BLACKROCK INC /NY
Form 10-Q
August 05, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended June 30, 2005

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from ______ to ______.

(Commission file number 001-15305)

BlackRock, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**51-0380803**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

40 East 52nd Street, New York, NY 10022

(Address of principal executive offices)

(Zip Code)

(212) 810-5300

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act.) Yes x No ¨

As of July 31, 2005, there were 19,767,663 shares of the registrant s class A common stock outstanding and 44,502,957 shares of the registrant s class B common stock outstanding.

BlackRock, Inc.

Index to Form 10-Q

PART I

FINANCIAL INFORMATION

		Page
Item 1.	Financial Statements	
	Consolidated Statements of Financial Condition	1
	Consolidated Statements of Income	2
	Consolidated Statements of Cash Flows	3
	Notes to Consolidated Financial Statements	4
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	32
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	66
Item 4.	Controls and Procedures	69

PART II

OTHER INFORMATION

Item 1.	Legal Proceedings	70
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	71
Item 4.	Submission of Matters to a Vote of Security Holders	72
Item 6.	Exhibits	73

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

BlackRock, Inc.

Consolidated Statements of Financial Condition

(Dollar amounts in thousands)

	June 30, 2005 (unaudited)	December 31, 2004
Assets		
Cash and cash equivalents	$ 367,386	$ 457,673
Accounts receivable	210,431	153,152
Investments	282,807	227,497
Property and equipment, net	115,323	93,701
Intangible assets, net	499,991	184,110
Receivable from affiliates	33,365	12,190
Deferred mutual fund commissions	15,398	
Other assets	37,843	16,912
Total assets	$ 1,562,544	$ 1,145,235
Liabilities		
Accrued compensation	$ 317,201	$ 311,351
Long term borrowings	250,000	
Purchase price contingencies	55,332	
Accounts payable and accrued liabilities		
Affiliate	10,722	3,632
Other	38,616	27,185
Acquired management contract obligation	3,791	4,810
Other liabilities	22,690	12,736
Total liabilities	698,352	359,714
Minority interest	10,577	17,169
Stockholders equity		
Common stock, class A, 19,965,305 and 19,243,878 shares issued, respectively	200	192
Common stock, class B, 45,447,417 and 45,499,510 shares issued, respectively	455	455
Additional paid-in capital	210,998	165,377
Retained earnings	711,244	650,016
Unearned compensation	(14,716)	(4,588)
Accumulated other comprehensive gain	4,680	8,254
Treasury stock, class A, at cost, 338,241 and 270,998 shares held, respectively	(25,436)	(17,545)
Treasury stock, class B, at cost, 806,667 shares held	(33,810)	(33,809)
Total stockholders equity	853,615	768,352

Total liabilities and stockholders equity	$ 1,562,544	$ 1,145,235

See accompanying notes to consolidated financial statements.

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

BlackRock, Inc.

Consolidated Statements of Income

(Dollar amounts in thousands, except share data)

(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2005	**2004**	**2005**	**2004**
Revenue				
Investment advisory and administration fees				
Mutual funds	$ 77,247	$ 54,981	$ 147,618	$ 111,427
Separate accounts	154,224	107,032	296,109	210,904
Other income				
Affiliate	1,250	1,378	2,500	2,636
Other	38,668	20,421	75,244	40,668
Total revenue	271,389	183,812	521,471	365,635
Expense				
Employee compensation and benefits	131,015	81,618	257,959	147,687
Fund administration and servicing costs				
Affiliate	4,096	4,948	8,113	10,016
Other	6,330	3,070	11,422	6,362
General and administration				
Affiliate	1,678	1,411	4,795	5,336
Other	44,719	29,952	87,769	57,326
Amortization of intangible assets	1,656	232	2,937	463
Impairment of intangible assets				6,097
Total expense	189,494	121,231	372,995	233,287
Operating income	81,895	62,581	148,476	132,348
Non-operating income (expense)				
Investment income	6,027	16,038	15,814	22,935
Interest expense	(2,063)	(550)	(4,077)	(1,634)
Total net non-operating income	3,964	15,488	11,737	21,301
Income before income taxes and minority interest	85,859	78,069	160,213	153,649
Income taxes	31,324	26,521	58,655	46,610

Income before minority interest		54,535		51,548		101,558		107,039
Minority interest		1,200		3,552		1,687		3,836
Net income	$	53,335	$	47,996	$	99,871	$	103,203
Earnings per share								
Basic	$	0.83	$	0.75	$	1.55	$	1.62
Diluted	$	0.80	$	0.73	$	1.49	$	1.57
Dividends paid per share	$	0.30	$	0.25	$	0.60	$	0.50
Weighted-average shares outstanding								
Basic		64,354,069		63,647,316		64,322,465		63,701,625
Diluted		66,796,087		65,766,979		66,844,720		65,776,975

See accompanying notes to consolidated financial statements.

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

BlackRock, Inc.

Consolidated Statements of Cash Flows

(Dollar amounts in thousands)

(unaudited)

	Year to Date June 30,	
	2005	**2004**
Cash flows from operating activities		
Net income	$ 99,871	$ 103,203
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	14,468	10,105
Impairment of intangible assets		6,097
Minority interest	1,687	3,836
Stock-based compensation	35,251	6,942
Deferred income taxes	(8,312)	7,210
Tax benefit from stock-based compensation	2,503	1,761
Net gain on investments	(3,856)	(11,889)
Amortization of bond issuance costs	403	
Amortization of deferred mutual commissions	5,426	
Changes in operating assets and liabilities:		
Increase in accounts receivable	(20,575)	(19,783)
Increase in investments, trading	(7,159)	(9,156)
Increase in receivable from affiliates	(12,863)	(209)
Increase in other assets	(4,906)	(914)
Decrease in accrued compensation	(132,071)	(36,870)
Increase (decrease) in accounts payable and accrued liabilities	11,734	(18,069)
Increase (decrease) in other liabilities	8,152	(2,489)
Cash (used in) provided by operating activities	(10,247)	39,775
Cash flows from investing activities		
Purchase of property and equipment	(29,138)	(9,892)
Purchase of investments	(13,572)	(36,006)
Sale of investments	28,129	89,742
Sale of real estate held for sale	112,184	
Deemed cash contribution upon consolidation of VIE		6,412
Consolidation of sponsored investment funds		(41,193)
Acquisitions, net of cash acquired and purchase price contingencies	(249,535)	(73)
Cash (used in) provided by investing activities	(151,932)	8,990
Cash flows from financing activities		

Borrowings, received, net of issuance costs	395,000	
Principal repayment of borrowings	(150,000)	
Repayment of short term borrowings	(111,840)	
Subscriptions to consolidated sponsored investment funds	9,891	5,000
Decrease in cash due to deconsolidated sponsored investment fund	(5,509)	
Distributions paid to minority interest holders		(3,975)
Dividends paid	(38,434)	(31,757)
Reissuance of treasury stock	8,315	10,049
Purchase of treasury stock	(32,606)	(47,429)
Issuance of class A common stock	706	
Acquired management contract obligation payment	(1,019)	(926)
Cash provided by (used in) financing activities	74,504	(69,038)
Effect of exchange rate changes on cash and cash equivalents	(2,612)	1,028
Net decrease in cash and cash equivalents	(90,287)	(19,245)
Cash and cash equivalents, beginning of period	457,673	315,941
Cash and cash equivalents, end of period	$ 367,386	$ 296,696

See accompanying notes to consolidated financial statements.

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

BlackRock, Inc.

Notes to Consolidated Financial Statements

(Dollar amounts in thousands, except share data)

(unaudited)

1. Significant Accounting Policies

Basis of Presentation

BlackRock, Inc., a Delaware Corporation (together with its subsidiaries, BlackRock or the Company) is majority-owned indirectly by the PNC financial services group, Inc. (PNC). The consolidated financial statements of BlackRock include the assets, liabilities and earnings of its wholly-owned subsidiaries BlackRock Advisors, Inc., BlackRock Institutional Management Corporation, BlackRock Financial Management, Inc., BlackRock Investments, Inc., BlackRock Funding, Inc., BlackRock Overseas Investment Corp. and BlackRock Portfolio Holdings, Inc. and each of their subsidiaries. The Company also consolidates entities in which it holds a majority of the outstanding equity or has been deemed primary beneficiary. Intercompany accounts and transactions between the consolidated entities have been eliminated. The consolidated interim financial statements of BlackRock. Included herein have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and Rule 10-01 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. These consolidated financial statements are unaudited and should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2004. The Company follows the same accounting policies in the preparation of interim reports as set forth in the annual report. In the opinion of management, the consolidated financial statements reflect all adjustments, which are of a normal recurring nature and necessary for a fair presentation of the financial position, results of operations and cash flows of BlackRock for the interim periods presented and are not necessarily indicative of a full year s results.

Use of Estimates

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates.

Investments

Readily Marketable Securities

The accounting method used for the Company s readily marketable securities is dependent upon the Company s ownership level. If the Company does not possess significant influence over the issuer s operations, the securities are classified as trading or available for sale, depending on the Company s intent to hold the security. Investments, trading, primarily represent investments made by the Company in certain of the *BlackRock Funds* which are held in a Rabbi trust with respect to senior employee elections under BlackRock deferred compensation plans and securities held by Company-sponsored investment funds which have been consolidated due to the Company s majority ownership. These securities are recorded at fair market value with unrealized gains and losses included in the accompanying consolidated statements of income as investment income (expense). Investments, available for sale, consist primarily of corporate investments in BlackRock funds and collateralized debt obligations. The resulting unrealized gains and losses on investments, available for sale, are included in the accumulated other comprehensive income or loss component of stockholders equity, net of tax. If the Company holds significant influence over the issuer of a readily marketable equity security, the investment is accounted for under the equity method of accounting and included in investments, other. The Company s share of the investee s net income is included in investment income (expense) on the consolidated statements of income.

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

1. Significant Accounting Policies (continued)

Investments (continued)

Nonmarketable Equity Securities

Items classified as investments, other, consist primarily of certain institutional and private placement portfolios (alternative investment products) and are accounted for using the cost or equity methods of accounting. If the Company has significant influence over the investee s operations, the equity method of accounting is used and the Company s share of the investee s net income is recorded as investment income (expense). If the Company does not maintain significant influence over the investee s operations, the cost method of accounting is used.

Occasionally, the Company will acquire a controlling equity interest in a sponsored investment fund as a seed investment. The cash flows originating from consolidation of sponsored investment funds, as presented in the consolidated statements of cash flows, primarily represents the purchases of securities by such funds using proceeds from the Company s initial seed investments to establish such funds. When the Company s interests in any of these funds falls below 50%, those funds will be deconsolidated and accounted for under the equity method or other methods as appropriate. This deconsolidation will result in a decrease in the Company s cash and cash equivalents in an amount equal to the amount of the funds cash and cash equivalents at that time.

These funds are organized as investment companies, as defined in the American Institute of Certified Public Accountants Audit and Accounting Guide, *Audits of Investment Companies* (the IC Guide). As required by the IC Guide, all of the fund s investments are carried at value, regardless of the Company s ownership and the availability of a readily determinable market value for the investments, with the corresponding changes in the securities fair values reflected in investment income in the Company s consolidated statement of income. In the absence of a publicly-available market value, fair value for an investment is estimated in good faith by the Company s management based on such factors as the liquidity, financial condition and current and projected operating performance of the investment and, in the case of private investment fund investments, the net asset value provided by the fund s investment manager. At June 30, 2005, these investments represent 19%, or approximately $54,000, of total investments.

Realized gains and losses on trading, available for sale and other investments are calculated on a specific identification basis and, along with interest and dividend income, are included in investment income (expense), in the accompanying consolidated statements of income**.** The Company s management periodically assesses impairment on investments to determine if it is other than temporary. Several of the Company s available for sale investments represent interests in collateralized debt obligations in which the Company acts in the capacity of collateral manager. The Company reviews cash flow estimates throughout the life of each collateralized debt obligation to determine if an impairment charge is required to be taken through current period s earnings. If the updated estimate of future cash flows (taking into account both timing and amount) is less than the last revised estimate, an impairment is recognized based on the excess of the carrying amount of the investment over its fair value. In evaluating impairments on all other available for sale and other securities, the Company considers the length of time and the extent to which the security s market value, if determinable, has been less than its cost, the financial condition and near-term prospects of the security s issuer and the Company s intended holding period for the security. Any impairment on investments that is deemed other than temporary is recorded in non-operating income (expense) on the consolidated statements of income as a realized loss.

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

1. Significant Accounting Policies (continued)

Stock-Based Compensation

Prior to 2003, the Company accounted for all awards issued under its 1999 Stock Award and Incentive Plan (the Award Plan) and shares issued under the BlackRock, Inc. 2001 Employee Stock Purchase Plan (ESPP) under the intrinsic method of accounting.

Effective January 1, 2003, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards Statement (SFAS) No. 123, Accounting for Stock-Based Compensation, prospectively to all employee awards granted, modified, or settled after January 1, 2003. Awards under the Company s plans vest over periods ranging from two to four years. Therefore, the cost related to stock-based employee compensation included in the determination of net income for the periods ending June 30, 2005 and June 30, 2004 is less than that which would have been recognized if the fair value based method had been applied to all awards since the effective date of SFAS No. 123.

The following table illustrates the effect on net income and earnings per share if the fair value based method had been applied to all outstanding and unvested awards in each period.

