%
Early Debt Extinguishment	$2	($40)	$0	($45)	($83)					
Other Income (Expenses)	($13)	($14)	$25	($2)	($3)	10%	289%	69%	-9%	27%
Income Before Tax	$6	$249	$509	$485	$1,248	-116%	233%	70%	368%	187%
Provision for Taxes	($21)	($92)	($179)	($182)	($473)	139%	61%	124%	386%	159%
Equity in Inc of Affiliates	($11)	($7)	($13)	($10)	($41)	-2%	119%	7%	37%	21%
Minority Interest	$0	$0	$0	$0	$0					
Net Income-Reported	($26)	$150	$317	$293	$734					237%
Non Recurring, net	$61	$25	($72)	$0	$14					
Net Income-Operations	$34	$175	$245	$293	$748	-195%	183%	42%	71%	114%
EPS - Reported	**($0.04)**	**$0.22**	**$0.46**	**$0.42**	**$1.06**	NM	902%	51%	395%	233%
EPS - Contg Ops	**$0.05**	**$0.25**	**$0.35**	**$0.42**	**$1.08**	NM	178%	40%	70%	111%
Avg. Dil Shs Out.	676	693	694	695	690					

Sources: Company Reports, Needham & Company estimates.

ANALYST CERTIFICATION

I, Laura Martin, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company (ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

I, Dan Medina, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company (ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Price, Rating, and Price Target History: CBS Corp. (CBS/NYSE) as of 12-13-10

Source: Factset (Prices) / Needham (ratings and target price)

Disclosures applicable to this security: B.

Price, Rating, and Price Target History: Viacom Inc. CL B (VIAB/NYSE) as of 12-13-10

Source: Factset (Prices) / Needham (ratings and target price)

Disclosures applicable to this security: B.

	% of companies under coverage with this rating	% for which investment banking services have been provided for in the past 12 months
Strong Buy	9	15
Buy	62	15
Hold	27	3
Under Perform	<1	0
Rating Suspended	1	25
Restricted	0	0
Under Review	0	0

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