

Vivendi Universal ADR V



Analyst Report | 08-02-2001

by George E. Nichols

Thesis

Vivendi is here to stay, but as a mature company it lacks the growth prospects to be a worthwhile long-term investment, in our opinion. The stock has plenty of room to fall before we would consider it attractive.

The company is fresh out of the gate on some massive restructuring efforts that include the disposal of beverage producer Seagram's assets, the \$2.2 billion acquisition of educational publisher Houghton Mifflin [HTN](#) , and the recent purchase of MP3.com [MPPP](#) . While these deals are all but closed, the financial and cultural integration will take much longer. Prospective investors deserve proof from Vivendi that operational changes are leading to increasing cash flows.

Financially, Vivendi has managed its business well. Revenue grew 30% in 1999 and another 27% in 2000. Revenue growth could hit 15% over the long term, but could be hampered by competition from other media conglomerates like Disney [DIS](#) and Viacom [VIA](#) . More important, cash flows have wavered because of acquisitions like PolyGram Records and disposals like Tropicana and Vivendi's stake in Time Warner. Free cash flows went from \$458 million in 1998 to negative \$5.2 billion in 1999 to \$518 million in 2000 because of these transactions.

We would like to see more-consistent cash flows from a mature company like Vivendi before we consider it a worthy investment. The firm has taken on more debt and issued additional shares to maintain healthy cash balances, but it has brought additional financial risk by doing so.

Vivendi has significantly underperformed the market over the past six months and we do not see any catalysts on the horizon to make a significant change for the better. We think investors are better off sitting on the sidelines for now.

Valuation

Strategy

The company is intent on becoming the pioneer of the wireless Internet by providing entertainment like music to consumers primarily over cell phones and other wireless

As of 08-02-2001

Morningstar Rating



Business Risk

Avg

Stock Price

\$58.80

Fair Value Estimate

\$49.00

Bulls Say

- The combination of Seagram, Vivendi, and CanalPlus into Vivendi Universal has created a global media company with both revenue and cash flow growth opportunities.
- Universal Studios' performance has significantly improved. Box-office revenue topped \$1 billion last year and Universal Pictures had a year-end market share of 15%.
- Universal's combination with CanalPlus, Europe's leading pay-TV company, should offer new avenues for cost savings and sales growth. CanalPlus increased subscriptions by 32% in 2000, to 5.3 million subscribers throughout Europe, and is now profitable.

Bears Say

- The merger has many risks associated with it, including integrating three companies from different parts of the world.
- Vivendi's planned wireless and Internet distribution of music is fraught with risks. It is untested and may not prove to be as lucrative as forecasted.
- The slowdown in Internet advertising spending could make it difficult for the company's wireless Web portal, Vizzavi, to meet its goal of an operating profit in three years. Every dollar will be

devices. Through a joint venture with Vodafone VOD called Vizzavi, Vivendi hopes to leverage its bountiful entertainment assets to become the leader on the wireless Internet frontier.

Management

Vivendi is led by the charismatic Jean-Marie Messier, who has transformed a former French government-owned utility into an entertainment, communication, and utility conglomerate. Now he has the challenge of making his vision work.

Profile

Growth

Revenue projections are decent, but not spectacular. The company expects its core entertainment business to grow 10% annually through 2002; its utility business is expected to grow at 8%.

Profitability

The ability to deliver on goals for EBITDA (earnings before interest, taxes, depreciation, and amortization), a proxy for cash flow, is key. The entertainment unit is forecast to increase EBITDA by 35%, while the utility business increases 11%-13%.

Financial Health

Most of Vivendi's debt was eliminated with the sale of Seagram's wine and spirits business. The company continues to invest heavily in its Internet operations through Vizzavi. The unit's projected investment is expected to reach \$1.42 billion.

critical if the firm is to meet its aggressive target of 35% EBITDA growth in 2001 and 2002.

- Management's projections of 10% top-line and 35% earnings growth this year and next are more than accounted for in Vivendi's pricey stock.