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Net income, as reported	$ 53,335	$ 47,996	$ 99,871	$ 103,203
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	2,117	1,075	3,834	2,336
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(4,120)	(3,746)	(7,840)	(8,056)
Pro forma net income	$ 51,332	$ 45,325	$ 95,865	$ 97,483
Earnings per share:				
Basic - as reported	$ 0.83	$ 0.75	$ 1.55	$ 1.62
Basic - pro forma	$ 0.80	$ 0.71	$ 1.49	$ 1.53
Diluted - as reported	$ 0.80	$ 0.73	$ 1.49	$ 1.57
Diluted - pro forma	$ 0.77	$ 0.69	$ 1.43	$ 1.48

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

1. Significant Accounting Policies (continued)

Deferred Mutual Fund Commissions

Currently, an indirect wholly-owned subsidiary of PNC acts as a financial intermediary associated with the sale of back-end loaded shares of certain *BlackRock Funds*. This entity finances certain broker sales commissions and receives associated sales charges. Upon the closing of the Company s acquisition of SSRM Holdings, Inc. (SSR) (see note 2), the Company acquired approximately $20,800 in deferred mutual fund commissions, representing broker sales commissions related to certain shares of SSR s mutual fund family. Concurrent with the closing of the SSR acquisition, these mutual funds were merged into the *BlackRock Funds*. All commissions incurred subsequent to that date will be financed by the indirect wholly-owned subsidiary of PNC.

Deferred mutual fund commissions are amortized over an estimated useful life of six years, based on the estimated recoverability of the asset through distribution fee payments or contingent deferred sales charges. Contingent deferred sales charges received from early shareholder withdrawals reduce the unamortized deferred commissions balance.

The Company will periodically evaluate the recoverability of deferred mutual fund commissions by assessing whether the unamortized asset can be recovered over its remaining life through an analysis of net undiscounted future cash flows related to the asset. If such an assessment indicates that the undiscounted cash flows are not sufficient to recover the recorded carrying value, the assets will be adjusted to fair value with a corresponding impairment charge reflected in the consolidated statements of income. No such impairments were recorded in the periods presented.

Revenue Recognition

Investment advisory and administration fees are recognized as the services are performed. Such fees are primarily based on predetermined percentages of the market values of the assets under management or, in the case of certain real estate separate accounts, net operating income generated by the underlying properties, and are affected by changes in assets under management, including market appreciation or depreciation and net subscriptions or redemptions. Investment advisory and administration fees for mutual funds are shown net of fees waived pursuant to expense limitations. Certain real estate fees are earned upon the acquisition or disposition of properties in accordance with applicable investment management agreements and are recognized at the closing of the respective real estate transactions.

The Company also receives performance fees or an incentive allocation from alternative investment products and certain separate accounts. These performance fees are earned upon attaining specified investment return thresholds. Such fees are recorded as earned. Should the alternative investment products and separate accounts subject to performance fees not continue to meet specified investment return thresholds, performance fees and related employee compensation expense previously recorded may be subject to reversal. At June 30, 2005, no performance fees recorded by the Company are subject to reversal.

BlackRock provides a variety of risk management, investment analytics and investment system services to insurance companies, finance companies, pension funds, asset managers, foundations, consultants, mutual fund sponsors, REITs, commercial and mortgage banks, savings institutions and government agencies. These services are provided under the brand name *BlackRock Solutions*® and include a wide array of risk management services and enterprise investment system outsourcing to clients. Fees earned for *BlackRock Solutions* services are either based on predetermined percentages of the market value of assets subject to the services or on fixed monthly or quarterly payments. Certain client accounts can also be subject to discretionary performance fees. The fees earned on risk management, investment analytics and investment system assignments are recorded as other income on the consolidated statements of income.

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

1. Significant Accounting Policies (continued)

Recent Accounting Developments

In December 2004, the FASB issued Statement of Financial Accounting Standards Statement (SFAS) No. 123R, Share-Based Payment. This statement is a revision to SFAS No. 123, Accounting for Stock-Based Compensation and supercedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. This statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services, primarily focusing on the accounting for transactions in which an entity obtains employee services in share-based payment transactions. Entities will be required to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide service (usually the vesting period) in exchange for the award. The grant-date fair value of employee share options and similar instruments will be estimated using option-pricing models. If an equity award is modified after the grant date, incremental compensation cost will be recognized in an amount equal to the excess of the fair value of the modified award over the fair value of the original award immediately before the modification. As amended by Rule 4-01(a) of Regulation S-X promulgated by the Securities and Exchange Commission (the SEC), this statement is effective as of the beginning of the first interim or annual reporting period of the Company s first fiscal year beginning on or after June 15, 2005. In accordance with the SFAS No. 123R, as amended, the Company will adopt SFAS No. 123R effective January 1, 2006.

Upon adoption, the Company has two application methods from which to choose: the modified-prospective transition approach or the modified-retrospective transition approach. Under the modified-prospective transition method, the Company would be required to recognize compensation cost for share-based awards to employees based on their grant-date fair value from the beginning of the fiscal period in which the recognition provisions are first applied as well as compensation cost for awards that were granted prior to, but not vested as of, the date of adoption. Prior periods remain unchanged and pro forma disclosures previously required by SFAS No. 123 continue to be required. Under the modified-retrospective transition method, the Company would restate prior periods by recognizing compensation cost in the amounts previously reported in the pro forma footnote disclosure under SFAS No. 123. Under this method, the Company is permitted to apply this presentation to all periods presented or to the start of the fiscal year in which SFAS No. 123R is adopted. The Company would follow the same guidelines as in the modified-prospective transition method for awards granted subsequent to adoption and those that were granted and not yet vested. The Company will adopt the modified-prospective transition approach, which will reduce the Company s net income by the grant-date fair value of all unvested stock options as of the date of adoption, January 1, 2006. In addition, diluted shares outstanding will be reduced for all shares reserved for unvested stock options expensed under SFAS No. 123R (approximately 1.8 million shares at June 30, 2005). The adoption of SFAS No. 123R is expected to reduce diluted earnings per share by approximately $0.01 per quarter through December 31, 2006.

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

1. Significant Accounting Policies (continued)

Recent Accounting Developments (continued)

In March 2005, the staff of the SEC issued Staff Accounting Bulletin (SAB) No. 107 regarding the Staff s interpretation of Share-Based Payments. This interpretation expresses the views of the staff regarding the interaction between SFAS No. 123R and certain SEC rules and regulations and provides the staff s views regarding the valuation of share-based payment arrangements for public companies. In particular, this SAB provides guidance related to share-based payment transactions with non-employees, the transition from nonpublic to public entity status, valuation methods, the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first time adoption of SFAS No. 123R in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS 123R, the modification of employee share options prior to adoption of SFAS No. 123R and disclosures in Management s Discussion and Analysis subsequent to adoption of SFAS No. 123R. The Company adopted the disclosure provisions of SAB No. 107 during the first quarter of 2005. Upon adoption of these provisions, the Company discontinued separate disclosure of expenses, and the corresponding accrued amounts, related to the vesting of awards under the BlackRock, Inc. 2002 Long Term Retention and Incentive Plan (LTIP) in the Company s financial statements. The Company will adopt the remaining provisions of SAB 107 in connection with its adoption of SFAS No. 123R on January 1, 2006. The adoption of these provisions is not expected to have a significant impact on the Company s consolidated financial statements.

In March 2005, the FASB issued FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations (FIN 47). FIN 47 establishes a framework for liability recognition related to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. In addition, FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. This Interpretation is effective no later than the end of fiscal years ending after December 15, 2005 and will be adopted by the Company on December 31, 2005. The adoption of FIN 47 is not expected to have a significant impact on the Company s consolidated financial statements.

In March 2005, the FASB issued FASB Staff Position (FSP) FIN 46(R)-5, Implicit Variable Interests Under FIN 46. FSP FIN 46(R)-5 states that a reporting entity should consider whether it holds an implicit variable interest in a variable interest entity (VIE) or in a potential VIE. If the aggregate of the explicit and implicit variable interests held by the reporting entity and its related parties would, if held by a single party, identify that party as the primary beneficiary, the party within the group most closely associated with the VIE should be deemed the primary beneficiary. The effective date of FSP FIN 46(R)-5 is the first reporting period beginning after March 31, 2005, with early application permitted for periods for which financial statements have not been issued. The adoption of FSP FIN 46(R)-5 is not expected to have a significant impact on the Company s consolidated financial statements.

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

1. Significant Accounting Policies (continued)

Recent Accounting Developments (continued)

FSP No. 109-2, Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004, provides guidance under SFAS No. 109, Accounting for Income Taxes, with respect to recording the potential impact of the repatriation provisions of the American Jobs Creation Act of 2004 (the Jobs Act) on enterprises income tax expense and deferred tax liability. The Jobs Act was enacted on October 22, 2004. FSP No. 109-2 states that an enterprise is allowed time beyond the financial reporting period of enactment to evaluate the effect of the Jobs Act on its plan for reinvestment or repatriation of foreign earnings for purposes of applying SFAS No. 109, Accounting for Income Taxes. The Company has not yet completed evaluating the impact of the repatriation provisions. Accordingly, as provided in FSP No. 109-2, the Company has not adjusted its tax expense or deferred tax liability to reflect the repatriation provisions of the Jobs Act. The expected impact of the Company s repatriation of its foreign subsidiaries undistributed earnings is discussed in note 12 to the consolidated financial statements.

In June 2005, the FASB issued Statement of Financial Accounting Standards No. 154, Accounting Changes and Error Corrections (FAS 154). FAS 154 replaces APB Opinion No. 20, Accounting Changes and FAS No. 3, Reporting Accounting Changes in Interim Financial Statements. FAS 154 requires that a voluntary change in accounting principle be applied retrospectively with all prior period financial statements presented on the new accounting principle. FAS 154 also requires that a change in method of depreciating or amortizing a long-lived nonfinancial asset be accounted for prospectively as a change in estimate, and correction of errors in previously issued financial statements should be termed a restatement. FAS 154 is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. The implementation of FAS 154 is not expected to have a material impact on the Company s consolidated financial statements.

Reclassification of Prior Period s Financial Statements

Certain items previously reported may have been reclassified to conform with the current period presentation.

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

2. Acquisition

In January 2005, the Company closed the acquisition of SSR, the holding company of State Street Research & Management Company and BlackRock Realty Advisors, Inc. (formerly known as SSR Realty Advisors, Inc. Realty), from MetLife, Inc. (MetLife) for an adjusted purchase price of $233,115 in cash and approximately 550,000 shares of BlackRock restricted class A common stock. MetLife is precluded from selling these shares until the third anniversary of closing, except in very limited circumstances. In deriving a fair value for this common stock, the Company referred to a valuation discount recommendation that was compiled by an independent third party valuation services firm on the Company s behalf. This firm based its recommended discount range of 15% to 20% on Black Scholes and Longstaff valuations of the embedded put option on the Company s restricted shares and historical differentials between restricted stock and freely-marketable stock of publicly-traded companies.

The stock purchase agreement for the SSR transaction provides for an additional payment to MetLife on the first anniversary of the closing of the SSR transaction (January 31, 2006) of up to $75,000 based on the Company achieving specified retention levels of AUM and run rate revenue as of the signing date of the stock purchase agreement. The first anniversary contingent payment has two components: directly-sourced revenue and MetLife-sourced revenue. The directly-sourced revenue payment is subject to a maximum of $30,000, provided one year anniversary revenue exceeds 120% of signing date revenue. The MetLife-sourced revenue payment is subject to a maximum of $45,000, provided one year anniversary revenue exceeds 120% of signing date revenue. These payments decline to $20,000 and $30,000, respectively, if one year anniversary revenue approximates 100% of signing date levels. No contingent payment is required if directly-sourced and MetLife-sourced revenue fall below 80% and 95%, respectively, of revenue on the signing date of the stock purchase agreement. In addition, the stock purchase agreement provides for two other contingent payments. On December 31, 2006, MetLife will receive 32.5% of any performance fees earned on a large institutional real estate client. In addition, on the fifth anniversary of the closing of the SSR transaction, MetLife could receive an additional payment up to a maximum of $10,000 based on the Company s retained AUM associated with the MetLife defined benefit and defined contribution plans.

At closing, the Company recorded the excess of assets acquired and liabilities assumed over the cost of the acquired entity as a pro rata reduction of the amounts assigned to relevant fixed and intangible acquired assets. Subsequent to this determination, the Company recognized a contingent liability of $55,332 for the excess due to potential additional payments to MetLife and recorded the net assets acquired at fair value. Any additional contingencies in excess of the amount recorded as a liability will be reflected as additional purchase price and recorded as goodwill when the contingency is resolved and additional consideration is distributable.

In addition to the potential contingent payments described above, the stock purchase agreement provided for a hold-back of the initial purchase price payable to MetLife primarily associated with the value of customer accounts which, as of the closing date, had not committed to maintaining their accounts with the Company. The amount of the payment due to MetLife will be based on the status of these accounts as of July 31, 2005. The Company has estimated the amount of the true-up payment to be approximately $20,000. The true-up payment will be recorded as a reduction in the contingent liability to MetLife.

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

2. Acquisition (continued)

The Company initially financed $150,000 of the purchase price with a bridge promissory note at an annual rate of 2.875%. SSR, through its subsidiaries, actively managed approximately $49,700,000 in stock, bond, balanced and real estate portfolios for both institutional and individual investors at January 31, 2005. SSR s results have been included in the Company s results since February 1, 2005.

In preparation for a commingled fund launch, Realty acquired, during the fourth quarter of 2004 and January 2005, six properties having a total purchase price of $112,200 and assumed a $19,000 mortgage on one of these properties. Exclusive of the assumed mortgage, Realty financed the purchase price under a line of credit with an affiliated company. The closing of the fund occurred in March 2005 at which time the commingled fund purchased the six properties at Realty s cost in accordance with its contract with Realty. Accordingly, no gain or loss was recognized by Realty on these sales. Each property, prior to the launch of the aforementioned commingled fund, was carried at cost, which management concluded approximated fair value due to the length of Realty s holding period for each property.

