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**Media Mosaic: A Comprehensive Case Study on the  
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**Shaping the Media Landscape: Analyzing the  
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# **Media Mosaic: A Comprehensive Case Study on the Merger between AT&T and Time Warner**

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## **Abstract**

On October 22, 2016, the intention of a corporate merger between AT&T and Time Warner was announced. This acquisition represents the first media conglomerate within the telecommunications industry, which has influenced its evolution over the years. "We're building a modern media company," were the words of AT&T's CEO Randall Stephenson, but despite the initial optimism, the acquisition has been subject to controversy. The case study identifies what were the most significant aspects of this merger and which learnings could be drawn from them. Individual components are proposed as deepening, delving into specific researches as portfolio analysis, industry consequences, and risk management.

## **Key Words**

- *SIZE*
- *MEDIA CONGLOMERATE*
- *CONTROVERSY*
- *VERTICAL INTEGRATION*
- *OVERVALUATION*

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## **Contextual Overview**

The media and entertainment industry is an environment of continuous evolution where thinking about new business strategies may be a winning approach. Keeping up with the dynamic demands of the audience and the fierce competition can be a daunting task, and for this reason, trying to create something that no one has ever managed before is a noteworthy action. This ambition led AT&T to seek to create a market hegemony within the entertainment sector, based on a merger with another giant in the industry, which could guarantee the right counterpart to create a media conglomerate.

### **TIMELINE**

*22/10/2016* - AT&T announces its intention to acquire Time Warner for \$85.4 billion in cash and stock.

*15/02/2017* - Time Warner shareholders approve the merger with AT&T.

*20/11/2017* - US Department of Justice files antitrust suit blocking merger.

*26/03/2018* - The trial to determine the legality of the merger begins in the U.S. District Court for the District of Columbia.

*12/06/2018* - US federal court dismisses Justice Department's antitrust lawsuit.

*15/06/2018* - AT&T closes the deal with Time Warner at the end of an antitrust case won against the Trump administration.

*3/07/2019* - AT&T renamed Warner Media as part of its strategy to restructure and reorganize its operations.

## **Telecommunications Industry & its Evolution**

The telecommunications sector is made up of companies and organizations that provide services and technologies for the transmission of information, data, voice, and video over long distances.

This sector encompasses a wide range of services and technologies, including wired and wireless communication, the internet, cable television, satellite communication, and more. The telecommunications sector can trace its origins back to the 1830s with the invention of the electrical telegraph, this early technology marked the sector's beginnings and its role in transforming communication. The subsequent emergence and widespread adoption of the telephone further revolutionized how individuals connected and communicated, establishing telecommunications as a dynamic and swiftly evolving field that has continuously undergone substantial changes since its inception. Before AT&T's acquisition of Time Warner the telecom and media industries were already experiencing a trend of convergence, with many telecommunications companies seeking to expand into the media and content creation space to diversify their services. The competitive landscape implied that telecom companies needed to continually invest in network infrastructure and services to maintain and grow their market share. Upon this, regulatory scrutiny was also a challenge, particularly concerning issues like net neutrality and competition in the broadband market.

## **Sector Outlook**

The stability of the sector's growth, even during periods of recession, means that it is a solid defensive investment while maintaining its appeal to growth investors. Even during uncertain and volatile economic times, the steady demand for voice and data services, along with extensive subscription plans, assures a stable source of revenues for major telecom firms. Telecommunications have become increasingly vital, which bodes well for the sector's continued growth and prospects. The continuing advances in high-speed mobile services and internet connectivity keep spurring innovation and competition within the sector. Today, the United States telecommunication sector, which underpins the operations of all enterprises, public safety groups, and the government, is a crucial part of the country's economy. The US

telecom industry generated more than \$400 billion in revenue in the previous year, with the major companies in the market accounting for more than 70% of that total. Broadband internet access, cable and satellite television, streaming services, mobile and fixed-line telephone, and other services were all included in this income total. The sector remained stable in 2018 and continued to adjust to shifting customer preferences and technical improvements, even though revenue growth was not as high as in previous years. Looking forward, the sector's biggest challenge is to keep up with people's demand for speedier data connectivity, higher resolution, quicker video streaming, and ample multimedia applications. The need for faster and better connections as people consume and create content requires significant capital expenditures. Companies that can meet this need may thrive.

## **Media & Entertainment Industry**

The media and entertainment industry encompasses a broad spectrum of businesses and activities with a common goal: creating, delivering, and monetizing content and experiences that captivate, educate, or engage audiences. As observable in *Exhibit 1*, this multifaceted sector includes film, television, radio, music, publishing, and various other segments, all working together to produce and disseminate content for public consumption. The industry's resilience and evolution are closely intertwined with the dynamic landscape of technology and external factors. Wireless communication, mobile devices, digitization, internet access speeds, cloud storage, and the ever-expanding realm of social media have all played pivotal roles in shaping its trajectory. Throughout each generation, the industry has adeptly embraced these advancements, adapting its strategies and platforms to meet the changing demands of consumers. This ability to stay nimble and responsive to evolving technology has been essential in maintaining its relevance and continued success. Before acquisition, the industry was characterized by a fragmented landscape, with numerous media and entertainment companies

operating independently. There was a mix of content creators, broadcasters, cable networks, and digital streaming services. The biggest challenge was how to distribute content in the digital age, traditional cable providers were losing subscribers to cord-cutting, while streaming services were on the rise. The acquisition allowed AT&T to combine content creation and distribution, potentially offering bundled packages that combine mobile, broadband, and content services. This could create innovative, all-in-one offerings.

## **Sector Financials**

The Media and Entertainment industry is a thriving part of the US economy; the U.S. M&E market, which is 33% of the global industry, is the largest market in the world and it is expected to reach \$804 billion by 2021. In 2018, total core copyright industries added 2.2 trillion dollars to the U.S. economy (accounting for 11.6%) and employed over 11.6 million workers. These industries grew on average 5.23% a year, while the U.S. economy as a whole averaged 2.21% annually. The media and entertainment industry has long relied on advertising as a crucial source of income. This revenue stream encompasses various formats while the landscape of advertising has evolved significantly due to the rise of social media, prompting traditional industry players to make the transition to digital platforms. As social media gained prominence, it disrupted the conventional advertising model pushing companies to reallocate their advertising budgets towards digital media. The transition to digital tools and platforms has brought about a transformation in the industry, it has facilitated a more streamlined approach to content production, distribution, and consumption. This shift towards digital has not only increased the industry's reach but also revolutionized its market expansion. The ability to adapt to these technological advancements and changing consumer behaviour has become paramount for success in the media and entertainment sector.

