Ritual Sacrifice: how the AT&T's sale of DirectTV represents the end of an Era for the American Media giants

Introduction

The recent spin-off of DirectTV from AT&T marked the unceremonious end of an era in the American TMT arena almost as a ritual sacrifice to fully embrace the new wave of content-driven megadeals already underway since 2017. What is striking about this story is that, back in 2015, AT&T's acquisition of DirectTV for $48.5bn was perceived as brilliant deal-making and received the praise of the financial community. Flash forward to the 25th of February 2021 and the transaction met its demise with the spin-off of the company (merged with U-verse the cable TV bundle brand) and the sale of a 30% stake to the PE group TPG with a total implied valuation of only $16.5bn.

To understand what happened we need to rewind a bit and look at the M&A trend dominating the early 2010s and what turned them upside down in the latter part of the decade.

The triple-play Era (2009 – 2015)

The protagonists of our story are the largest cable providers in the United states that dominated the growing telephone and broadband lines of the country: Comcast, AT&T, Time Warner and the then-under-restructuring Charter Communications (now under the Spectrum brand). In a snapshot of 2009, all those companies used their coaxial cable (or increasingly optic fiber networks) to provide telephone, broadband and most importantly Pay-TV services to households. It was a powerful combination that was known as triple-play and exploited the synergies of an all-inclusive (although pricey) bundle.

The most prominent company was Comcast which, strong of its dominant position in all three markets, was already hunting for content after a failed attempt at a shocking (in hindsight) hostile takeover of non-other-than The Walt Disney Company for $41bn in 2004. However, it reached success in 2011 when it completed the acquisition of NBC Universal from the collapsing giant GE for a total of more than $30bn over multiple stages until 2013, adding a big budget production studio and a portfolio of broadcast shows to its portfolio. With this deal Comcast managed to leap a step beyond its competition in terms of content. However, the bundling model dictated that to truly dominate it needed all three branches to be unapproachable and started looking for a target to consolidate its position in cable infrastructure. This ambition brought to the 2014 proposal to buy the cable division of Time Warner, one of its rivals. The opportunity was unprecedented, as Time Warner was on paper one of the strongest players with a large cable presence and a huge portfolio of content including Warner Bros and HBO, but in reality it was a dead shell still oppressed by the huge debt pile derived from the ill-fated merger with American On Line in early 2000s. The new CEO decided to split the company by spinning off the Cable division in a quasi-desperate attempt to lower the debt and later on it sold Time Inc. (the news company) and AOL as well (which ended up in the hands of Verizon the wireless communication giant in 2015). This last resort move opened up the opportunity for Comcast to bid as much as $45.2bn for Time Warner Cable in 2014, but the regulators opposed the deal in fear of a giant with more than a 60% share of the broadband market and halted once and for all Comcast's ambitions at a blockbuster cable deal. However, those high quality assets were not left

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on the plate for long as in 2016 TWC's shareholders finally gave in to the tempting offer of $55bn of an Apollo-restructured Charter Communication and this time, with the approval of the regulators, the new triple-play giant was born combining the two companies and becoming the undiscussed 3rd broadband player behind AT&T and Comcast.

But in the midst of all this deal frenzy, what was the strategic response of AT&T?

Well its business was a bit different to begin with because it was the only one able to bundle wireless mobile services together and that was its main strength. However, its cable TV platform U-verse could count only about 5m subscribers compared to the more than 25m of Comcast, thus AT&T started looking at complimentary services to reach a wider audience and beat Comcast at the bundling game offering a four-play service with broadband, fixed line telephone, wireless mobile and a stronger Pay-TV service. The result was a $48.5bn purchase of DirectTV, by far the largest satellite TV provider with a subscriber base of about 15m households. The plan was to bundle it with the rest of the product and win over the competition with superior reach and greater pricing power and the best thing was that there was no overlapping in the broadband segment, so the regulators posed no threat to the transaction. It is easy to see why the case for the acquisition was so compelling and why it was received well by the market. But in hindsight, that was a good deal only in the triple-play era, an era that was rapidly coming to an end with the advent of….

Well spoiler: online streaming!

The content Era (2016-today)

As always technological progress changed the rules of the game, forcing a paradigm shift in the very business model of media companies. With online streaming taking a larger and larger slice of the cake, the attractiveness of pay-TV services added to broadband internet is less and less significant, unless the content is engaging enough to retain consumers. This led to a scramble for high quality assets that shook the industry and saw a sequence of back to back blockbuster deals and the rise to prominence of a new protagonist: Disney, that now seems to be the main challenger of Netflix through its flagship platform Disney+.

The graph reflects the significance of investments in new original content.