Realty accumulated these properties prior to closing to provide potential investors with a better understanding of the type and quality of assets to be purchased by the fund.

In February 2005, the Company issued $250,000 of convertible debentures (see note 15). The Company used a portion of the net proceeds from this issuance to retire the bridge promissory note.

A summary of the fair values of the net assets acquired in this acquisition is as follows:

Accounts receivable	$ 36,704
Assets held for sale	112,184
Investments	74,077
Property and equipment	4,015
Deferred mutual fund commissions	20,824
Other assets	4,172
Goodwill	12,966
Management contracts acquired	300,979
Liabilities assumed	(295,594)
Total purchase price, including acquisition costs	$ 270,327
Summary of consideration, net of cash acquired	
Cash	$ 233,115
Restricted class A common stock, at fair value	37,212
	$ 270,327

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

2. Acquisition (continued)

The following unaudited pro forma combined financial information is presented for illustrative purposes only and is not necessarily indicative of the combined results of operations for future periods or the results of operations that actually would have been realized had BlackRock and SSR been a combined company during the specified periods prior to the closing. The pro forma combined financial information is based on the respective historical unaudited interim financial statements of BlackRock and SSR and does not reflect acquisition-related compensation incurred by SSR during 2005 and is adjusted for benefits associated with the termination of a lease held by SSR in January 2005. In addition, the pro forma combined financial information has been adjusted to reflect a full quarter s recognition of amortization expense of intangible assets related to SSR management contracts acquired, recognition of interest expense related to borrowings used to finance the acquisition, and depreciation benefits associated with the write-off of SSR property and equipment that will not be used in the Company s ongoing operations. Management expects to and has realized net operating synergies from this transaction due to the related product expansion and scale benefits. The pro forma combined financial information does not reflect the potential impact of these net operating synergies.

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Total revenue	$ 271,389	$ 270,474	$ 543,259	$ 507,741
Operating income	$ 81,895	$ 85,940	$ 154,751	$ 165,553
Net income	$ 53,335	$ 61,257	$ 101,866	$ 121,421
Earnings per share:				
Basic	$ 0.83	$ 0.95	$ 1.58	$ 1.89
Diluted	$ 0.80	$ 0.92	$ 1.52	$ 1.83

3. Investments

A summary of the cost and carrying value of investments, available for sale, is as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Value
June 30, 2005				
Mutual funds	$ 11,920	$ 108	$ (59)	$ 11,969
Collateralized debt obligations	28,676	686	(2)	29,360
Total investments, available for sale	$ 40,596	$ 794	$ (61)	$ 41,329

December 31, 2004				
Mutual funds	$ 6,226	$ 70	$ (17)	$ 6,279
Collateralized debt obligations	10,576	2,184		12,760
Total investments, available for sale	$ 16,802	$ 2,254	$ (17)	$ 19,039

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

3. Investments (continued)

A summary of the cost and carrying value of investments, trading and other, is as follows:

	Cost	Carrying Value
June 30, 2005		
Mutual funds	$ 20,368	$ 21,668
Equity securities	15,964	19,935
Mortgage backed securities	14,232	14,112
Corporate notes and bonds	8,668	8,662
Municipal debt securities	119	130
Total investments, trading	59,351	64,507
Equity method	72,011	79,276
Cost method	62,294	63,532
Fair value	33,453	34,163
Total investments, other	167,758	176,971
Total investments, trading and other	$ 227,109	$ 241,478
December 31, 2004		
U.S. government securities	$ 22,276	$ 22,275
Mutual funds	13,869	15,688
Mortgage backed securities	12,435	12,388
Equity securities	5,976	9,384
Corporate notes and bonds	9,373	9,371
Municipal debt securities	119	120
Total investments, trading	64,048	69,226
Equity method	70,873	74,248
Cost method	33,885	34,605
Fair value	30,688	30,379
Total investments, other	135,446	139,232
Total investments, trading and other	$ 199,494	$ 208,458

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

3. Investments (continued)

The carrying value of investments in debt securities by contractual maturity at June 30, 2005 is as follows:

Maturity Date	Carrying Value
1-5 years	$ 11,857
5-10 years	3,036
After 10 years	8,011
Total	$ 22,904

4. Other Income

Other income consists of the following:

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
BlackRock Solutions	$ 23,927	$ 18,220	$ 50,562	$ 37,260
Real estate property management fees	8,742		14,340	
Other	7,249	3,579	12,842	6,044
	$ 39,918	$ 21,799	$ 77,744	$ 43,304

Real estate property management fees for the three and six months ended June 30, 2005 include $6,239 and $10,298, respectively, for reimbursement of the cost of compensation and benefits related to certain Realty employees. The related compensation and benefits of these employees are included in the Company s employee compensation and benefits expense in the consolidated financial statements.

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

5. Derivative Instruments Held For Trading

SSR acts as investment manager for a synthetic collateralized credit default swap obligation. A synthetic collateralized credit default swap obligation occurs when a counterparty provides credit protection through a series of credit default swaps to third parties. The counterparty further securitizes this credit protection by obtaining a super senior insurance policy and issuing several classes of credit default swaps to third parties. Losses in the counterparty s reference pool (i.e., asset backed securities and corporate bonds) are first absorbed by the most subordinated class of the credit default swaps issued by the structure. As collateral manager for this specific synthetic collateralized credit default swap obligation (Pillars), the Company bears no risk beyond reputational risk contingent on the performance of the structure. In addition, the Company has entered into a credit default swap with Pillars affording the structure credit protection of approximately $16,700, representing the Company s maximum risk of loss. This swap represents seed capital invested by the Company in a new product and facilitated the issuance of credit default swaps to third parties. Under the terms of its credit default swap with Pillars, the Company is entitled to an annual coupon of 4% of its notional balance ($16,700) and ¼ of the structure s residual balance at its scheduled termination, December 23, 2009. The Company s management has performed a control assessment of its variable interests in Pillars (a collateral management agreement and the credit default swap) under FIN 46R and has concluded the Company is not Pillar s primary beneficiary. Pursuant to SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, the Company carries the Pillars credit default swap at fair value based on the expected future cash flows under the arrangement. At June 30, 2005, the fair value of the Pillars credit default swap was $2,913.

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

6. Intangible Assets

	Weighted-avg. estimated useful life	June 30, 2005		
		Gross Carrying Amount	Accumulated Amortization	Intangible Assets, Net
Goodwill	N/A	$ 255,732	$ 65,842	$ 189,890
Management contracts acquired:				
Mutual funds	N/A	197,963		197,963
Private investment funds	N/A	46,423		46,423
Other	N/A	23		23
Total goodwill and unamortized intangible assets		500,141	65,842	434,299
Management contracts acquired:				
Institutional separate accounts	10.7	57,915	2,143	55,772
Collateralized debt obligations	9.0	6,309	279	6,030
Private investment funds	5.0	8,124	4,234	3,890
Total amortized intangible assets	10.5	72,348	6,656	65,692
Total intangible assets		$ 572,489	$ 72,498	$ 499,991

	Weighted-avg. estimated useful life	December 31, 2004		
		Gross Carrying Amount	Accumulated Amortization	Intangible Assets, Net
Goodwill	N/A	$ 242,766	$ 65,842	$ 176,924
Management contracts acquired:				
Private investment funds	N/A	2,842		2,842
Other	N/A	23		23
Total goodwill and unamortized intangible assets		245,631	65,842	179,789
Management contract acquired:				
Private investment funds	10.0	8,040	3,719	4,321
Total amortized intangible assets	10.0	8,040	3,719	4,321
Total intangible assets		$ 253,671	$ 69,561	$ 184,110

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

6. Intangible Assets (continued)

The $12,966 increase in goodwill and the $305,829 increase in management contracts acquired during the six months ended June 30, 2005 relates to the SSR acquisition.

Future expected amortization of intangible assets expense for each of the five succeeding years is as follows:

2005	$ 4,568
2006	8,114
2007	8,114
2008	8,114
2009	8,114

7. BlackRock, Inc. 2002 Long Term Retention and Incentive Plan (LTIP)

The LTIP permits the grant of up to $240,000 in deferred compensation awards (the LTIP Awards), which were previously subject to the achievement of certain performance hurdles by the Company. Under the terms of the LTIP, grants of awards fully vest if BlackRock s average closing stock price is at least $62 for any 3-month period beginning on or after January 1, 2005 and ending on or prior to March 30, 2007. During the first quarter of 2005, the Company s average closing stock price exceeded the $62 threshold. In addition to the stock price threshold, the vesting of awards is contingent on the participants continued employment with the Company for periods ranging from two to five years. The Company has granted approximately $232,100 in LTIP awards, net of forfeitures. Quarterly expense attributable to LTIP awards during the period from July 1, 2005 through December 31, 2006 will be approximately $15,400 based on awards granted.

Up to $200,000 of the LTIP Awards will result in no economic cost to the Company as this amount will be funded with up to 4 million shares of BlackRock Class A common stock to be surrendered by The PNC Financial Services Group, Inc. (PNC) and distributed to LTIP participants, less income tax withholding. Shares attributable to value in excess of PNC s $200,000 LTIP funding requirement will be available to support future long-term retention and incentive programs but are not subject to surrender by PNC until the programs are approved by the Compensation Committee of the Company s Board of Directors. In addition, shares distributed to LTIP participants will include an option to put such distributed shares back to BlackRock at fair market value. The remaining $40 million of awards are payable in cash by the Company with the corresponding expense fully reflected in both reported and adjusted earnings. On the payment date, the Company will record a $200 million capital contribution from PNC. Since the stock based awards payable under the plan will consist of previously issued and outstanding shares of Class A common stock currently owned by PNC, dilution would not result from the stock based awards. The put option was provided to LTIP participants for liquidity purposes due to the Company s small public float (over 80% of outstanding shares are owned by PNC and employees). The Company s average daily trading volume for the past four quarters approximated 70,000 shares of Class A common stock as compared to approximately 2.5 million shares of Class A common stock that will be distributed to employees in early 2007. Put elections made by employees will be accounted for as treasury stock repurchases and will be accretive to the Company s earnings per share.

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

8. Employee Benefit and Incentive Compensation Plans

In addition to the employee benefit plans described in the Company s annual report, the Company assumed certain employee benefit plans from SSR as a result of the acquisition.

Deferred Compensation Plans

SSR s deferred compensation plan (the SSR New Plan) allowed participants to elect to defer a portion of their annual incentive compensation for either a fixed term or until retirement. SSR has funded a portion of the obligation through the purchase of life insurance policies to the benefit of SSR. At June 30, 2005, obligations under the SSR New Plan totaled $15,168. Changes in the Company s obligations under the SSR New Plan, as a result of appreciation or depreciation of the underlying life insurance policies cash surrender value, are recorded as compensation and benefits in the consolidated statements of income.

Prior to 2003, SSR sponsored a deferred compensation plan (the SSR Old Plan) under which eligible participants could defer annual incentive compensation and commissions for a fixed term or upon retirement. Obligations under this plan are funded through insurance policies acquired by SSR to the benefit of the respective participant. SSR is entitled to the return of any premium paid and, as such, premiums paid are recorded by SSR as a receivable from the participant. At the end of a participant s deferral period, all amounts advanced by SSR will be applied against SSR s obligation under the SSR Old Plan. All obligations under the SSR Old Plan are convertible to obligations under the SSR New Plan at the election of the participant at the respective insurance policy s cash surrender value. At June 30, 2005, SSR advances to employees and obligations under the SSR Old Plan are each $3,700.

401(k) and Retirement Savings Plans

The Company assumed two 401(k) and Retirement Savings Plans, covering employees of State Street Research & Management Company and BlackRock Realty Advisors, Inc. (the Research Plan and Realty Plan, respectively) as a result of the SSR acquisition.

Effective with the closing of the SSR acquisition, accrued benefits for all participants in the Research Plan and selected participants in the Realty Plan were frozen and the Research Plan was closed to new participants. All participants whose accrued benefits were frozen will participate in the PNC Incentive Savings Plan (ISP). The terms of the ISP are included in note 10 to the Company s consolidated financial statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2004. For all employees who remain active participants in the Realty Plan, employee contributions of up to 3%, as well as an additional 50% of the next 2% of eligible compensation, subject to Internal Revenue Code limitations, are matched by the Company with cash.

Defined Benefit Pension Plan

Through the SSR acquisition, the Company assumed a defined benefit pension plan. All accrued benefits under the defined benefit pension plan are currently frozen and the plan is closed to new participants. Participant benefits under the plan will not change with salary increases or additional years of service.

SSR pension benefit costs are developed from actuarial valuations. Inherent in these valuations are key assumptions, including the discount rate and expected long-term rate of return on plan assets. Material changes in its pension benefit costs may occur in the future due to changes in these assumptions, changes in the number of plan participants and changes in plan asset levels.

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

8. Employee Benefit and Incentive Compensation Plans (continued)

Defined Benefit Pension Plan (continued)

The measurement date used to determine pension benefit measures for the defined pension benefit plan is January 31, 2005, the closing date of the SSR acquisition. It should be noted that the measurement date on a going forward basis will be December 31 of each year.