## **AT&T: leader of the Communication Industry for over a Century**

AT&T, an acronym for American Telephone and Telegraph Company, has a history spanning more than a century, representing one of the giants in the telecommunications industry. The firm has been founded in 1885 in Boston, Massachusetts, by Alexander Graham Bell, inventor of the telephone, and Gardiner Hubbard, with a mandate to build and develop a long-range telephone network in the United States. By operating within a fast-growing and expanding industry, AT&T was able to achieve enormous success early on, so much so that the firm obtained a substantial monopoly status at the turn of the 19th and 20th centuries. A first notable event happened in 1913, year in which AT&T was forced to separate into several smaller companies due to antitrust laws. This led to a subsequent reunification during the late 1920s, forming what would become known as the "Bell System." The same situation manifested itself again in the early 1980s, when the U.S. Department of Justice took antitrust action against the firm, leading to its division in 1984. This gave rise to seven independent Baby Bells and a new AT&T, which was mainly focused on long-distance service business. Over the following years, AT&T underwent significant transformations, aligning itself with new technologies and expanding within related industries such as Internet and cable television. A notable transaction in this regard is the acquisition of SBC Communications, one of the Baby Bells, in 2005. In more recent years, AT&T has continued to evolve, focusing increasingly on the convergence between content and distribution.

## **Corporate Overview**

Today, AT&T is a diversified company operating in the telecommunications, media and entertainment industries. It should be emphasized that the organizational structure of the company reflects the convergence of these sectors, aiming to offer integrated solutions to both consumers and businesses. In detail, AT&T's organization is focused on the synergy of its

different divisions with the aim of generating a rich experience that integrates communications, media and advanced services. In addition, it should be emphasized that the continuous transformation of the telecommunications and media industry leads to a constant business evolution, in order to keep up with the periodic challenges (such as globalization, enlarged offerings for the consumers, ecc.) and opportunities offered by the digital world. With that being said, the main elements of its organizational structure include:

- *Communications*: AT&T maintains a strong presence in the telecommunications industry, offering mobile and landline services, high-speed Internet connections, and network services for enterprises.
- *Media and Entertainment*: Following the acquisition of Time Warner in 2018, AT&T has become a major player in the media and entertainment industry. It now controls a wide range of content, including TV channels, movie studios, and streaming platforms like HBO.
- *Enterprise Services*: This section of the firm is designed to accommodate enterprises of different sizes, and includes network services, unified communications, security solutions, and cloud services.
- *Emerging Technologies*: The company is active in the development and implementation of emerging technologies such as artificial intelligence, the Internet of Things (IoT) and 5G connectivity.

## Financial statistics

In order to get a more detailed perspective of AT&T's strength and presence within the media and telecommunications industry, it is useful to go over some financial indicators. Note that the time horizon to which our analysis refers is the 4<sup>TH</sup> of June 2018, the day when the acquisition process of Time Warner Inc. actually begins. A first important financial indicator is market capitalization, which represents the total value of a company's outstanding shares in the market. With reference to the AT&T case, the figure is \$214.85B, broken down into 6.374 billion shares (*Exhibit 2 & Exhibit 3*). This data is particularly relevant because it reflects the dominant situation in which the firm finds itself within the industry. Specifically, the difference with its competitors is very high given that the average market capitalization in the industry is \$92.5B (+\$122.35B). AT&T's strength is also evidenced by other financial statistics, such as the historical trend of revenues, which began to grow starting from June 2015. Specifically, while the average value of this indicator is \$127.82 billion between 2010 and 2015, there is an exponential growth that brings this variable to an average value of \$148.74 billion between 2015 and 2018 (*Exhibit 4*). This trend is also reflected in the historical trend of net income which, as of the 31<sup>st</sup> of March 2018, is around a value of \$30.64 billion (*Exhibit 5*). In conclusion, after a thorough analysis of key financial indicators, it is clear that AT&T has a positive financial situation as of the 4<sup>th</sup> of June 2018. In detail, the market capitalization reflects the strength and confidence of investors in the company's potential, indicating a significant market valuation. Revenues, on the other hand, show a steady growth, suggesting a solid operating performance and sustained demand for the firm's products and services. At the same time, a positive and above sectoral average net income indicates an effective financial management and a sustainable profitability over time. Overall, it can be said that AT&T enjoys a solid financial position, which provides a stable foundation for future growth and value creation for investors.

## **Time Warner: A History of Takeovers**

Time Warner was founded in 1990, following the merger between the two American giants Time Inc and Warner Communications. Its history and evolution are characterized by a succession of corporate acquisitions spanning over 30 years that involved the most important players in the American and global media industry. In fact, during 1996 the corporate group decided to expand its boundaries through the acquisition of Turner Broadcasting System, a division of which is CNN. Time Warner's rapid corporate expansion did not go unnoticed, catching the attention of another major American corporate group employed in the media sector, AOL, which subsequently decided to acquire it in 2001. However, the marriage between these two companies did not yield the benefits and advantages that both parties expected, and after countless financial losses, which in 2002 alone led to the group losing around \$99 billion, the divorce was finalized in 2009. Another major loss occurred in 2013, when Time Inc decided to leave the group and become a listed company, while Time Warner continued to operate independently. Only five years later, the group was fully acquired by the American giant AT&T for approximately \$85 billion, and the company took the name of Warner Media. The importance of this acquisition led to revitalize Time Warner's balance sheet and financial health after the disappointments and losses experienced in the early 2000s.

### **Company profile**

Time Warner is one of the most relevant US public publishing groups and is active in the media and entertainment sector. Since the early 1990s, the firm has based its offer to the public on four main branches, including television channels, cinema, film distribution, and magazines. The importance of this corporate group is demonstrated not only by its economic size and financial figures, but above all by the popularity of the brands within it. Proving this, Time Warner is the owner of some of the most important American television broadcasters known worldwide, such

as HBO, CNN, and TNT. As far as cinema is concerned, Warner Bros is the flagship of the corporate group, since it represents one of the most renowned movie production companies in the world that every year releases dozens of successful films. Time Warner has also historically been involved in publishing. Until Time Inc was part of the corporate group, the company controlled one of the most famous newspapers in the world, Time magazine. Nowadays the firm has a controlling interest in the comic book company DC Comics, mother of iconic characters such as Batman and Superman. The above shows how the strength of this group has been its ability to integrate some of the most important American companies over the years, with the aim of creating a benchmark within the entertainment and media industry.

