

Case Analysis: The \$ 85.4 Billion Merger of AT&T and Time Warner

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Background

On October 22, 2016, AT&T, a telecommunications giant, announced its intention to acquire Time Warner, a leading media and entertainment company, for \$107.50 per share, totaling approximately \$85.4 billion in equity value or \$108.7 billion total enterprise value. The merger aimed to integrate AT&T's distribution capabilities with Time Warner's content creation, fostering innovation and enhancing consumer offerings.

Key Issues

Upon examining the proposed acquisition, it is crucial to evaluate the fairness of Time Warner's valuation, assess potential integration risks, and determine the strategic merit of the merger. This analysis will provide insights into the potential impact on shareholder value and the overall likelihood of a successful merger.

Attractiveness of Time Warner as an Acquisition Target

Time Warner's attractiveness as an acquisition target is multifaceted. Its historical stable revenue growth from subsidiaries like HBO, Warner Bros., and Turner Broadcasting suggests intrinsic value. However, the merger poses short-term risks and a significant debt burden on AT&T. From a valuation perspective, the DCF analysis indicates an optimistic intrinsic value of \$125 per share and a pessimistic value of \$115 per share, exceeding the acquisition price of \$107.50. This suggests Time Warner could be an attractive acquisition, considering the potential synergy between AT&T's distribution capabilities and Time Warner's content production. However, the

multiple-based valuation yields a lower intrinsic value range of \$67-\$69 per share, suggesting the deal may be overvalued. Despite this, Time Warner remains a compelling acquisition target, albeit at a potentially lower price point.

Anticipated Integration Risks

The proposed merger entails several integration risks, notably antitrust concerns and cultural integration challenges. The merger would create a significant entity in the telecommunications and media space, raising scrutiny from regulatory authorities regarding potential monopolistic practices. Regulatory bodies may impose conditions or even block the merger to preserve competitive market dynamics.

Cultural integration also poses a significant challenge. AT&T and Time Warner operate within different industry frameworks, each with unique operational philosophies. Aligning these methodologies will require careful management and clear communication to minimize employee resistance and operational disruptions. Additionally, financing the acquisition through significant debt (\$25 billion from JPMorgan Chase & Co. and \$15 billion from Bank of America Merrill Lynch) may strain AT&T's financial health, especially if anticipated synergies do not materialize.

Strategic Perspective on the Merger

The merger appears to be a sound business combination. It is a horizontal-vertical hybrid acquisition. While it primarily represents vertical integration by combining different segments of

the supply chain, it also exhibits horizontal elements by expanding AT&T's footprint in the media industry. This strategic combination can enhance AT&T's competitive positioning against rivals like Verizon and Comcast. The integration is likely to yield cost savings through shared resources and streamlined operations. It also increases bargaining power in negotiations with advertisers and content providers. In an increasingly competitive landscape dominated by tech giants like Netflix and Amazon, the merger enables AT&T to better compete by offering bundled services that combine telecommunications and entertainment. Moreover, AT&T can benefit from Time Warner's established media presence, particularly in digital streaming and international regions.

Advice to Janey Frank

Janey should closely evaluate the antitrust implications and potential regulatory hurdles that may arise during the merger process. She should perform more comprehensive sensitivity analyses on various growth and cost scenarios concerning the merged entity's valuation. It is important to analyze the implications of the increased debt burden on AT&T's financial stability and evaluate the company's ability to service debt under different market conditions. According to our estimation, the deal may be overvalued. I would recommend Janey diversify her clients' investment portfolios to mitigate risks associated with the merger's uncertainties and potential short-term volatility.