Accrued pension costs are included in accrued compensation in the consolidated statement of financial condition. The following table presents the funded status of the plan:

	January 31, 2005
Funded status:	
Benefit obligation at measurement date	$ (3,732)
Fair value of plan assets	2,339
Funded status at measurement date	$ (1,393)

There are no reconciling items between the pension plan s funded status and accrued pension costs reflected in the Company s consolidated statement of financial condition at the measurement date. Pension costs incurred from the measurement date through June 30, 2005 consist of the following:

Interest cost	$ 80
Expected return on plan assets	(81)
Total period net pension income	$ (1)

Weighted-average assumptions used to determine benefit obligations at January 31, 2005:

Discount rate	5.25%
Expected long-term return on plan assets	8.50%
Rate of compensation increase	N/A

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

8. Employee Benefit and Incentive Compensation Plans (continued)

Defined Benefit Pension Plan (continued)

The weighted-average allocation of pension plan assets is as follows:

	January 31, 2005
Asset Category	
Equity	54.0%
Debt	41.0
Other	5.0
Total	100.0%

Plan assets consist primarily of listed domestic equity securities and U.S. government, agency and corporate debt securities held in two *BlackRock Funds*. Plan assets do not include common stock or any debt of BlackRock.

Target allocations of pension assets and investment options are currently being evaluated by the Company s Retirement Committee and will be revised from historical levels. The Company s Retirement Committee anticipates finalizing the pension plan s revised target allocations by December 31, 2005 and does not expect this revision to have a material impact on the Company s consolidated financial statements. Once finalized, the weighted average target allocation of pension plan assets will be included in the notes to the Company s consolidated financial statements.

The Company does not expect to make a contribution into the pension plan during 2005. The following benefit payments are expected to be paid:

Periods	
July 1, 2005 - December 31, 2005	$ 49
January 1, 2006 - December 31, 2006	100
January 1, 2007 - December 31, 2007	112
January 1, 2008 - December 31, 2008	127
January 1, 2009 - December 31, 2009	142
January 1, 2010 - December 31, 2014	843

PART I - FINANCIAL INFORMATION (continued)

Item 1. Financial Statements (continued)

9. Common Stock

BlackRock s class A common stock, $0.01 par value, authorized was 250,000,000 shares as of June 30, 2005 and December 31, 2004. BlackRock s class B common stock, $0.01 par value, authorized was 100,000,000 shares as of June 30, 2005 and December 31, 2004.

The Company s common stock issued and outstanding and related activity during the six month period ended June 30, 2005 consists of the following:

	Shares issued					
	Common shares		Treasury shares		Shares outstanding	
	Class		Class		Class	
	A	B	A	B	A	B
December 31, 2004	19,243,878	45,499,510	(270,998)	(806,667)	18,972,880	44,692,843
Conversion of class B stock to class A stock	52,093	(52,093)			52,093	(52,093)
Issuance of class A common stock	690,780		345,655		1,036,435	
Treasury stock transactions			(434,344)		(434,344)	
June 30, 2005	19,986,751	45,447,417	(359,687)	(806,667)	19,627,064	44,640,750

10. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Net income	$ 53,335	$ 47,996	$ 99,871	$ 103,203
Basic weighted-average shares outstanding	64,354,069	63,647,316	64,322,465	63,701,625

Dilutive potential shares from stock options	2,442,018	2,119,663	2,522,255	2,075,350
Dilutive weighted-average shares outstanding	66,796,087	65,766,979	66,844,720	65,776,975
Basic earnings per share	$ 0.83	$ 0.75	$ 1.55	$ 1.62
Diluted earnings per share	$ 0.80	$ 0.73	$ 1.49	$ 1.57

In the nine months ended June 30, 2018, we redeemed $1.039 billion of senior notes and debentures for a redemption price of $1.000 billion. As a result, we recognized a net pre-tax extinguishment gain of $25 million, net of $14 million of unamortized debt costs and transaction fees included in Other items, net in the Consolidated Statements of Earnings.

Our 5.875% junior subordinated debentures accrue interest at a fixed rate of 5.875% until February 28, 2022, on which date the rate will switch to a floating rate based on three-month LIBOR plus 3.895%, reset quarterly. Our 6.250% junior subordinated debentures accrue interest at a fixed rate of 6.250% until February 28, 2027, on which date the rate will switch to a floating rate based on three-month LIBOR plus 3.899%, reset quarterly. The junior subordinated debentures can be called by us at any time after the expiration of the fixed-rate period.

The total unamortized discount and issuance fees and expenses related to our notes and debentures outstanding was $435 million and $457 million as of June 30, 2018 and September 30, 2017, respectively. The fair value of our notes and debentures outstanding was approximately $10.2 billion as of June 30, 2018. The valuation of our publicly traded debt is based on quoted prices in active markets (Level 1 in the fair value hierarchy).

Credit Facility

As of June 30, 2018, there were no amounts outstanding under our $2.5 billion revolving credit facility due November 2019. The credit facility is used for general corporate purposes and to support commercial paper outstanding. The credit facility has one principal financial covenant that requires our interest coverage for the most recent four consecutive fiscal quarters to be at least 3.0x, which we met as of June 30, 2018.

Table of Contents
VIACOM INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

NOTE 4. PENSION BENEFITS
The components of net periodic benefit cost for our defined benefit pension plans, which are currently frozen to future benefit accruals, are set forth below.

Net Periodic Benefit Cost (in millions)	Quarter Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
Interest cost	$9	$ 8	$26	$24
Expected return on plan assets	(10)	(10)	(30)	(28)
Recognized actuarial loss	1	2	5	6
Net periodic benefit cost	$—	$ —	$1	$2

NOTE 5. REDEEMABLE NONCONTROLLING INTEREST
We are subject to a redeemable put option, payable in a foreign currency, with respect to an international subsidiary. The put option expires in December 2022 and is classified as Redeemable noncontrolling interest in the Consolidated Balance Sheets.

The activity reflected within redeemable noncontrolling interest is as follows:

Redeemable Noncontrolling Interest (in millions)	Nine Months Ended June 30,	
	2018	2017
Beginning balance	$248	$211
Net earnings	13	13
Distributions	(14)	(13)
Translation adjustment	(4)	(1)
Redemption value adjustment	2	(1)
Ending Balance	$245	$209

NOTE 6. COMMITMENTS AND CONTINGENCIES
Commitments
As more fully described in Note 11 of the 2017 Form 10-K, our commitments primarily consist of programming and talent commitments, operating and capital lease arrangements, and purchase obligations for goods and services. These arrangements result from our normal course of business and represent obligations that may be payable over several years.
Contingencies
We have certain indemnification obligations with respect to leases primarily associated with the previously discontinued operations of Famous Players Inc. (“Famous Players”). In addition, we have certain indemnities provided by the acquirer of Famous Players. These lease commitments amounted to approximately $151 million, and are recorded as a liability as of June 30, 2018. The amount of lease commitments varies over time depending on expiration or termination of individual underlying leases, or of the related indemnification obligation, and foreign exchange rates, among other things. We may also have exposure for certain other expenses related to the leases, such as property taxes and common area maintenance. We believe our accrual is sufficient to meet any future obligations based on our consideration of available financial information, the lessees’ historical performance in meeting their lease obligations and the underlying economic factors impacting the lessees’ business models.

Legal Matters

Litigation is inherently uncertain and always difficult to predict. However, based on our understanding and evaluation of the relevant facts and circumstances, we believe that the legal matter described below and other litigation to which we are a party are not likely, in the aggregate, to have a material adverse effect on our results of operations, financial position or operating cash flows.

Purported Derivative Action

In July 2016, a purported derivative action was commenced in the Delaware Chancery Court by a purported Viacom stockholder against Viacom and its directors. The complaint alleged that Viacom’s directors breached their fiduciary duties to

9

Table of Contents
VIACOM INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

Viacom in connection with compensation paid to Mr. Redstone and that these breaches permitted a waste of corporate assets and the unjust enrichment of Mr. Redstone. In October 2017, the Court granted Viacom's motion to dismiss the action. In May 2018, following an appeal by the plaintiff, the Delaware Supreme Court affirmed the dismissal.

NOTE 7. STOCKHOLDERS' EQUITY

The components of stockholders' equity are as follows:

Stockholders' Equity (in millions)	Nine Months Ended June 30, 2018 Total Viacom Stockholders' Equity	Noncontrolling Interests	Total Equity	Nine Months Ended June 30, 2017 Total Viacom Stockholders' Equity	Noncontrolling Interests	Total Equity
Beginning Balance	$6,035	$ 84	$6,119	$4,277	$ 53	$4,330
Net earnings	1,325	27	1,352	1,200	27	1,227
Other comprehensive loss [1]	(150)	(2)	(152)	(5)	—	(5)
Noncontrolling interests	(2)	(44)	(46)	1	(27)	(26)
Dividends declared	(243)	—	(243)	(240)	—	(240)
Equity-based compensation and other	41	—	41	176	—	176
Ending Balance	$7,006	$ 65	$7,071	$5,409	$ 53	$5,462

(1) The components of other comprehensive loss are net of tax expense of $15 million and $7 million for the nine months ended June 30, 2018 and 2017, respectively.

NOTE 8. RESTRUCTURING AND RELATED COSTS

In the second quarter of fiscal 2018, we launched a program of cost transformation initiatives to improve our margins, including an organizational realignment of support functions across Media Networks, new sourcing and procurement policies, real estate consolidation and technology enhancements. We recognized pre-tax restructuring-related costs of $15 million in the quarter, comprised of third-party professional services. In the nine months ended June 30, 2018, we recorded $200 million of restructuring and related costs. The charges, as detailed in the table below, included severance charges, exit costs principally resulting from vacating certain leased properties and related costs comprised of third-party professional services.

Restructuring and Related Costs (in millions)	Nine Months Ended June 30, 2018 Media Networks	Filmed Entertainment	Corporate	Total
Severance [1]	$123	$ —	$ —	$123
Exit costs	40	—	—	40
Other related costs	—	—	37	37
Total	$163	$ —	$ 37	$200

(1) Includes equity-based compensation expense of $6 million.

Our restructuring liability by reportable segment is as follows:

Restructuring Liability (in millions)	Media Networks	Filmed Entertainment	Corporate	Total
September 30, 2017	$ 119	$ 45	$ 44	$208
Accruals	157	—	—	157

Severance payments	(74)	(21)	(19)	(114)
Lease payments	(10)	—	—	(10)
June 30, 2018	$ 192	$ 24	$ 25	$241

As of June 30, 2018, of the remaining $241 million liability, $168 million is classified as a current liability in the Consolidated Balance Sheets, with the remaining $73 million classified as a noncurrent liability. We expect to complete our restructuring actions in fiscal 2019. Amounts classified as noncurrent are expected to be substantially paid through 2021, in accordance with applicable contractual terms.

Table of Contents
VIACOM INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

NOTE 9. EARNINGS PER SHARE

Basic earnings per common share is computed by dividing Net earnings attributable to Viacom by the weighted average number of common shares outstanding during the period. The determination of diluted earnings per common share includes the weighted average number of common shares plus the dilutive effect of equity awards based upon the application of the treasury stock method. Anti-dilutive common shares were excluded from the calculation of diluted earnings per common share.

The following table sets forth the weighted average number of common shares outstanding used in determining basic and diluted earnings per common share and anti-dilutive common shares:

Weighted Average Number of Common Shares Outstanding and Anti-dilutive Common Shares (in millions)	Quarter Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
Weighted average number of common shares outstanding, basic	402.8	402.0	402.6	399.1
Dilutive effect of equity awards	0.5	0.6	0.3	0.9
Weighted average number of common shares outstanding, diluted	403.3	402.6	402.9	400.0
Anti-dilutive common shares	18.9	16.8	19.2	14.7

NOTE 10. SUPPLEMENTAL CASH FLOW AND OTHER INFORMATION

Our supplemental cash flow information is as follows:

Supplemental Cash Flow Information (in millions)	Nine Months Ended June 30,	
	2018	2017
Cash paid for interest	$403	$455
Cash paid for income taxes	$95	$480

Cash paid for income taxes in the nine months ended June 30, 2018 reflects the benefits from a lower corporate United States (“U.S.”) income tax rate as a result of the Tax Cuts and Jobs Act enacted on December 22, 2017 and the retroactive reenactment of legislation allowing for accelerated tax deductions on certain qualified film and television productions.

Accounts Receivable

We had $493 million and $486 million of noncurrent trade receivables as of June 30, 2018 and September 30, 2017, respectively. Accounts receivables are principally related to long-term television license arrangements at Filmed Entertainment and subscription video-on-demand and other over-the-top arrangements at Media Networks. These amounts are included within Other assets - noncurrent in our Consolidated Balance Sheets. Such amounts are due in accordance with the underlying terms of the respective agreements with companies that are investment grade or with which we have historically done business under similar terms. We have determined that credit loss allowances are generally not considered necessary for these amounts.

Acquisitions

During the nine months ended June 30, 2018, the Company acquired WhoSay, a leading influence marketing firm, and VidCon, a host of conferences dedicated to online video, for total consideration of $70 million, net of cash acquired.

Investments

During the nine months ended June 30, 2018, we recognized an impairment loss of $46 million to write off certain cost method investments. We also completed the sale of a 1% equity interest in Viacom18 to our joint venture partner for $20 million, resulting in a gain of $16 million. The impairment charge and gain on asset sale are included in Other items, net in the Consolidated Statements of Earnings.

During the quarter ended June 30, 2017, we recognized an impairment loss of $10 million to write off a cost method investment. The impairment charge is included in Other items, net in the Consolidated Statements of Earnings. We also completed the sale of our 49.76% interest in EPIX, a premium entertainment network, to Metro-Goldwyn-Mayer. The sale resulted in proceeds of $593 million, net of transaction costs of $4 million, and a gain of $285 million. In addition, prior to the closing of the sale, EPIX paid a dividend, of which our pro rata share was $37 million.

Variable Interest Entities
In the normal course of business, we enter into joint ventures or make investments with business partners that support our underlying business strategy and provide us the ability to enter new markets to expand the reach of our brands, develop new programming and/or distribute our existing content. In certain instances, an entity in which we make an investment may qualify as a variable interest entity ("VIE"). In determining whether we are the primary beneficiary of a VIE, we assess whether we have the power to direct matters that most significantly impact the activities of the VIE and have the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE.