## **Financial overview**

Observing Time Warner's indices and financial data is useful to realize the real economic weight and dimension of the corporate group. As of June 14, 2018, before being acquired by AT&T, Time Warner's market capitalization was around \$77.27 billion, for a total of nearly 800 million shares outstanding. This value is high compared to the industry average where only the giant Disney exceeds \$100 billion in market capitalization. During the same year, the wide range of companies and brands controlled by the corporate group enabled the parent company to generate \$33 billion in global revenues and employ more than 25,500 people. Time Warner's financial strength was also confirmed by other values. As reported in *Exhibit 6*, between 2015 and 2017 there was an important growth in net income, which went from being \$3.833 billion to \$5.247 billion in just two years, realizing a growth of 36.89%. In addition, the profit margin, depending on various factors, was in the range of 8% to 12% in those years, and the net debt value was reduced between 2016 and 2017, moving from \$22.800 to \$21.113 billion, as depicted in *Exhibit 7*. After the difficulties encountered in the early 2000s with the AOL merger, Time Warner seemed to have returned to financial stability within its industry, and the economic

strength demonstrated by firm's financial statements in the period between 2015 and 2017, has led analysts and investors to have a positive market sentiment towards the company. As a result, the confidence and optimism injected into the market not only attracted individual investors but something broader was starting to move on the horizon.

## **The first Deal**

The details of the first agreement between the two companies in 2016 included several important features. AT&T valued the total transaction around \$108.7 billion, including Time Warner's net debt and its equity valuation of \$85.4 billion. The acquisition would have been half in cash and half in equity, guaranteeing a price of \$53.75 per share in cash plus \$53.75 per share in AT&T stock. This means that based on the amount of AT&T shares outstanding at that time, Time Warner shareholders will possess between 14.4% and 15.7% of AT&T shares on a fully diluted basis. Additionally, the cash portion of the takeover price would have been financed with new debt and cash on AT&T's balance sheet. The picture that has emerged since the announcement of the deal presents two different sides of the same coin. On one hand there is the optimism of the acquirer, as Randall Stephenson, CEO of AT&T, stated that the transaction represents "the perfect union" between two companies and that could result in an innovative approach on how the media and communications industry works for consumers, content creators, and advertisers. On the other side, Jeff Bewkes, CEO of Time Warner, thought that the 2016 deal was not aimed to a better management of Time Warner's network, but only gave to AT&T the control over target's cable channels as HBO and CNN, and the Warner Bros film and cinema studio. Since the beginning of its history, the merger of these two companies has failed to maintain unanimity, fueling confusion in the environment and among the protagonists. The size and importance of the deal are certainly guilty of this confusion, so much

that what seemed like an announced marriage turned out to be a judicial process, which was about to collapse at the first hurdle.

### **Wall Street doesn't like the Deal**

As stated above, AT&T and Time Warner view their merger as strategically sound. However, the real challenge lies in convincing skeptical investors of the validity of this perspective. AT&T's CEO Randall Stephenson and Time Warner's chief executive Jeff Bewkes addressed analysts and investors on a conference call on the next Monday following the announcement and the call followed a media blitz in order to discuss and defend the deal. Wall Street doesn't seem to think the marriage of AT&T and Time Warner is a smart move at this price. AT&T's \$107.50 a share offer for the company is 35% higher than where Time Warner's stock was trading before the rumors started. Investors seem worried that AT&T may be spending too much for Time Warner and that the financial and strategic benefits won't be as significant as Stephenson has promised. The deal also seems to be reminding some of the massive merger between AOL and Time Warner back in 2000. That is now acknowledged as one of the least successful in history and was completely undone years later. Despite the general skepticism, the prevailing and general outlook was uncertainty.

### **Trump and the Department of Justice**

The \$85 billion deal solicited strong words from then-presidential candidate Donald Trump, who claimed the merger would put "too much concentration of power in the hands of too few." After Donald Trump was elected U.S. President, his Justice Department filed a lawsuit against AT&T and Time Warner to block the proposed merger arguing that it would limit competition and raise costs. The companies countered that the deal would allow Time Warner and AT&T to compete more effectively against Silicon Valley companies like Google and Netflix. DOJ stated

that regulators primarily focus on safeguarding competition and consumer interests in cases like these. While this oversimplifies the assessment of complex mergers, antitrust regulators often use consumer prices as an indicator of competition's well-being. If a merger leads to price increases, it may be detrimental to consumers and could trigger further regulatory evaluation. On the other hand, from candidate to the president-elect to the president of the U.S., Donald Trump has had no problem sharing his disapproval of cable network CNN. On the campaign trail, President Trump spoke about the merger, saying that "as an example of the power structure I'm fighting, AT&T is buying Time Warner and thus CNN, a deal we will not approve in my administration." The lawsuit ended up in the jurisdiction of Judge Richard Leon, who was appointed by George W. Bush, in a U.S. District Court located in Washington, D.C. Following a six-week trial, Judge Leon ruled in favor of AT&T and Time Warner on June 12, 2018, granting the companies approval to finalize their merger. The judge said the Justice Department had not proved that the telecom company's acquisition of Time Warner would lead to fewer choices for consumers and higher prices for television and internet services. To underline his final decision, Judge Leon wrote in his opinion "If there ever were an antitrust case where the parties had a dramatically different assessment of the current state of the relevant market and a fundamentally different vision of its future development, this is the one". Just three days later, on June 15, 2018, AT&T officially announced the acquisition of Time Warner.

### **The After-Ruling**

Shares of AT&T declined, while Time Warner's stock surged, following the judge's decision permitting the telecom giant's acquisition of the media conglomerate to move forward. AT&T's stock saw a decrease of up to 3%, while Time Warner's shares experienced an increase of as much as 5.3%, reaching over \$100 per share during after-hours trading. "The content and creative talent at Warner Bros., HBO and Turner are first-rate. Combine all that with AT&T's

strengths in direct-to-consumer distribution, and we offer customers a differentiated, high-quality, mobile-first entertainment experience,” said Randall Stephenson after the acquisition “We’re going to bring a fresh approach to how the media and entertainment industry works for consumers, content creators, distributors and advertisers.” AT&T rebranded its media business as Warner Media and subsequently restructured its workforce and streaming services, including streamlining HBO's streaming options.