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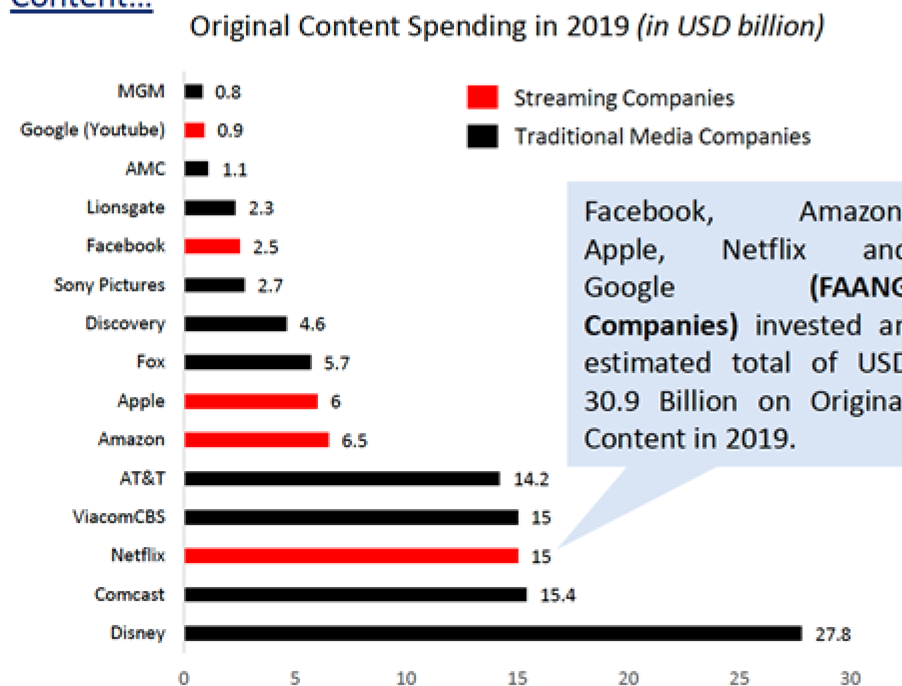

Source: variety business intelligence, companies' filings

But let's go to the first deal that started this new wave. In late October 2016 AT&T announced it would acquire Time Warner, now a lean and thriving pure media company, for $108.7bn at a 52.5% premium. The transaction was a monumental milestone. One of the largest acquisitions in history, that brought the entire Warner Bros catalog under AT&T's control consolidating its position as a dominant force in all of its businesses. But in particular it was a significant move for its then-weak platform HBO Max and an attempt to synergize with the newly acquired DirectTV and Cable-TV U-verse. But what is so special about this transaction is not only the size, but also the fact that truly represented the beginning of the new era as only a few years prior early acquisition rumors lead to an immediate shut off by the antitrust authority. This acquisition was the unintended outcome of the growth of Netflix, Amazon Prime Video and Apple TV, that put too much pressure on traditional media companies so that authorities were willing, after 2 years of back and forth, to give the approval to the deal in 2018. However, this acquisition would prove a tough financial challenge, bringing the net debt to a staggering $180bn.

The following key transaction was the acquisition of Twenty-First Century Fox by Walt Disney, which closed in 2019 and was valued at $71.3bn from an initial price of $52.4bn in 2017. The transaction was under the multiple regulatory reviews for more than 1 year, therefore leaving the space for Comcast to unexpectedly bid $65bn to lure Fox away from Disney and outcompete the rival AT&T. Yet, Disney was able to keep the deal moving forward by upping its offer to the final price with a larger percentage in cash. The deal has been seen as critical to Disney as the company was actively seeking to bolster its entertainment offerings and develop its own streaming

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service to be able to stay relevant in the new content rush against Netflix and Amazon. Disney, which had already purchased the Pixar, Marvel and the Star Wars brands before, gained this way Deadpool and the Fox-owned Marvel characters such as the X-Men and Fantastic Four, thus allowing for the full Marvel family to be in one hand.

Comcast was once again left with nothing on its plate, unable to secure any relevant acquisition with the exception of Dreamworks in 2016 for $3.8bn. Furthermore, without any strong streaming platform it really started to feel the pressure to make a blockbuster deal that would complement its capabilities. The target of choice was Sky, the notorious UK based pay-TV platform. The irony is that 30% of the company was owned by 20th century Fox, currently in the process of being acquired by Disney, which decided to suddenly take interest in the remaining 60% of shares and start a second bidding war with Comcast. This time however Comcast was relentless and ended up bidding $31.4bn with a mind-blowing premium of 125%. This deal itself has significantly expanded Comcast's international footprint, making the share of revenues from overseas to rise from 9% to approximately 25%, mainly due to new markets. Additionally, the acquisition increased the customer base of Comcast to approximately 53m customers. This transaction moved Comcast in a somewhat different direction, leveraging SkyTV platforms to emulate the streaming experience.

Finally, there is at least another deal worth mentioning: the $12bn CBS and Viacom Merger, which was signed in 2019, after long talks started in 2016. The companies' holdings include a library with 3,600 film titles and 140,000 TV episodes along with Paramount Pictures studio, the CBS broadcast network, cable network brands such as MTV, BET, Nickelodeon, and Comedy Central as well as such streaming services including CBS All Access.

Conclusion

It should be clear by now that content is the key value driver in today's media M&A landscape. In order to win the content war many players were willing to pay the price… quite literally. In the grand scheme of things securing a competitive content portfolio might seem worth it, but sometimes the debt burden becomes excessive and simply unbearable. This is the case of AT&T acquisition of Time Warner which put the finance department into an uncomfortable position, forcing them to realize the losses made on DirectTV and sell a sizable minority to a specialized PE group. However it seems a fit destiny for an ill-fated acquisition made at the end of the old era, to roll over to leave space for the first great acquisition of the next one.

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