Our Consolidated Balance Sheets include amounts related to consolidated VIEs totaling $154 million in assets and $6 million in liabilities as of June 30, 2018, and $159 million in assets and $8 million in liabilities as of September 30, 2017. The consolidated VIEs' revenues, expenses and operating income were not significant for all periods presented.
NOTE 11. INCOME TAXES
The Tax Cuts and Jobs Act (the "Act") was enacted on December 22, 2017. The currently relevant provisions of the Act provide for a reduction of the federal corporate income tax rate from 35% to 21% and a "transition tax" to be levied on the deemed repatriation of indefinitely reinvested earnings of international subsidiaries. As a result of these factors, as well as our fiscal year-end, the federal statutory tax rate will decrease from 35% to a prorated rate of 24.5% for fiscal 2018. While the Act includes many provisions, those applicable to Viacom will be phased in and will not be fully effective until fiscal 2019.
As a result of the Act, provisional amounts have been recorded in accordance with SEC guidance provided in Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act, for the remeasurement of deferred tax assets and liabilities and the transition tax. For the nine months, we recognized a net discrete tax benefit of $223 million that reflects the impact of the Act on our deferred tax balances. In addition, a provisional expense of $4 million in the quarter and $69 million in the nine months has been recorded on a net basis for the one-time transition tax on the deemed repatriation of indefinitely reinvested earnings of our international subsidiaries. These amounts are provisional because certain aspects were based on estimates and assumptions where guidance has yet to be provided. As guidance is received from federal and state authorities, the outcome of these provisional amounts could further change.
No additional income taxes have been provided for any remaining undistributed international cash not subject to the transition tax or any additional outside basis differences as these amounts continue to be indefinitely reinvested outside the U.S. These amounts could be subject to approximately $100 million to $150 million of U.S. tax to the extent they are repatriated in the future.
Our effective income tax rate was 15.3% and 10.6% in the quarter and nine months ended June 30, 2018, respectively. A net discrete tax benefit of $47 million in the quarter and $196 million in the nine months, taken together with the discrete tax impact of the restructuring and related costs, investment impairments, and gain on debt extinguishment, reduced the effective income tax rate by 7.9 and 13.4 percentage points in the quarter and nine months, respectively. The net discrete tax benefit in the quarter was principally related to a tax accounting method change granted by the Internal Revenue Service and the release of tax reserves with respect to certain effectively settled tax positions. In addition to the items in the quarter, the net discrete tax benefit in the nine months was principally related to tax reform, as well as the measurement of the deferred tax balances from the retroactive reenactment of legislation allowing for accelerated tax deductions on certain qualified film and television productions.
Our effective income tax rate was 25.3% and 25.4% in the quarter and nine months ended June 30, 2017, respectively. A net discrete tax benefit of $53 million in the quarter and $72 million in the nine months, taken together with the discrete tax impact of the gain on sale of our investment in EPIX, restructuring and programming charges, the gain or loss on debt extinguishment and an investment impairment, reduced the effective income tax rate by 5.2 and 5.1 percentage points, respectively. The net discrete tax benefit in the quarter was principally related to the reversal of a

valuation allowance on capital loss carryforwards in connection with the sale of our investment in EPIX and the release of tax reserves with respect to certain effectively settled tax positions. In addition to the items in the quarter, the net discrete tax benefit in the nine months included the reversal of valuation allowances on net operating losses upon receipt of a favorable tax authority ruling.

NOTE 12. FAIR VALUE MEASUREMENTS

During the first fiscal quarter of 2018, an investment previously accounted for using the cost method was listed on a public exchange. As a result, we reclassified our investment as available-for-sale. The fair value of our available-for-sale securities was $46 million as of June 30, 2018, which is included within Other assets, noncurrent in our Consolidated Balance Sheets, as

Table of Contents
VIACOM INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

determined utilizing a market approach based on quoted market prices in active markets at period end (Level 1 in the fair value hierarchy).
The fair value of our foreign exchange contracts was a liability of $4 million as of June 30, 2018 and an asset of $7 million as of September 30, 2017, as determined utilizing a market-based approach (Level 2 in the fair value hierarchy). The notional value of all foreign exchange contracts was $665 million and $869 million as of June 30, 2018 and September 30, 2017, respectively. As of June 30, 2018, $275 million related to our foreign currency balances and $390 million related to future production costs. As of September 30, 2017, $287 million related to our foreign currency balances and $582 million related to future production costs.
NOTE 13. REPORTABLE SEGMENTS
The following tables set forth our financial performance by reportable segment. Our reportable segments have been determined in accordance with our internal management structure. We manage our operations through two reportable segments: (i) Media Networks and (ii) Filmed Entertainment. Typical intersegment transactions include the purchase of advertising by the Filmed Entertainment segment on Media Networks' properties and the licensing of Filmed Entertainment's feature film and television content by Media Networks. The elimination of such intercompany transactions in the Consolidated Financial Statements is included within eliminations in the tables below.

Our measure of segment performance is adjusted operating income. Adjusted operating income is defined as operating income, before equity-based compensation and certain other items identified as affecting comparability, when applicable.

Revenues by Segment (in millions)	Quarter Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
Media Networks	$2,502	$2,560	$7,491	$7,543
Filmed Entertainment	772	847	2,057	2,500
Eliminations	(37)	(43)	(90)	(99)
Total revenues	$3,237	$3,364	$9,458	$9,944

Adjusted Operating Income/(Loss) (in millions)	Quarter Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
Media Networks	$799	$870	$2,418	$2,604
Filmed Entertainment	44	9	(77)	(237)
Corporate expenses	(60)	(58)	(175)	(163)
Eliminations	(6)	(8)	(2)	(1)
Equity-based compensation	(10)	(8)	(39)	(38)
Programming charges (1)	—	(38)	—	(144)
Restructuring and related costs (2)	(15)	(21)	(200)	(237)
Operating income	752	746	1,925	1,784
Interest expense, net	(138)	(155)	(428)	(469)
Equity in net earnings of investee companies	2	47	5	78
Gain on sale of EPIX	—	285	—	285
Other items, net	(9)	(2)	(15)	(37)
Earnings from continuing operations before provision for income taxes	$607	$921	$1,487	$1,641

(1) Included in Operating expenses in the Consolidated Statements of Earnings.
(2) Includes equity-based compensation expense of $6 million in the nine months ended June 30, 2018. Includes expense reduction of $6 million in the quarter ended June 30, 2017 due to modification of an equity award and equity-based compensation expense of $14 million in the nine months ended June 30, 2017.

Table of Contents
VIACOM INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

Total Assets (in millions)	June 30, 2018	September 30, 2017
Media Networks	$17,456	$ 17,984
Filmed Entertainment	5,396	6,188
Corporate/Eliminations	309	(474)
Total assets	$23,161	$ 23,698

Revenues by Component (in millions)	Quarter Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
Advertising	$1,191	$1,235	$3,604	$3,638
Affiliate	1,153	1,190	3,403	3,490
Feature film	731	781	1,917	2,244
Ancillary	199	201	624	671
Eliminations	(37)	(43)	(90)	(99)
Total revenues	$3,237	$3,364	$9,458	$9,944

NOTE 14. RELATED PARTY TRANSACTIONS
National Amusements, Inc. (“National Amusements”), directly and indirectly, is the controlling stockholder of both Viacom and CBS Corporation (“CBS”). National Amusements owns shares in Viacom representing approximately 79.8% of the voting interest in Viacom and approximately 10% of Viacom’s combined common stock. National Amusements is controlled by Sumner M. Redstone, our Chairman Emeritus, who is the Chairman and Chief Executive Officer of National Amusements, through the Sumner M. Redstone National Amusements Trust (the “SMR Trust”), which owns shares in National Amusements representing 80% of the voting interest of National Amusements. The shares representing the other 20% of the voting interest of National Amusements are held through a trust controlled by Shari E. Redstone, who is Mr. Redstone’s daughter and the non-executive Vice Chair of Viacom’s Board of Directors and the President and a member of the Board of Directors of National Amusements. The shares of National Amusements held by the SMR Trust are voted solely by Mr. Redstone until such time as his incapacity or death. Upon Mr. Redstone’s incapacity or death, (1) Ms. Redstone will also become a trustee of the SMR Trust and (2) the shares of National Amusements held by the SMR Trust will be voted by the trustees of the SMR Trust. The current trustees include Mr. Redstone and David R. Andelman, a member of the boards of directors of National Amusements and CBS. The current Board of Directors of National Amusements includes Mr. Redstone, Ms. Redstone and Mr. Andelman. In addition, Mr. Redstone serves as Chairman Emeritus of CBS and Ms. Redstone serves as non-executive Vice Chair of CBS.
Transactions between Viacom and related parties are overseen by our Governance and Nominating Committee.
Viacom and National Amusements Related Party Transactions
National Amusements licenses films in the ordinary course of business for its motion picture theaters from all major studios, including Paramount. During the nine months ended June 30, 2018 and 2017, Paramount earned revenues from National Amusements in connection with these licenses in the aggregate amount of approximately $5 million in both periods.
Viacom and CBS Corporation Related Party Transactions
In the ordinary course of business, we are involved in transactions with CBS and its various businesses that result in the recognition of revenues and expenses by us. Transactions with CBS are settled in cash.

Our Filmed Entertainment segment earns revenues and recognizes expenses associated with its distribution of certain television products into the home entertainment market on behalf of CBS. Pursuant to its agreement with CBS, Paramount distributes CBS's library of television and other content on DVD and Blu-ray disc on a worldwide basis. Under the terms of the agreement, Paramount is entitled to retain a fee based on a percentage of gross receipts and is generally responsible for all out-of-pocket costs, which are recoupable prior to any participation amounts paid. Paramount also earns revenues from CBS through leasing of studio space and licensing of certain film products.

Our Media Networks segment recognizes advertising revenues and purchases television programming from CBS. The cost of the programming purchases is initially recorded as acquired program rights inventory and amortized over the estimated period that revenues will be generated.

Table of Contents
VIACOM INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(continued)

Both of our segments recognize advertising expenses related to the placement of advertisements with CBS.
The following table summarizes the transactions with CBS as included in our Consolidated Financial Statements:

CBS Related Party Transactions (in millions)	Quarter Ended June 30, 2018	2017	Nine Months Ended June 30, 2018	2017
Consolidated Statements of Earnings				
Revenues	$21	$ 25	$90	$ 99
Operating expenses	$25	$ 39	$110	$ 129

	June 30, 2018	September 30, 2017
Consolidated Balance Sheets		
Accounts receivable	$7	$ 5
Participants' share and residuals, current	$69	$ 69
Program obligations, current	37	54
Program obligations, noncurrent	38	49
Other liabilities	1	1
Total due to CBS	$145	$ 173

Other Related Party Transactions
In the ordinary course of business, we are involved in related party transactions with equity investees. These related party transactions primarily relate to the provision of advertising services, licensing of film and programming content, distribution of films and provision of certain administrative support services, for which the impact on our Consolidated Financial Statements is as follows:

Other Related Party Transactions (in millions)	Quarter Ended June 30, 2018	2017	Nine Months Ended June 30, 2018	2017
Consolidated Statements of Earnings				
Revenues	$7	$15	$38	$ 110
Operating expenses	$3	$2	$8	$ 59
Selling, general and administrative	$—	$(1)	$—	$ (7)

	June 30, 2018	September 30, 2017
Consolidated Balance Sheets		
Accounts receivable	$41	$ 49
Other assets	3	5
Total due from other related parties	$44	$ 54
Accounts payable	$6	$ 8
Other liabilities	5	—
Total due to other related parties	$11	$ 8

All other related party transactions are not material in the periods presented.