### **TEACHING NOTE**

#### **Synopsis**

In 2016, AT&T, a major telecommunications company, proposed acquiring Time Warner, a prominent player in media and entertainment. This move marked a significant development in the evolving relationship between telecommunications and media. AT&T aimed to gain a competitive advantage through the first vertical integration within the sector. The decision to pursue this acquisition was driven by various factors. Students tasked with analysing the situation should focus on the unique characteristics and financial aspects of the telecommunications and media industries. They should also delve into the distinctive features of both companies, consider the legal implications of the deal, and the market reactions. This comprehensive analysis, encompassing both quantitative and qualitative aspects, aims to provide a thorough insight into the complexities of the acquisition.

#### **Pedagogical Objectives**

The case study is structured to be taught in one standard 80-minute session, since the concepts analyzed and topics covered perfectly fit into the single lesson, without extending the teaching to two consecutive days. To best prepare MSc in Finance students for this case study, it is beneficial if they possess a good understanding of valuation concepts, as well as familiarity

with M&A processes, which include the stages of mergers and acquisitions, integration strategies, and regulatory considerations. A grasp of financial principles, such as capital structure, cost of capital, and financial decision-making, will also prove advantageous. This case study delves into the intricate acquisition of Time Warner by AT&T, a complex and multifaceted business transaction. To ensure that students develop a comprehensive understanding, the pedagogical objectives should foster critical thinking, strategic analysis, and a deeper comprehension of various business concepts that were addressed during the Merger & Acquisition course. The pedagogical objectives of this case study encompass the following:

**1. *Strategic Objectives Analysis:***

- Comprehend and identify the strategic objectives motivating AT&T's consideration of the Time Warner acquisition. This analysis provides an opportunity to explore how aligning with Time Warner can help AT&T attain these objectives.

**2. *Impact of Acquisition Size:***

- Evaluate the potential advantages and challenges associated with the scale of the acquisition and its potential impact on AT&T's ability to achieve its strategic objectives.

**3. *Payment Structure Analysis:***

- Assess the rationale behind the payment structure chosen by AT&T's executives (50% cash and 50% equity) and consider the financial and strategic implications of this payment method on both AT&T and Time Warner.

#### 4. *Public vs. Private Companies:*

- Analyse how the public company status of both AT&T and Time Warner may have influenced the success of the merger.

#### 5. *Comparison between Evaluation Methods:*

- Compare and contrast various methods for evaluating a company, including discounted cash flow (DCF) analysis, market multiples, and the dividend discount model (DDM), to determine which method is the most reliable for this case.

#### 6. *Share price Valuation:*

- Explore the methods used to assess the acquisition price and engage in a discussion about whether Time Warner' shares were undervalued or overvalued relative to a fair price per share.

### **Motivation for the Merger**

Begin the discussion by asking students why AT&T is acquiring Time Warner. Before examining in detail the key features of the merger between AT&T and Time Warner, it is important to consider a fundamental question: 'What was the rationale for an acquisition of this magnitude in the media and telecommunications industry, which is known for its wealth and low concentration?'. The answer to this question is not immediate and requires an in-depth analysis of numerous variables both from a business point of view and related to the economic context of reference. Indeed, throughout the history of this sector, there have been numerous M&A transactions but, no operation has ever reached the scale of the case that is being analyzed.

From a general point of view, the main motivation behind this M&A transaction is the achievement of operational synergies, i.e. when the value and performance of two firms combined is greater than the sum of the separate firms apart and, as such, allows for the firms to increase their operating income and achieve higher growth. Despite the truthfulness of what has just been said, however, it must be emphasized that the framework of this financial transaction is particularly complex, and it is therefore possible to trace additional secondary strategic objectives that led AT&T to acquire Time Warner. In other words, in order to fully understand the rationale behind this merger, it is necessary to understand what are the above-mentioned strategic objectives that drove AT&T to consider the acquisition of Time Warner, and how does the size of the acquisition might have affected the acquirer's ability to achieve them.

## **Strategic Objectives**

From a general point of view, it is worth bearing in mind that AT&T's main objective has always been to try to create greater integration between content and distribution within the media and telecommunications industry. However, as we shall see below, this has raised numerous competition and regulatory concerns, leading to legal challenges that have affected the path of the acquisition. On the other hand, by deepening the level of detail of the analysis, it is possible to trace further strategic objectives, which were decisive in the completion of an operation of this size:

- *Expanding Content Offerings:* Prior to the acquisition, AT&T was primarily a telecommunications service provider, offering services such as mobile telephony, Internet connections, and cable TV. In such an organizational context, therefore, the firm had identified the expansion within the content and entertainment sector as the way to

grow and strengthen its Market Cap. In this sense, the identification of Time Warner as a target company was a 'perfect fit' as an eventual merger would have granted access to a vast library of premium content, including prestigious brands such as HBO, Warner Bros. and CNN. Indeed, from a strategic standpoint, this transaction would have allowed AT&T to diversify its offerings and compete successfully in an evolving media landscape.

- *Value Chain Control:* Within the telecommunications sector, which is particularly complex in terms of supply and production management, having a high level of control over the value chain can lead to numerous important strategic advantages. First of all, it is possible to achieve a higher degree in independence and cost reduction: in fact, when a company is able to exert high influence over the main elements of the value chain, it becomes less dependent on external suppliers. This can result in greater decision-making independence and in the ability to negotiate more competitive prices for the acquisition of related content or services. Secondly, it is possible to obtain a greater level of flexibility and timeliness: in this sense, by having direct control over the production and distribution of content, a company can respond more quickly to market needs. This is especially important in an ever-changing industry like the media sector, where timeliness in launching new content or services can make all the difference. Finally, the third major order of advantages that can be obtained through a higher level of control over the value chain concerns a series of benefits linked to the achievement of better-quality management. In fact, given that Time Warner was very well known for producing high-quality content through prestigious brands, the acquisition would have allowed AT&T to have more control over the production of these contents, ensuring greater consistency in quality.

- *Defense against competition:* Since the early 2000s, the telecommunications and media industry has been under increasing pressure in terms of competition from streaming services and online content platforms. In an economic context where the boundaries are particularly blurred, in fact, companies such as Netflix and Amazon Prime Video were gaining popularity and attracting more and more users. This trend has led to a major shift in media consumption habits, with viewers increasingly turning to on-demand streaming services to access movies, TV series, and original content. In this sense, for a company like AT&T, which specializes in telephone and telecommunications services, the challenge was to retain and attract new customers in a changing media landscape. In light of the above, the acquisition of Time Warner would have allowed the company to face the growing competition in several ways that mainly included: offering premium content through the brands owned by Time Warner, exploiting synergies between the distribution of services and content creation, and the creation of cutting-edge streaming services.
- *Revenue diversification:* Similar to the previous discussion regarding the greater level of control over the value chain, AT&T's acquisition of Time Warner has also allowed the company to dramatically reduce its reliance on individual sources of revenue. In particular, the expansion into a new sector has allowed for the diversification of the sources of income, reducing the risk associated with the dependence on a single commercial activity. In addition, by having numerous channels through which wealth can be generated, the firm is also less vulnerable to sectoral fluctuations related to economic conditions, competition, and government regulations. In this sense, the acquisition of Time Warner brought numerous benefits, especially in the event that the media and telecommunications sector had gone through a prolonged period of severe

recession or short-lived "turbulence": AT&T, in fact, being a diversified company, could have relied on other sources of income capable of compensating for any losses.

In conclusion, it can be established that AT&T's acquisition of Time Warner was the result of a well-thought-out and targeted strategy towards expansion in the telecommunications and media industry. The strategic objectives that guided this transaction highlight AT&T's deliberate approach to diversifying its businesses and meeting the challenges of a rapidly changing market. Integration between content and distribution, control over the value chain, and diversification of revenue sources are all key elements of this thoughtful growth strategy. As a result, the acquisition of Time Warner has enabled AT&T to position itself competitively in a new industry, offering a wide range of high-quality services and content, improving its financial stability and preparing for a future of sustainable expansion.

### **How size impacts Strategic Objectives**

The next step in studying the process of AT&T's acquisition of Time Warner is to examine the reasons why the dimension of the target company may have slowed and hindered the M&A deal, by preventing AT&T from completing, partially or totally, the aforementioned strategic objectives. However, before delving into the level of analysis, it is necessary to make a brief general premise, by pointing out that mergers and acquisitions are key strategies for expanding operations and achieving strategic goals. Hence, it is of fundamental importance to recognize that the size of the target company can play a critical role in determining the success or failure of an M&A deal. For this reason, this section will examine how the dimension of the target company affects the M&A process and the challenges that can arise when dealing with firms of considerable size. With reference to the above, AT&T's acquisition of Time Warner has been the subject of considerable attention and has raised several challenges related to the size of the

target company. In particular, the main reasons that hindered the M&A deal, preventing AT&T from achieving its strategic objectives, include:

- *Concentration of Power:* This issue arose because the companies involved were already leaders within their respective sectors, both from a purely economic perspective, given that both had high market shares, and from a reputational perspective (*Exhibit 8 & Exhibit 9*). Notably, AT&T was America's largest telecommunications provider, while Time Warner was one of the world's largest media and entertainment companies. Hence, as it was assumed, the outcome of the M&A deal led to the creation of a jumbo company and to the consequent concentration of power held by a single firm. This has raised concerns about competition and the potential abuse of dominance in the market, so much so that some of the major regulatory authorities, such as the Federal Communications Commission (FCC) and the U.S. Department of Justice, have examined the potential effects of this acquisition on competition and consumers. The fear was that AT&T, through its control over a wide range of content and distribution through telecommunications networks, could limit competitors' access to Time Warner's content or impose unfavorable terms on other media and telecommunications service providers.
- *Cultural differences:* The issue in question emerged because AT&T and Time Warner were two companies with very different histories, corporate cultures, and operating models. Specifically, it can be said that this operational complexity is the factor that caused the biggest problems for AT&T. In detail, the cultural incompatibilities occurred with reference to two important aspects: the Strategic Focus, and the Organizational structure. The first irreconcilability arises because AT&T was a company with a strong emphasis on providing network and communications services, while Time Warner's

focus was predominantly on contents. This industry diversity has led to significant differences in business strategies, product cycles, and operations. Second, the two firms had different organizational structures and decision-making hierarchies and processes. In detail, AT&T was characterized by a more telecommunications-oriented organization, while Time Warner was structured to manage the production and distribution of contents. Again, these differences led to challenges in defining roles and responsibilities in the new post-acquisition organization.

- *Operational complexity:* This is the factor that has caused the biggest problems for AT&T in evaluating, realizing and completing the M&A deal. In fact, with reference to the acquisition of a large target firm, the integration of the companies' operations is a fundamental part that requires a detailed analysis of the operational processes, supply chains and organizational structures. In particular, this is especially important to ensure that processes are streamlined and optimized in order to maximize efficiency, a variable that is often overlooked in large companies. During AT&T's acquisition of Time Warner, the challenges of operational complexity emerged in several ways, including:
- *Diversity of activities:* As pointed out above, Time Warner was a company involved in a wide range of media and entertainment-related activities; while AT&T, on the other hand, was primarily a telecommunications service provider with complex network operations. It can be seen that the integration of these activities, which are typical of complementary sectors, is a particularly intricate operation that requires a careful planning and management.

- *Operational synergies:* As noted above, the primary objective of AT&T's acquisition of Time Warner was to realize any operational synergies to reduce costs, maximize efficiency, and offer a complete product to consumers. However, the complexity of both companies' operations has made it difficult to identify and capture such synergies effectively. In addition, considering that the two companies used different infrastructures and technological systems to support their respective activities, process integration, data migration and ensuring interoperability required significant technological commitment. However, despite this technological diversity, the process of achieving operational synergies is made even more complex, as in the acquisition phase, the presence of possible duplication risks can emerge, i.e. situations in which both companies have similar or overlapping structures/resources. This can lead to wasted resources and additional costs. Hence, identifying and mitigating these risks is essential to reducing operational complexity.
- *Human Resource Management:* Another challenge related to operational complexity was personnel management. Going back to what was said above with reference to organizational diversity, the integration of workforces from two companies of different sizes and cultures required attention to human resource planning, the definition of roles and responsibilities, and employee engagement. In conclusion, changing the way a workforce accustomed to operating according to certain practices has been one of AT&T's most difficult challenges.

## **Deal Structure in mergers**

The structure of the agreement between two companies within a corporate acquisition may be affected by several dimensions. The executives of the involved firms tend to consider various

features and aspects to be included within contracts, because the success or failure of an acquisition may be based on these. In this analysis, the focus will be on two aspects in particular, the form of payment and the nature of the companies involved.