15

Item 2. Management’s Discussion and Analysis of Results of Operations and Financial Condition.
Management’s discussion and analysis of results of operations and financial condition is provided as a supplement to and should be read in conjunction with the unaudited consolidated financial statements and related notes to enhance the understanding of our results of operations, financial condition and cash flows. Additional context can also be found in our Form 10-K for the fiscal year ended September 30, 2017, as filed with the Securities and Exchange Commission (“SEC”) on November 16, 2017 (the “2017 Form 10-K”). References in this document to “Viacom,” “Company,” “we,” “us” and “our” mean Viacom Inc. and our consolidated subsidiaries, unless the context requires otherwise.
Significant components of management’s discussion and analysis of results of operations and financial condition include:
Overview: The overview section provides a summary of our business.
Results of Operations: The results of operations section provides an analysis of our results on a consolidated and reportable segment basis for the quarter and nine months ended June 30, 2018, compared with the quarter and nine months ended June 30, 2017. In addition, we provide a discussion of items that affect the comparability of our results of operations.
Liquidity and Capital Resources: The liquidity and capital resources section provides a discussion of our cash flows for the nine months ended June 30, 2018, compared with the nine months ended June 30, 2017, and of our outstanding debt, commitments and contingencies existing as of June 30, 2018.
OVERVIEW
Summary
We are home to premier global media brands that create compelling entertainment content - including television programs, motion pictures, short-form content, games, consumer products, podcasts, live events and social media experiences - for audiences in 183 countries on various platforms and devices.
We operate through two reportable segments: Media Networks and Filmed Entertainment. Our measure of segment performance is adjusted operating income. We define adjusted operating income for our segments as operating income, before equity-based compensation and certain other items identified as affecting comparability, when applicable. Equity-based compensation is excluded from our segment measure of performance since it is set and approved by the Compensation Committee of Viacom’s Board of Directors in consultation with corporate executive management, and is included as a component of consolidated adjusted operating income.
Our Media Networks segment provides high-quality entertainment content, services and related branded products for consumers in targeted demographics attractive to advertisers, content distributors and retailers. Increasingly, our advertising and marketing services are enhanced by our advanced marketing solutions portfolio, which both utilizes advanced addressable video inventory to allow dynamic ad insertion and advanced targeting, and provides our marketing partners with a variety of consulting, creative services and associated activations. We create, acquire and distribute programming and other content for our audiences worldwide, distributed through cable, satellite and broadband services, on linear, streaming and on-demand bases, via a variety of owned and third party platforms, including television services, branded apps and sites, for viewing on a wide range of devices such as televisions, PCs, tablets, smartphones and other connected devices. The Media Networks segment also licenses its brands for consumer products and recreational opportunities, and produces live events.
Our Media Networks segment operates globally as Viacom Media Networks through three brand groups, our Global Entertainment Group, the Nickelodeon Group and BET Networks. Globally, our program services reach approximately 4.3 billion cumulative television subscribers in 183 countries and 43 languages, via 300 locally programmed and operated television channels, including Nickelodeon®, Nick Jr.®, MTV®, BET®, Comedy Central®, Paramount Network™ (formerly Spike® in the United States (“U.S.”)), VH1®, TV Land®, CMT®, Logo® and our program services created specifically for international audiences, such as British public service broadcaster Channel 5® (in the United Kingdom), Telefe® (in Argentina), Colors® (in India) and Paramount Channel™ (in a variety of territories). “Cumulative television subscribers” is an aggregation of the total subscribers to each Viacom owned and operated, joint venture and licensee channel.
Our Filmed Entertainment segment develops, produces, finances, acquires and distributes motion pictures, television programming and other entertainment content under the Paramount Pictures®, Paramount Players™, Paramount Animation® and Paramount Television™ divisions, in various markets and media worldwide, for itself and for third

parties. It partners on various projects with key Viacom franchises, including Nickelodeon Movies, MTV Films and BET.

Media Networks

Our Media Networks segment generates revenues in three categories: (i) the sale of advertising and marketing services, (ii) affiliate fees from distributors of our programming and program services and (iii) ancillary activities such as consumer products.

Media Networks segment expenses consist of operating expenses, selling, general and administrative ("SG&A") expenses and depreciation and amortization. Operating expenses are comprised of costs related to original and acquired programming, including programming amortization, expenses associated with the distribution of home entertainment products and consumer products licensing, participations and residuals, royalties, marketing services expenses and other costs of sales. SG&A expenses consist primarily of employee compensation, marketing, research and professional service fees and facility and occupancy costs. Depreciation and amortization expenses reflect depreciation of fixed assets, including transponders financed under capital leases, and amortization of finite-lived intangible assets.

Filmed Entertainment

Our Filmed Entertainment segment generates revenues in four categories: (i) the release and/or distribution of motion pictures theatrically, (ii) the release and/or distribution of film and television product through home entertainment, (iii) the licensing of film and television product to television and digital platforms and (iv) other ancillary activities. Filmed Entertainment segment expenses consist of operating expenses, SG&A expenses and depreciation and amortization. Operating expenses principally include the amortization of costs of our released feature films and television programming (including participations and residuals), print and advertising expenses and other distribution costs. SG&A expenses include employee compensation, facility and occupancy costs, professional service fees and other overhead costs. Depreciation and amortization expense principally consists of depreciation of fixed assets.

RESULTS OF OPERATIONS

Summary Consolidated Results of Operations

	Quarter Ended June 30,		Better/(Worse)		Nine Months Ended June 30,		Better/(Worse)	
(in millions, except per share amounts)	2018	2017	$	%	2018	2017	$	%
GAAP								
Revenues	$3,237	$3,364	$(127)	(4)%	$9,458	$9,944	$(486)	(5)%
Operating income	752	746	6	1	1,925	1,784	141	8
Net earnings from continuing operations attributable to Viacom	511	680	(169)	(25)	1,302	1,197	105	9
Diluted earnings per share from continuing operations	1.27	1.69	(0.42)	(25)	3.23	2.99	0.24	8
Non-GAAP*								
Adjusted operating income	$767	$805	$(38)	(5)%	$2,125	$2,165	$(40)	(2)%
Adjusted net earnings from continuing operations attributable to Viacom	475	471	4	1	1,259	1,201	58	5
Adjusted diluted earnings per share from continuing operations	1.18	1.17	0.01	1	3.12	3.00	0.12	4

* See "Factors Affecting Comparability" section below for a reconciliation of our reported results to our adjusted results, which are calculated on a non-GAAP basis.

Factors Affecting Comparability

The Consolidated Financial Statements reflect our results of operations, financial position and cash flows reported in accordance with accounting principles generally accepted in the United States of America ("GAAP"). Our results have been affected by certain items identified as affecting comparability. Accordingly, when applicable, we use non-GAAP measures such as consolidated adjusted operating income, adjusted earnings from continuing operations before provision for income taxes, adjusted provision for income taxes, adjusted net earnings from continuing operations

attributable to Viacom and adjusted diluted earnings per share (“EPS”) from continuing operations, among other measures, to evaluate our actual operating performance and for planning and forecasting of future periods. We believe that the adjusted results provide relevant and useful information for investors because they clarify our actual operating performance, make it easier to compare our results with those of other companies and allow investors to review performance in the same way as our management. Since these are not measures of performance calculated in accordance with GAAP, they should not be considered in isolation of, or as a substitute for, operating income, earnings from continuing operations before provision for income taxes, provision for income taxes, net earnings from continuing operations attributable to Viacom and diluted EPS from continuing operations as indicators of operating performance and they may not be comparable to similarly titled measures employed by other companies.

The following tables reconcile our reported results (GAAP) to our adjusted results (non-GAAP) for the quarter and nine months ended June 30, 2018 and 2017. The tax impacts included in the tables below have been calculated using the rates applicable to the adjustments presented.

(in millions, except per share amounts)

	Quarter Ended June 30, 2018				
	Operating Income	Earnings from Continuing Operations Before Provision for Income Taxes	Provision for Income Taxes	Net Earnings from Continuing Operations Attributable to Viacom	Diluted EPS from Continuing Operations
Reported results (GAAP)	$752	$ 607	$ 93	$ 511	$ 1.27
Factors Affecting Comparability:					
Restructuring and related costs	15	15	4	11	0.03
Discrete tax benefit	—	—	47	(47)	(0.12)
Adjusted results (Non-GAAP)	$767	$ 622	$ 144	$ 475	$ 1.18

(in millions, except per share amounts)

	Nine Months Ended June 30, 2018				
	Operating Income	Earnings from Continuing Operations Before Provision for Income Taxes	Provision for Income Taxes	Net Earnings from Continuing Operations Attributable to Viacom	Diluted EPS from Continuing Operations
Reported results (GAAP)	$1,925	$ 1,487	$ 158	$ 1,302	$ 3.23
Factors Affecting Comparability:					
Restructuring and related costs	200	200	48	152	0.38
Gain on extinguishment of debt	—	(25)	(6)	(19)	(0.05)
Gain on asset sale	—	(16)	—	(16)	(0.04)
Investment impairments	—	46	10	36	0.09
Discrete tax benefit	—	—	196	(196)	(0.49)
Adjusted results (Non-GAAP)	$2,125	$ 1,692	$ 406	$ 1,259	$ 3.12

(in millions, except per share amounts)

	Quarter Ended June 30, 2017				
	Operating Income	Earnings from	Provision for	Net Earnings from	Diluted EPS from

		Continuing Operations Before Provision for Income Taxes	Income Taxes	Continuing Operations Attributable to Viacom	Continuing Operations
Reported results (GAAP)	$746	$ 921	$ 233	$ 680	$ 1.69
Factors Affecting Comparability:					
Restructuring and programming charges	59	59	21	38	0.09
Gain on extinguishment of debt	—	(16)	(5)	(11)	(0.03)
Gain on sale of EPIX	—	(285)	(96)	(189)	(0.47)
Investment impairment	—	10	4	6	0.01
Discrete tax benefit	—	—	53	(53)	(0.12)
Adjusted results (Non-GAAP)	$805	$ 689	$ 210	$ 471	$ 1.17

18

Table of Contents

(in millions, except per share amounts)	Nine Months Ended June 30, 2017				
	Operating Income	Earnings from Continuing Operations Before Provision for Income Taxes	Provision for Income Taxes	Net Earnings from Continuing Operations Attributable to Viacom	Diluted EPS from Continuing Operations
Reported results (GAAP)	$1,784	$ 1,641	417	$ 1,197	$ 2.99
Factors Affecting Comparability:					
Restructuring and programming charges	381	381	135	246	0.62
Loss on extinguishment of debt	—	20	7	13	0.03
Gain on sale of EPIX	—	(285)	(96)	(189)	(0.47)
Investment impairment	—	10	4	6	0.02
Discrete tax benefit	—	—	72	(72)	(0.19)
Adjusted results (Non-GAAP)	$2,165	$ 1,767	$ 539	$ 1,201	$ 3.00

Restructuring and related costs: In the second quarter of fiscal 2018, we launched a program of cost transformation initiatives to improve our margins, including an organizational realignment of support functions across Media Networks, new sourcing and procurement policies, real estate consolidation and technology enhancements. We recognized pre-tax restructuring-related costs of $15 million in the quarter, comprised of third-party professional services. In the nine months ended June 30, 2018, we recorded $200 million of restructuring and related costs. The charges, as detailed in the table below, included severance charges, exit costs principally resulting from vacating certain leased properties and related costs comprised of third-party professional services.
In connection with completing our cost transformation initiatives, we expect to incur additional restructuring-related costs in the fourth fiscal quarter of approximately $20 million, and additional exit costs in the first half of fiscal 2019 of approximately $25 million. We expect our restructuring activities to give rise to approximately $100 million of savings in fiscal 2018, and to result in approximately $300 million of run-rate savings, the benefit of which will be phased in through fiscal 2020.

Restructuring and Related Costs (in millions)	Nine Months Ended June 30, 2018			
	Media Networks	Filmed Entertainment	Corporate	Total
Severance	$123	$ —	$ —	$123
Exit costs	40	—	—	40
Other related costs	—	—	37	37
Total	$163	$ —	$ 37	$200

We recognized pre-tax restructuring and programming charges of $59 million and $381 million in the quarter and nine months ended June 30, 2017, respectively, resulting from the execution of our flagship brand strategy and strategic initiatives at Paramount.

The following table presents the restructuring and programming charges incurred in the quarter and nine months ended June 30, 2017 by reportable segment:

Restructuring and Programming Charges (in millions)	Quarter Ended June 30, 2017				Nine Months Ended June 30, 2017			
	Media Networks	Filmed Entertainment	Corporate	Total	Media Networks	Filmed Entertainment	Corporate	Total
Severance	$12	$ 2	$ —	$ 14	$142	$ 50	$ 20	$212
Asset impairment	4	—	—	4	22	—	—	22
Lease termination	—	3	—	3	—	3	—	3
Restructuring	16	5	—	21	164	53	20	237
Programming	7	31	—	38	113	31	—	144
Total	$23	$ 36	$ —	$ 59	$277	$ 84	$ 20	$381

19

Table of Contents

Gain/loss on extinguishment of debt: We redeemed senior notes and debentures totaling $1.039 billion in the nine months ended June 30, 2018. As a result, we recognized a pre-tax extinguishment gain of $25 million included within Other items, net in the Consolidated Statements of Earnings.
We redeemed senior notes and debentures totaling $3.3 billion in the nine months ended June 30, 2017, of which $1.0 billion was redeemed in the quarter ended June 30, 2017. As a result of these transactions, we recognized a pre-tax extinguishment gain of $16 million in the quarter ended June 30, 2017 and a pre-tax extinguishment loss of $20 million in the nine months ended June 30, 2017, included within Other items, net in the Consolidated Statements of Earnings.
Gain on asset sale: We completed the sale of a 1% equity interest in Viacom18 to our joint venture partner for $20 million, resulting in a gain of $16 million in the nine months ended June 30, 2018, included within Other items, net in the Consolidated Statements of Earnings.
Gain on sale of EPIX: During the quarter ended June 30, 2017, we completed the sale of our 49.76% interest in EPIX, resulting in a gain of $285 million.
Investment impairments: We recognized impairment losses of $46 million in the nine months ended June 30, 2018 and $10 million in the quarter and nine months ended June 30, 2017, included within Other items, net in the Consolidated Statements of Earnings, resulting from the write-off of certain cost method investments.
Discrete taxes: The net discrete tax benefit in the quarter ended June 30, 2018 was principally related to a tax accounting method change granted by the Internal Revenue Service and the release of tax reserves with respect to certain effectively settled tax positions. In addition to the items in the quarter, the net discrete tax benefit in the nine months ended June 30, 2018 was principally related to tax reform, as well as the measurement of the deferred tax balances from the retroactive reenactment of legislation allowing for accelerated tax deductions on certain qualified film and television productions.
The net discrete tax benefit in the quarter ended June 30, 2017 was principally related to the reversal of a valuation allowance on capital loss carryforwards in connection with the sale of our investment in EPIX and the release of tax reserves with respect to certain effectively settled tax positions. In addition to the items in the quarter, the net discrete tax benefit in the nine months ended June 30, 2017 included the reversal of valuation allowances on net operating losses upon receipt of a favorable tax authority ruling.

Consolidated Results of Operations

The consolidated results discussed below should be read in conjunction with the "Segment Results of Operations" section.