## **Payment Decision and Merger Success**

It is interesting to analyze which assumptions and implications led AT&T management to formulate its payment offer in a specific formula. In fact, under the leadership of Randall Stephenson, a hybrid transaction was proposed, amounting to a total valuation of \$107.50 per share, of which \$53.75 was paid in cash and \$53.75 paid in AT&T stock. How did this solution come about? The most popular forms of payment within the takeover world are shares or cash, and these are decided based on the risk and benefits that can be derived by the shareholders of the companies involved. Generally, in fact, the use of equities tends to expose the target to higher risk of information asymmetry as market volatility can potentially reduce the purchase offer. For this reason, acquiring companies tend to pay in this mode when they believe that their shares are overvalued, and thus worth less than what the market claims. Full-stock transactions are used and proposed by buyers to reduce the risk they are exposed to and to try to share it with the target company's shareholders. The motivations behind this choice are influenced not only by the concept of risk, but also by that of market return. In fact, in many cases buyers tend to pay a higher price for the target with their overvalued shares, triggering a reaction from the financial market. This action is usually recognized by the investors, who therefore decide to sell the shares, causing a reduction in price and a negative return. *Exhibit 10* depicts this process, representing how during the days following most of US companies' acquisitions, between (-1;+1) and (+2;+20), there is an important reduction in the cumulative average excess return (CAAR) from 9.18% to 0.44%. On the other hand, firms involved in a merger may adopt a cash-only solution. In this case, the risk management and consequently associated return

changes. First, cash acquisitions are characterized by certainty of value, as they are not subject to market volatility like equities, thus reducing the risk of information asymmetry. This aspect greatly reduces the post-merger performance risk, as the target's shareholders are not exposed to the possibility that the acquiring company's performance will disappoint expectations or that its shares will be overvalued. In addition, cash provides immediate liquidity by allowing the target's shareholders to use it to invest and achieve financial goals, making a cash offering preferable to an equity offering. Regarding financial return, contrary to what has been observed above, when a cash acquisition proposal is made, the market reaction tends to be more positive. In fact, if a buying company tends to pay in cash, investors will be led to think that its shares are undervalued and for this reason they will tend to buy them, driving up their price. Observing *Exhibit 10*, it is possible to visualize what has been said, as the CAAR value of American cash acquisitions during the days of the announcement (-1;+1) is considerably higher than stock acquisitions, going from 9,18 to 25,99% respectively. It is important to notice that this difference in performance is connected to the days of the announcement and not to the following ones (+2;+20), where the CAAR for cash acquisitions reaches the value of -0.60%. Therefore, is correct to realize that, on average, this form of payment may guarantee higher returns around the announcement date, but it is not certain that this trend will also occur in post-merger periods. After learning the main characteristics of these two forms of payment, it is possible to understand that there is no mode that is considered systematically better than the other. This is precisely why, in most cases, companies involved in an acquisition adopt a hybrid solution that benefits both the acquirer and the target. An offer based on 50% cash and 50% stock may result in satisfying both parties, without preferring one. The main benefits of a hybrid solution are:

- A combination of cash and shares is distributed to target company shareholders, which can help diversify their investment portfolio.

- Cash helps to mitigate the market risk associated with equities, hedging the value of the transaction if stock prices fall.
- Mixed payment helps shareholder to manage their tax liabilities, since they choose between realizing immediate capital gains (cash) or hold for future gains (stock), and vice versa.

This form of payment also has some disadvantages, related to its dual nature. The main drawbacks of this mode are:

- The evaluation process turns out to be more complicated, as giving an estimate of the target using this mode needs additional attention regarding the financial valuation.
- Target shareholders might not completely profit from the mixed structure since they have a strong preference for either cash or equity.
- The shareholders that receive stocks are highly exposed to volatility and market risk, while the part that receive cash is not exposed to the same risk.

Nowadays, most corporate acquisitions feature a hybrid form of payment since through this mode it is possible to combine the advantages of full-stock and full-cash payment, achieving a perfect trade-off between risk and potential return. Risk mitigation is certainly behind the decisions made by the CEOs of AT&T and Time Warner on June 15, 2018, given that the goal was to safeguard the interests of both companies and their shareholders from the uncertainty of

stock performance in the financial markets. The acquiring company's desire to preserve cash reserves may also be considered as one of the reasons underlying the hybrid form of payment. In this specific case, due to the structure of the transaction, AT&T expects to realize cost synergies for the first 3 years of \$1 billion, and that its dividend coverage could potentially increase, as the revenue and earnings growth. In addition, the acquiring company expects that its balance sheets will remain strong and stable after the acquisition, with growth in EPS and FCF per share.

### **Implications for the public status**

The nature of the companies involved in an acquisition is a very important aspect to consider while valuing an overall deal. Did the public company status of both AT&T and Time Warner have an impact on the potential success of the acquisition? When reasoning about this aspect, students should be able to conclude that, as public companies, both firms were subject to a range of factors that influenced various aspects of the acquisition process. Firstly, the public nature of these companies subjected them to heightened regulatory scrutiny with regulatory bodies, such as the Securities and Exchange Commission (SEC), closely monitoring the acquisition. This additional layer of oversight added complexity and potential delays to the approval process. Another important aspect that students should be able to consider is that the ownership of public companies tends to be distributed across several shareholders, while private companies tend to be held by a much smaller group of owners (e.g. a family, partnership or private equity fund). This implicates that public companies are inherently driven by the expectations of their shareholders and these expectations revolve around maximizing the value of their investments through dividends and capital appreciation. For this, the terms and structure of the acquisition, as well as its post-acquisition performance, would have been closely watched by shareholders. Furthermore, the public status of both companies means that their stock prices

are influenced by market sentiment and investor reactions. Negative market responses, such as a significant drop in stock prices or an adverse impact on AT&T's and Time Warner's market capitalization, could directly affect the perceived success of the acquisition. This was evident when AT&T's stock price initially dropped after the acquisition announcement, while Time Warner's stock price surged. Students should conclude that the market exhibited scepticism regarding whether the acquisition would generate sufficient value to justify AT&T's investment, but also indicated that Time Warner shareholders viewed the deal favourably. Obviously, the public status of the two companies offered some advantages in the context of the acquisition, for example, the public status of Time Warner obliges the company to more stringent reporting and disclosure requirements, providing the bidder with a deeper insight into its financials, operations, and strategies. This increased transparency can aid in conducting due diligence and assessing risks. Another positive aspect is that the two companies have easier access to capital markets: AT&T and Time Warner have the ability to raise capital through the issuance of debt and equity in the public markets. For instance, when AT&T needed to finance its acquisition of Time Warner, it could issue bonds and sell shares to raise the necessary funds. This access to capital provides flexibility for financing the acquisition and other strategic initiatives. The conclusions to which the students are expected to be led, is that the public company status of both AT&T and Time Warner undeniably played a pivotal role in influencing the success of their acquisition. It introduced a multifaceted array of dynamics, ranging from heightened regulatory scrutiny and shareholder expectations to transparency and market reactions.

### **Time Warner Valuation**

When there is interest in acquiring a listed company, the first step is to analyse the target firm by evaluating its stock. There are several methods to determine the market value of shares, and the most important are the Discounted Cash Flow, the Dividend Discount Model, and

Comparable valuation. Within our analysis, all three were used, and understanding what reasoning underlies them and what are their strengths and weaknesses, is an important step to take in learning how to conduct a proper company valuation.

## **Valuation Insights**

Which is the most reliable method to evaluate a company? This should be the starting point of the in-class discussion. The answer should arise very soon, with the conclusion that there is not a single "most reliable" method for evaluating a company, as the choice of valuation method depends on various factors, including the company's industry, financial characteristics, and the specific purpose of the valuation. Each method has its strengths and weaknesses, and the most appropriate method can vary from one situation to another. As mentioned, during our analysis we focused on three of the most valid valuation methods, such as the Discounted Cash Flow, the Dividend Discount Model, and Comparable valuation. The Discounted Cash Flow estimates the value of an investment using its expected future cash flows, the goal here is to obtain Time Warner' share price by dividing its enterprise value by the shares outstanding. The reasons behind the use of this methodology are:

- it focuses on cash flows, which are usually considered the most critical aspect of business valuation.
- it can be tailored to incorporate a wide range of future scenarios, making it adaptable to specific cases like this acquisition.
- it calculates value apart from subjective market sentiment and is more objective than other methods.
- It assesses the earnings of a project or investment over its entire economic life and considers the time value of money.

On the other hand, during the analysis we had to bear in mind about its most debilitating weakness regarding its subjectivity, in fact DCF relies on numerous assumptions, such as growth rates, discount rates, and terminal values, which can introduce subjectivity and uncertainty. Moreover, small changes in assumptions can result in significantly different valuations. As second choice, we used the Comparable method. This strategy evaluates similar companies and compares relevant valuation metrics. The comparable approach is often one of the easiest valuations to perform as long as the company being valued has public company comparable. The decision of using this type of methodology is backed by the fact that Time Warner operates in the media and entertainment industry, which has specific valuation dynamics. Using this valuation allowed us to benchmark Time Warner against similar publicly traded media and entertainment companies providing context and insights into its relative value in the industry. Then, the fact that Time Warner was a publicly traded company made it suitable for a comparable valuation analysis considering the publicly available financial data for peer companies, which is essential for this method. Obviously, we considered its negative aspects too, like the assumption that market prices are correct, taking for granted that the market's valuation of the comparable companies is accurate or like the fact that ignores company-specific factors such as the unique qualities and potential synergies specific to the acquisition, which may not be reflected in peer valuations. As last method, we implemented the Dividend Discount Model, a quantitative method used for predicting the price of a company's stock based on the theory that its present-day price is worth the sum of all its future dividend payments when discounted back to their present value. We used it because DDM is relatively simple and intuitive, especially when a company has a history of stable dividend payments and because it emphasizes on the income-generating aspect of an investment, to which shareholders are deeply focused. Unfortunately, the fact that DDM does not account for potential capital gains or changes in the underlying asset's value led to some limitations for its use. In the end, students

should recognize that valuation is a complex and dynamic process that combines financial analysis with qualitative judgment. The AT&T-Time Warner case study provides an excellent opportunity for students to apply these principles in a real-world context. Additionally, they should appreciate that valuation is a critical aspect of strategic decision-making for businesses and investors, and it should be conducted with a clear understanding of its limitations and the broader business environment.

### **Overvalued or Undervalued Stock?**

To determine whether a stock is priced correctly, it is necessary to compare the current market value with that obtained from your own valuation. The first price can be found on major financial platforms, which describe company's market performances on a daily basis. The second price is more complicated to obtain, as it requires a series of assumptions and calculations. In case the valuation value is higher than the market value, the analysis suggests a “long” position on the stock, as it is undervalued, and a “short” position in the opposite case. If the difference between the two prices is minimal, holding the stock would probably be the safer strategy since the shares are fairly priced. The first methodology used is the Discounted Cash Flows. Several assumptions were made within the evaluation, starting from the cost repartition analysis, which was performed in order to separate Selling General & Administrative expenses from the Total Cost of Sold Goods. Depreciation expenses, net working capital and capital expenditures growth were computed as the average between their yearly growth values between 2011 and 2016, without considering possible outliers. As observable in *Exhibit 11*, tax rates were accounted as constant at 35% and the WACC was estimated to be 6.92%, using the CAPM procedure. Finally, to compute the value of Equity, the net debt was subtracted from the Enterprise Value. Hence, by dividing this value by the total number of shares, a price target of \$92.51 was calculated. The second method used is Comparables, which analyse the multiples

of seven competitors of Time Warner, operating in the same industry and with a similar market capitalization. The use of comparable is carried out in two modes; the first includes the average of all competitors' multiples, while the second involves the average of multiples similar to the Time Warner value. For a more precise analysis, the final price target is determined through the second modality. Specifically, the multiples considered are EV/FCF, EV/EBITDA and P/B, giving back target prices of \$75.71, \$87.54 and \$89.13 respectively. The third valuation approach used is Dividend Discount Model. The cash flows derived from future dividends were discounted to the cost of equity (5.66%), which is preferred to WACC, since the DDM is a model that takes into account only the cash flows addressed to shareholders. The final price obtained using this method is \$78.76. The results gathered from our analysis in the *Exhibit 12*, represent a Football Field Chart, which is a floating bar graph that compares several valuation analyses side-by-side to provide investors with the full context of a company's value. Considering that Time Warner's share market price the day before AT&T's acquisition was \$98.77 (*Red line*), it is immediate to visualize how the results obtained from the three valuation methods (*Blue bars*) are located to the left of the market benchmark. This means that the judgment derived from each approach used to evaluate Time Warner's stock is the same, indicating that the share is overvalued by the market. It may happen that, due to the different assumptions and the different natures of corporate valuation methods, there is no clear position compared with the market benchmark within a football field chart, and thus the fact that multiple sources lead to the same conclusion further corroborates the strategic position of “shorting” the stock, due to overvaluation. In addition, if revenue synergies are estimated in the form of future cash flows, it is possible to determine their price contribution, as depicted in *Exhibit 13*. In this case, revenue synergies have a valuation of \$8.952 per share and if this value is added to the output obtained from the corporate valuation, it is possible to obtain a total price of \$101.46 per share, which turns out to be less than the \$107.5 threshold that was paid by

AT&T. This is further proof in favour of the theory relative to the overvaluation of Time Warner's stocks.