Revenues

Worldwide revenues decreased $127 million, or 4%, to $3.237 billion in the quarter and $486 million, or 5%, to $9.458 billion in the nine months ended June 30, 2018. Filmed Entertainment revenues decreased $75 million, or 9%, in the quarter and $443 million, or 18%, in the nine months, reflecting the number and mix of released theatrical and home entertainment titles in each period, partially offset by increased revenues from Paramount Television product. Media Networks revenues decreased $58 million, or 2%, in the quarter and $52 million, or 1%, in the nine months, driven by lower affiliate and advertising revenues, partially offset by increased ancillary revenues.

Expenses

Total expenses decreased $133 million, or 5%, to $2.485 billion in the quarter and $627 million, or 8%, to $7.533 billion in the nine months ended June 30, 2018. Filmed Entertainment expenses decreased $110 million, or 13%, in the quarter and $603 million, or 22%, in the nine months, primarily driven by lower operating expenses. Media Networks expenses increased $13 million, or 1%, in the quarter, driven by higher operating expenses, partially offset by lower SG&A expenses, and $134 million, or 3%, in the nine months, driven by higher operating and SG&A expenses. The quarter and nine months ended June 30, 2018 include restructuring and related costs of $15 million and $200 million, respectively, compared with restructuring and programming charges of $59 million and $381 million in

the quarter and nine months ended June 30, 2017, respectively.

Operating

Operating expenses decreased $107 million, or 6%, to $1.681 billion in the quarter and $626 million, or 11%, to $4.925 billion in the nine months. Consolidated operating expenses included programming charges of $38 million and $144 million in the quarter and nine months ended June 30, 2017, respectively. Filmed Entertainment operating expenses decreased $100 million, or 13%, in the quarter and $606 million, or 25%, in the nine months. Media Networks operating expenses increased $28 million, or 3%, in the quarter and $115 million, or 4%, in the nine months.

Table of Contents

Selling, General and Administrative

SG&A expenses decreased $18 million, or 2%, to $738 million in the quarter and increased $44 million, or 2%, to $2.249 billion in the nine months. SG&A costs include a 2-percentage point benefit of cost savings from our restructuring activities in both the quarter and nine months. Media Networks SG&A expenses decreased $15 million, or 2%, in the quarter and increased $23 million, or 1%, in the nine months. Filmed Entertainment SG&A expenses decreased $8 million, or 9%, in the quarter and increased $8 million, or 3%, in the nine months.

Restructuring and Related Costs

As discussed in "Factors Affecting Comparability", restructuring and related costs of $15 million and $200 million were recognized in the quarter and nine months ended June 30, 2018, respectively, and restructuring charges of $21 million and $237 million were recognized in the quarter and nine months ended June 30, 2017, respectively.

Operating Income

Operating income increased $6 million, or 1%, to $752 million in the quarter and $141 million, or 8%, to $1.925 billion in the nine months ended June 30, 2018, reflecting the operating results discussed above. Excluding the items discussed in "Factors Affecting Comparability", adjusted operating income decreased $38 million, or 5%, to $767 million in the quarter and $40 million, or 2%, to $2.125 billion in the nine months. Media Networks adjusted operating income decreased $71 million, or 8%, in the quarter and $186 million, or 7%, in the nine months. Filmed Entertainment adjusted operating results improved by $35 million, or 389%, in the quarter and $160 million, or 68%, in the nine months. Corporate expenses increased $2 million, or 3%, in the quarter and $12 million, or 7%, in the nine months, reflecting increased costs for professional services.

Income Taxes

The Tax Cuts and Jobs Act (the "Act") was enacted on December 22, 2017. The currently relevant provisions of the Act provide for a reduction of the federal corporate income tax rate from 35% to 21% and a "transition tax" to be levied on the deemed repatriation of indefinitely reinvested earnings of international subsidiaries. As a result of these factors, as well as our fiscal year-end, the federal statutory tax rate will decrease from 35% to a prorated rate of 24.5% for fiscal 2018. While the Act includes many provisions, those applicable to Viacom will be phased in and will not be fully effective until fiscal 2019.

Our effective income tax rate was 15.3% and 10.6% in the quarter and nine months ended June 30, 2018, respectively. A net discrete tax benefit of $47 million in the quarter and $196 million in the nine months, taken together with the discrete tax impact of the other items discussed in "Factors Affecting Comparability", reduced the effective income tax rate by 7.9 and 13.4 percentage points in the quarter and nine months, respectively. Excluding the impact of these items, our adjusted effective income tax rate was 23.2% in the quarter and 24.0% in the nine months, a decline of 7.3 and 6.5 percentage points, respectively, from the prior year period, principally related to the enactment of the Act.

Our effective income tax rate was 25.3% and 25.4% in the quarter and nine months ended June 30, 2017, respectively. A net discrete tax benefit of $53 million in the quarter and $72 million in the nine months, taken together with the discrete tax impact of the other items discussed in "Factors Affecting Comparability", reduced the effective income tax rate by 5.2 and 5.1 percentage points, respectively. Excluding the impact of these items, our adjusted effective income tax rate was 30.5% in both the quarter and nine months.

Net Earnings from Continuing Operations Attributable to Viacom

Net earnings from continuing operations attributable to Viacom decreased $169 million, or 25%, to $511 million in the quarter, primarily due to the gain on sale of our investment in EPIX in the prior year partially offset by the impact of the Act on our income tax provision. Net earnings from continuing operations attributable to Viacom increased $105 million, or 9%, to $1.302 billion in the nine months, principally due to the impact of the Act on our income tax provision, higher operating income, the impact of debt extinguishment and lower interest expense, partially offset by the impact of the gain on the sale of EPIX in the prior year and lower equity in net earnings of investee companies. Excluding the items discussed in "Factors Affecting Comparability", adjusted net earnings from continuing operations

attributable to Viacom increased $4 million, or 1%, to $475 million in the quarter and $58 million, or 5%, to $1.259 billion in the nine months.

Diluted Earnings Per Share from Continuing Operations

Diluted EPS from continuing operations decreased $0.42 per diluted share to $1.27 in the quarter and increased $0.24 per diluted share to $3.23 in the nine months, reflecting the impact of net earnings. Excluding the items discussed in "Factors Affecting Comparability", adjusted diluted EPS from continuing operations increased $0.01 per diluted share to $1.18 in the quarter and $0.12 per diluted share to $3.12 in the nine months.

21

Table of Contents
Management's Discussion and Analysis
of Results of Operations and Financial Condition
(continued)

Segment Results of Operations
Transactions between reportable segments are accounted for as third-party arrangements for the purposes of presenting segment results of operations. Typical intersegment transactions include the purchase of advertising by the Filmed Entertainment segment on Media Networks' properties and the licensing of Filmed Entertainment's feature film and television content by Media Networks.
Media Networks

	Quarter Ended June 30,		Better/(Worse)		Nine Months Ended June 30,		Better/(Worse)	
(in millions)	2018	2017	$	%	2018	2017	$	%
Revenues by Component								
Advertising	$1,191	$1,235	$(44)	(4)%	$3,604	$3,638	$(34)	(1)%
Affiliate	1,153	1,190	(37)	(3)	3,403	3,490	(87)	(2)
Ancillary	158	135	23	17	484	415	69	17
Total revenues by component	$2,502	$2,560	$(58)	(2)%	$7,491	$7,543	$(52)	(1)%
Expenses								
Operating	$1,072	$1,044	$(28)	(3)%	$3,165	$3,050	$(115)	(4)%
Selling, general and administrative	589	604	15	2	1,781	1,758	(23)	(1)
Depreciation and amortization	42	42	—	—	127	131	4	3
Total expenses	$1,703	$1,690	$(13)	(1)%	$5,073	$4,939	$(134)	(3)%
Adjusted Operating Income	$799	$870	$(71)	(8)%	$2,418	$2,604	$(186)	(7)%

Revenues
Worldwide revenues decreased $58 million, or 2%, to $2.502 billion and $52 million, or 1%, to $7.491 billion in the quarter and nine months ended June 30, 2018, respectively. Domestic revenues decreased $45 million, or 2%, to $1.993 billion in the quarter and $224 million, or 4%, to $5.785 billion in the nine months, driven by lower affiliate and advertising revenues, partially offset by increased ancillary revenues. International revenues decreased $13 million, or 2%, to $509 million in the quarter. Excluding a 2-percentage point unfavorable impact from foreign exchange, international revenues were substantially flat in the quarter. International revenues increased $172 million, or 11%, to $1.706 billion in the nine months. Excluding a 4-percentage point favorable impact from foreign exchange, international revenues increased 7% in the nine months, driven by increases across all revenue streams and a 2-percentage point favorable impact from the acquisition of Televisión Federal S.A. ("Telefe").
Advertising
Worldwide advertising revenues decreased $44 million, or 4%, to $1.191 billion in the quarter and $34 million, or 1%, to $3.604 billion in the nine months. Worldwide advertising revenues include a 2-percentage point unfavorable impact from foreign exchange in the quarter. Domestic advertising revenues decreased $33 million, or 3%, to $922 million in the quarter and $117 million, or 4%, to $2.700 billion in the nine months, principally reflecting lower linear impressions partially offset by higher pricing and growth in revenues from advanced marketing solutions, which increased 33% in both the quarter and nine months. International advertising revenues decreased $11 million, or 4%, to $269 million in the quarter. Excluding a 5-percentage point unfavorable impact from foreign exchange, international advertising revenues increased 1%. International advertising revenues increased $83 million, or 10%, to $904 million in the nine months. Excluding a 3-percentage point favorable impact from foreign exchange, international advertising revenues increased 7%, primarily driven by a 4-percentage point favorable impact from the acquisition of Telefe, as well as continued growth at Telefe after the acquisition.
Affiliate

Worldwide affiliate revenues decreased $37 million, or 3%, to $1.153 billion in the quarter and $87 million, or 2%, to $3.403 billion in the nine months. Domestic affiliate revenues decreased $34 million, or 3%, to $978 million in the quarter, due to the lapping of a subscription video-on-demand agreement renewal in the prior year quarter. Subscriber declines were substantially offset by contractual rate increases. In the nine months, domestic affiliate revenues decreased $153 million, or 5%, to $2.819 billion, primarily driven by subscriber declines, which were partially offset by contractual rate increases. Rate increases were negatively impacted in the nine months by renewal rate resets with certain distributors. International affiliate revenues decreased $3 million, or 2%, to $175 million in the quarter, reflecting lower subscription video-on-demand revenues, partially offset by growth in linear revenues. In the nine months, international revenues increased $66 million, or 13%, to $584 million.

Table of Contents

Excluding a 5-percentage point favorable impact from foreign exchange, international affiliate revenues increased 8% in the nine months, primarily driven by increased subscription video-on-demand and other over-the-top revenues.

Ancillary

Worldwide ancillary revenues increased $23 million, or 17%, to $158 million in the quarter and $69 million, or 17%, to $484 million in the nine months, driven by increased consumer product, recreation and live event revenues. Worldwide ancillary revenues include a 3-percentage point favorable impact from foreign exchange in the nine months. Domestic ancillary revenues increased $22 million, or 31%, to $93 million in the quarter and $46 million, or 21%, to $266 million in the nine months, benefiting from SpongeBob SquarePants: The Broadway Musical and higher consumer product revenues. International ancillary revenues increased $1 million, or 2%, to $65 million in the quarter and $23 million, or 12%, to $218 million in the nine months. Excluding a 5-percentage point favorable impact from foreign exchange, international ancillary revenues increased 7% in the nine months.

Expenses

Media Networks segment expenses increased $13 million, or 1%, to $1.703 billion and $134 million, or 3%, to $5.073 billion in the quarter and nine months ended June 30, 2018, respectively.

Operating

Operating expenses increased $28 million, or 3%, to $1.072 billion in the quarter and $115 million, or 4%, to $3.165 billion in the nine months. Programming costs increased $19 million, or 2%, in the quarter and $69 million, or 3%, in the nine months, reflecting our continued investment in original content. Distribution and other expenses increased $9 million, or 6%, in the quarter and $46 million, or 13%, in the nine months, primarily driven by costs related to growth initiatives.

Selling, General and Administrative

SG&A expenses decreased $15 million, or 2%, to $589 million in the quarter, primarily driven by cost savings from our restructuring initiatives, and increased $23 million, or 1%, to $1.781 billion in the nine months, driven by increased advertising and promotional costs for the launch of Paramount Network. SG&A costs include a 3-percentage point benefit of savings in both the quarter and nine months.

Adjusted Operating Income

Adjusted operating income decreased $71 million, or 8%, to $799 million and $186 million, or 7%, to $2.418 billion in the quarter and nine months ended June 30, 2018, respectively, reflecting the operating results discussed above.

Filmed Entertainment

	Quarter Ended June 30,		Better/(Worse)		Nine Months Ended June 30,		Better/(Worse)	
(in millions)	2018	2017	$	%	2018	2017	$	%
Revenues by Component								
Theatrical	$208	$263	$(55)	(21)%	$358	$693	$(335)	(48)%
Home entertainment	119	218	(99)	(45)	465	659	(194)	(29)
Licensing	404	300	104	35	1,094	892	202	23
Ancillary	41	66	(25)	(38)	140	256	(116)	(45)
Total revenues by component	$772	$847	$(75)	(9)%	$2,057	$2,500	$(443)	(18)%
Expenses								
Operating	$641	$741	$100	13 %	$1,849	$2,455	$606	25 %
Selling, general and administrative	79	87	8	9	257	249	(8)	(3)
Depreciation and amortization	8	10	2	20	28	33	5	15
Total expenses	$728	$838	$110	13 %	$2,134	$2,737	$603	22 %
Adjusted Operating Income/(Loss)	$44	$9	$35	389 %	$(77)	$(237)	$160	68 %

Revenues

Worldwide revenues decreased $75 million, or 9%, to $772 million and $443 million, or 18%, to $2.057 billion in the quarter and nine months ended June 30, 2018, respectively. Domestic revenues increased 20% to $464 million in the quarter and decreased 15% to $1.112 billion in the nine months. International revenues decreased 33% to $308 million in the quarter and 21% to $945 million in the nine months. Foreign exchange had a 2-percentage point favorable impact on international revenues in the nine months.

Theatrical
Worldwide theatrical revenues decreased $55 million, or 21%, to $208 million in the quarter. Revenues from our current quarter releases decreased $21 million, reflecting a difficult comparison against the release of Transformers: The Last Knight in the prior year quarter. Carryover revenues declined $34 million primarily due to the mix of films in theatrical release, with the prior year quarter benefiting from Ghost In The Shell revenues. Domestic theatrical revenues increased 58%, reflecting the strong performance of current quarter releases A Quiet Place and Book Club, while international theatrical revenues decreased 58%, impacted by the strong international performance of Transformers: The Last Knight and Ghost In The Shell in the prior year quarter. Foreign exchange had a 2-percentage point favorable impact on international theatrical revenues in the quarter.
Worldwide theatrical revenues decreased $335 million, or 48%, to $358 million in the nine months, principally reflecting the number and mix of current year releases. Significant current year releases included A Quiet Place, Daddy's Home 2, Sherlock Gnomes and Book Club, compared with Transformers: The Last Knight, xXx: Return of Xander Cage, Ghost in the Shell, Jack Reacher: Never Go Back, Baywatch and Arrival in the prior year. Domestic theatrical revenues decreased 20% and international theatrical revenues decreased 67%. Foreign exchange had a 2-percentage point favorable impact on international theatrical revenues in the nine months.
Home Entertainment
Worldwide home entertainment revenues decreased $99 million, or 45%, to $119 million in the quarter and $194 million, or 29%, to $465 million in the nine months, primarily reflecting the mix and number of titles in release. Worldwide home entertainment revenues include a 2-percentage point favorable impact from foreign exchange in the nine months. Significant current year releases included Daddy's Home 2, compared to Star Trek Beyond, Jack Reacher: Never Go Back and Arrival in the prior year. Domestic home entertainment revenues decreased 47% and 38%, while international home entertainment revenues decreased 41% and 10% in the quarter and nine months, respectively. Foreign exchange had a 3-percentage point and 6-percentage point favorable impact on international home entertainment revenues in the quarter and nine months, respectively.
Licensing
Worldwide licensing revenues increased $104 million, or 35%, to $404 million in the quarter and $202 million, or 23%, to $1.094 billion in the nine months, primarily driven by the availability of Paramount Television product such as 13 Reasons Why and Tom Clancy's Jack Ryan and the mix of titles available in each market. The nine months also benefited from the availability of The Alienist and the release of The Cloverfield Paradox. Worldwide licensing revenues include a 2-percentage point favorable impact from foreign exchange in the nine months. Domestic licensing revenues increased 122% and 40%, and international licensing revenues decreased 8% and increased 11%, in the quarter and nine months, respectively. Foreign exchange had a 2-percentage point favorable impact on international licensing revenues in the nine months.
Ancillary
Worldwide ancillary revenues decreased $25 million, or 38%, to $41 million in the quarter and $116 million, or 45%, to $140 million in the nine months. The prior year includes revenues from the sale of a partial copyright interest in certain films in connection with an agreement then in place. Domestic ancillary revenues decreased 40% and 53% and international ancillary revenues decreased 27% and 5% in the quarter and nine months, respectively.
Expenses
Filmed Entertainment segment expenses decreased $110 million, or 13%, to $728 million and $603 million, or 22%, to $2.134 billion in the quarter and nine months ended June 30, 2018, respectively, driven by lower operating expenses.
Operating
Operating expenses decreased $100 million, or 13%, to $641 million in the quarter and $606 million, or 25%, to $1.849 billion in the nine months. Distribution and other costs, principally print and advertising expenses, decreased

$103 million, or 32%, in the quarter and $570 million, or 45%, in the nine months, primarily driven by the number and mix of theatrical releases including Transformers: The Last Knight in the prior year quarter. Film costs increased $3 million, or 1%, in the quarter and decreased $36 million, or 3%, in the nine months.

Selling, General and Administrative

SG&A expenses decreased $8 million, or 9%, to $79 million in the quarter and increased $8 million, or 3%, to $257 million in the nine months, driven by increased incentive compensation costs.

Adjusted Operating Income/Loss

Adjusted operating income was $44 million in the quarter and adjusted operating loss was $77 million in the nine months ended June 30, 2018, compared with adjusted operating income of $9 million and adjusted operating loss of $237 million in the respective prior year periods. The improvements of $35 million in the quarter and $160 million in the nine months reflect the

operating results discussed above. Operating losses reflect the recognition of print and advertising expenses incurred in the period, generally before and throughout the theatrical release of a film, while revenues for the respective film are recognized as earned through its theatrical exhibition and subsequent distribution windows.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

Sources and Uses of Cash

Our primary source of liquidity is cash provided through the operations of our businesses. We have access to external financing sources such as our revolving credit facility and the capital markets. Our principal uses of cash from operations include the creation of new programming and film content, acquisitions of third-party content, and interest and income tax payments. We also use cash for the repayment of debt, quarterly cash dividends, capital expenditures and acquisitions of businesses.

As a result of the enactment of the Act on December 22, 2017, the Company has recorded a $69 million provisional transition tax on $997 million of indefinitely reinvested foreign earnings. We are in the process of repatriating the related amounts of these funds to the U.S. We do not currently have plans to repatriate any remaining undistributed international cash not subject to the transition tax. Should we require additional capital in the U.S., we could elect to repatriate these additional funds or access external financing, but repatriating these funds could result in approximately $100 million to $150 million of U.S. tax. Cash from earnings of our international subsidiaries generated after December 31, 2017 can be repatriated to the U.S. without incremental U.S. federal tax under the Act.

We believe that our cash flows from operating activities together with our credit facility provide us with adequate resources to fund our anticipated ongoing cash requirements. We anticipate that future debt maturities will be funded with cash and cash equivalents, cash flows from operating activities and future access to capital markets, including our credit facility.

We may continue to access external financing from time to time depending on our cash requirements, assessments of current and anticipated market conditions and after-tax cost of capital. Our access to capital markets can be impacted by factors outside our control, including economic conditions; however, we believe that our strong cash flows and balance sheet, our credit facility and our credit rating will provide us with adequate access to funding given our expected cash needs. Any new borrowing cost would be affected by market conditions and short and long-term debt ratings assigned by independent rating agencies, and there can be no assurance that we will be able to access capital markets on terms and conditions that will be favorable to us.

Cash Flows

Cash and cash equivalents were $929 million as of June 30, 2018, a decrease of $460 million compared with September 30, 2017. The following tables include information regarding the change in cash and cash equivalents and a reconciliation of net cash provided by operating activities (GAAP) to free cash flow and operating free cash flow (non-GAAP). We define free cash flow as net cash provided by operating activities minus capital expenditures, as applicable. We define operating free cash flow as free cash flow, excluding the impact of the cash premium on the extinguishment of debt, as applicable. Free cash flow and operating free cash flow are non-GAAP measures. Management believes the use of these measures provide investors with an important perspective on, in the case of free cash flow, our liquidity, including our ability to service debt and make investments in our businesses, and, in the case of operating free cash flow, our liquidity from ongoing activities.

Table of Contents

Management's Discussion and Analysis
of Results of Operations and Financial Condition
(continued)

Change in cash and cash equivalents (in millions)	Nine Months Ended June 30, 2018	2017	Better/(Worse) $
Net cash provided by operating activities	$997	$654	$ 343
Net cash provided by/(used in) investing activities	(128)	256	(384)
Net cash used in financing activities	(1,309)	(862)	(447)
Effect of exchange rate changes on cash and cash equivalents	(20)	(2)	(18)
Increase/(decrease) in cash and cash equivalents	$(460)	$46	$ (506)
Reconciliation of net cash provided by operating activities to free cash flow and operating free cash flow			
Net cash provided by operating activities (GAAP)	$997	$654	$ 343
Capital expenditures	(102)	(139)	37
Free cash flow (Non-GAAP)	895	515	380
Debt retirement premium	—	33	(33)
Operating free cash flow (Non-GAAP)	$895	$548	$ 347

Operating Activities

Cash provided by operating activities increased $343 million for the nine months ended June 30, 2018, primarily reflecting the timing of collections.

Investing Activities

Cash used in investing activities was $128 million for the nine months ended June 30, 2018, primarily reflecting capital expenditures and our acquisitions of WhoSay and VidCon. Cash provided by investing activities was $256 million in the prior year, principally reflecting net proceeds from the sale of our investment in EPIX and the sale of marketable securities, partially offset by the acquisition of Telefe.

Financing Activities

Cash used in financing activities increased $447 million for the nine months ended June 30, 2018, primarily reflecting the impact of debt transactions as well as reduced proceeds from stock option exercises.

Capital Resources

Capital Structure and Debt

Total debt was $10.088 billion as of June 30, 2018, a decrease of $1.031 billion from $11.119 billion as of September 30, 2017.

In the nine months ended June 30, 2018, we redeemed $1.039 billion of senior notes and debentures for a redemption price of $1.000 billion. As a result, we recognized a net pre-tax extinguishment gain of $25 million, which included $14 million of unamortized debt costs and transaction fees.

Our junior subordinated debentures, currently accruing interest at a fixed rate, will switch to a floating rate after a specified period of time. The junior subordinated debentures can be called by us at any time after the expiration of the fixed-rate period. See Note 3 to the Consolidated Financial Statements for further information.

The junior debentures' subordination, interest deferral option and extended term provide significant credit protection measures for senior creditors and as a result of these features, the debentures were awarded a 50% equity credit by S&P and Fitch, and a 25% equity credit by Moody's.

Credit Facility

As of June 30, 2018, there were no amounts outstanding under our $2.5 billion revolving credit facility due November 2019. See Note 3 to the Consolidated Financial Statements for further information.

Commitments and Contingencies

See Note 6 to the Consolidated Financial Statements for information regarding our commitments and contingencies, including legal matters.

OTHER MATTERS

Related Parties

In the ordinary course of business, we enter into transactions with related parties, including National Amusements, Inc., CBS Corporation, their respective subsidiaries and affiliates, and companies that we account for under the equity method of accounting. For additional information, see Note 14 to the Consolidated Financial Statements.

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q, including "Item 2. Management's Discussion and Analysis of Results of Operations and Financial Condition," contains both historical and forward-looking statements. All statements that are not statements of historical fact are, or may be deemed to be, forward-looking statements. Forward-looking statements reflect our current expectations concerning future results, objectives, plans and goals, and involve known and unknown risks, uncertainties and other factors that are difficult to predict and which may cause future results, performance or achievements to differ. These risks, uncertainties and other factors include, among others: the public acceptance of our brands, programs, motion pictures and other entertainment content on the various platforms on which they are distributed; technological developments, alternative content offerings and their effects in our markets and on consumer behavior; the potential for loss of carriage or other reduction in the distribution of our content; significant changes in our senior leadership and the ability of our strategic initiatives to achieve their operating objectives; economic fluctuations in advertising and retail markets, and economic conditions generally; evolving cybersecurity and similar risks; the impact of piracy; increased costs for programming, motion pictures and other rights; the loss of key talent; competition for content, audiences, advertising and distribution; fluctuations in our results due to the timing, mix, number and availability of our motion pictures and other programming; other domestic and global economic, political, business, competitive and/or regulatory factors affecting our businesses generally; changes in the Federal communications or other laws and regulations; and other factors described in our news releases and filings with the Securities and Exchange Commission, including but not limited to our 2017 Form 10-K and reports on Form 10-Q and Form 8-K. The forward-looking statements included in this document are made only as of the date of this document, and we do not have any obligation to publicly update any forward-looking statements to reflect subsequent events or circumstances.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

We are exposed to the impact of interest rate changes, foreign currency fluctuations and changes in the market value of investments. In the ordinary course of business, we may employ established and prudent policies and procedures to manage our exposure principally to changes in interest rates and foreign exchange risks. The objective of such policies and procedures is to manage exposure to market risks in order to minimize the impact on earnings and cash flows. We do not hold or enter into financial instruments for speculative trading purposes.

Item 4. Controls and Procedures.

Our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934, as amended ("Exchange Act")) were effective, based on the evaluation of these controls and procedures required by Rule 13a-15(b) or 15d-15(b) of the Exchange Act.

There were no changes in our internal control over financial reporting during the quarter ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

Since our 2017 Form 10-K, there have been no material developments in the material legal proceedings in which we are involved, except as set forth in Note 6 to the Consolidated Financial Statements.

Item 1A. Risk Factors.

A wide range of risks may affect our business and financial results, now and in the future. We consider the risks described in our 2017 Form 10-K to be the most significant. There may be other currently unknown or unpredictable economic, business, competitive, regulatory or other factors that could have material adverse effects on our future results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not Applicable.

Item 5. Other Information.

None.

Table of Contents

Item 6. Exhibits.

Exhibit No.	Description of Exhibit
31.1*	Certification of the Chief Executive Officer of Viacom Inc. pursuant to Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of the Chief Financial Officer of Viacom Inc. pursuant to Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of the Chief Executive Officer of Viacom Inc. furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of the Chief Financial Officer of Viacom Inc. furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

*Filed herewith

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

VIACOM INC.

Date: August 9, 2018 By: /s/ WADE DAVIS
Wade Davis
Executive Vice President, Chief Financial Officer

Date: August 9, 2018 By: /s/ KATHERINE GILL-CHAREST
Katherine Gill-Charest
Senior Vice President, Controller
(Chief Accounting Officer)