### **P/E as and additional evidence**

The P/E multiple represents how many times a company's earnings are incorporated into its stock price, and for this reason is often used within company valuations. Another interesting usage of this comparable is derived from its ability to determine whether market prices are fair, by comparing multiples of companies operating in the same industry. Higher levels of speculation are typically built around higher P/E ratios due to optimistic predictions of future growth. This indicates that for every \$1 in earnings the company generates, investors are willing to pay more for their stocks. Hence, if a firm's P/E ratio is higher than that of its competitors, it means that its shares are potentially overvalued by the market. Observing *Exhibit 14*, it is possible to observe that as of 1/1/2018, Time Warner's P/E is higher than five out of seven direct competitors, with a value of 12.22 (*Red line*). Solely Disney and Lions Gate Entertainment have higher values than Time Warner, while all the others present lower ratios.

### **Conclusion**

After the detailed analysis proposed by the case study on the AT&T-Time Warner merger, it is possible to conclude that this corporate acquisition will be remembered in the years to come regardless of its performance or heritage. Attempting to create such a large conglomerate within the competitive media and entertainment industry is a very difficult task to accomplish without making mistakes. The complexity of this corporate takeover was due to several factors, ranging from the public nature of the companies involved and their massive market capitalizations, to the lack of ability to achieve an effective vertical integration. In addition, as highlighted by our analysis, AT&T paid an unjustifiably high price to acquire a company as overvalued by the

market as Time Warner, considering that the estimated synergies did not match the acquisition premium offered by the acquirer. Despite this, the merger represents an excellent storyline which may be useful for students to touch on the complexities that investors inevitably face within the world of acquisitions and understand which key factors need to be considered in this form of analysis. Therefore, being able to observe the mistakes made in the past and understand the underlying reasons for them, is the first step in structuring a winning strategy and preventing the same dynamics from occurring in future corporate takeovers.

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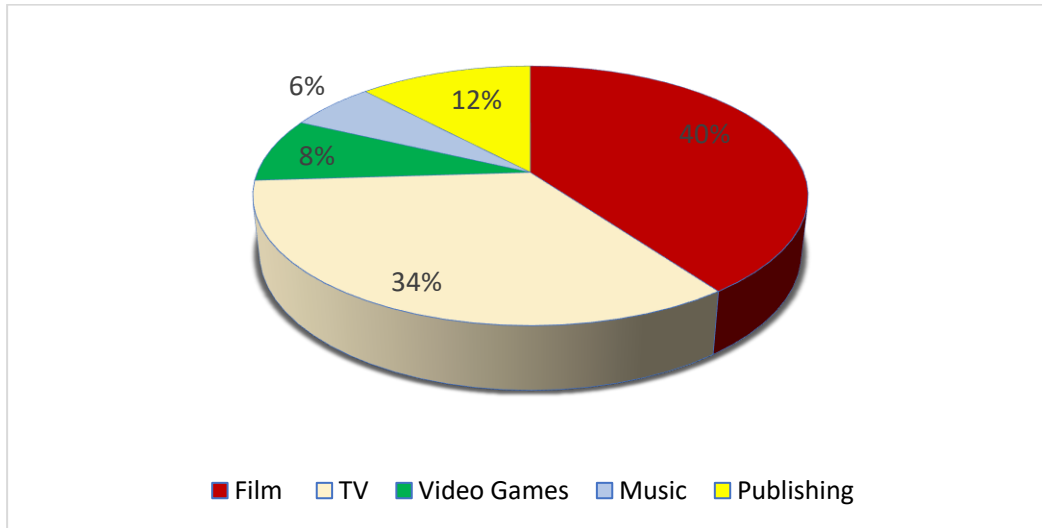
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**APPENDIX**

**Exhibit 1 – U.S Media & Entertainment industry composition.**



**Exhibit 2 – AT&T Market capitalization between 2010 and 2022.**



Exhibit 3 – AT&T Shares time series between 2010 and 2022.

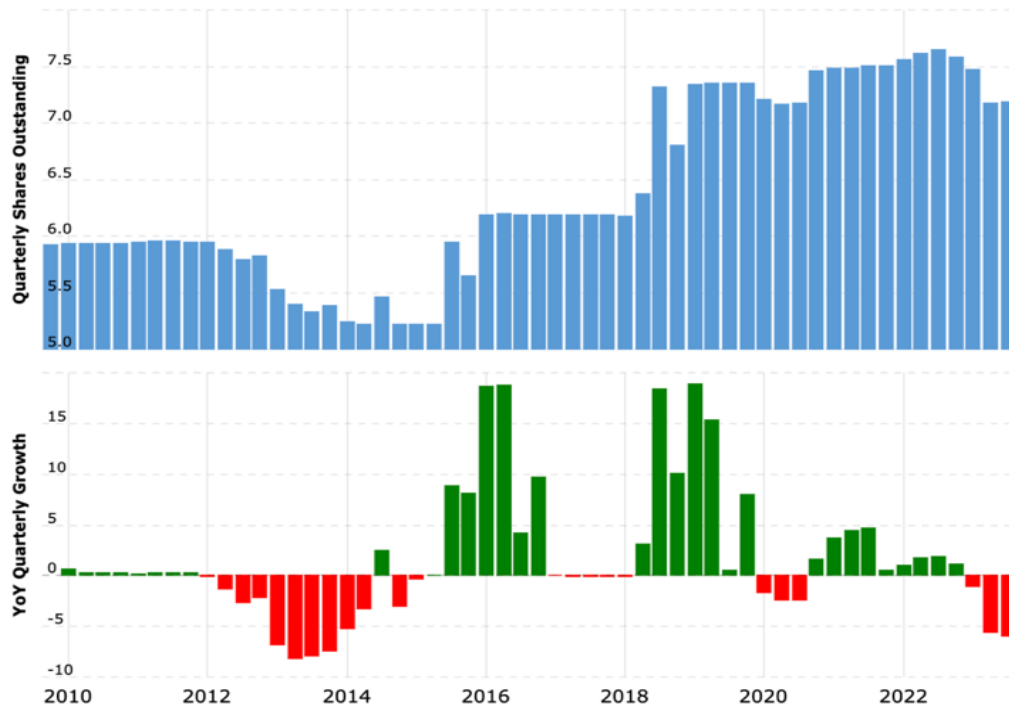


Exhibit 4 – AT&T Revenues time series between 2010 and 2022.

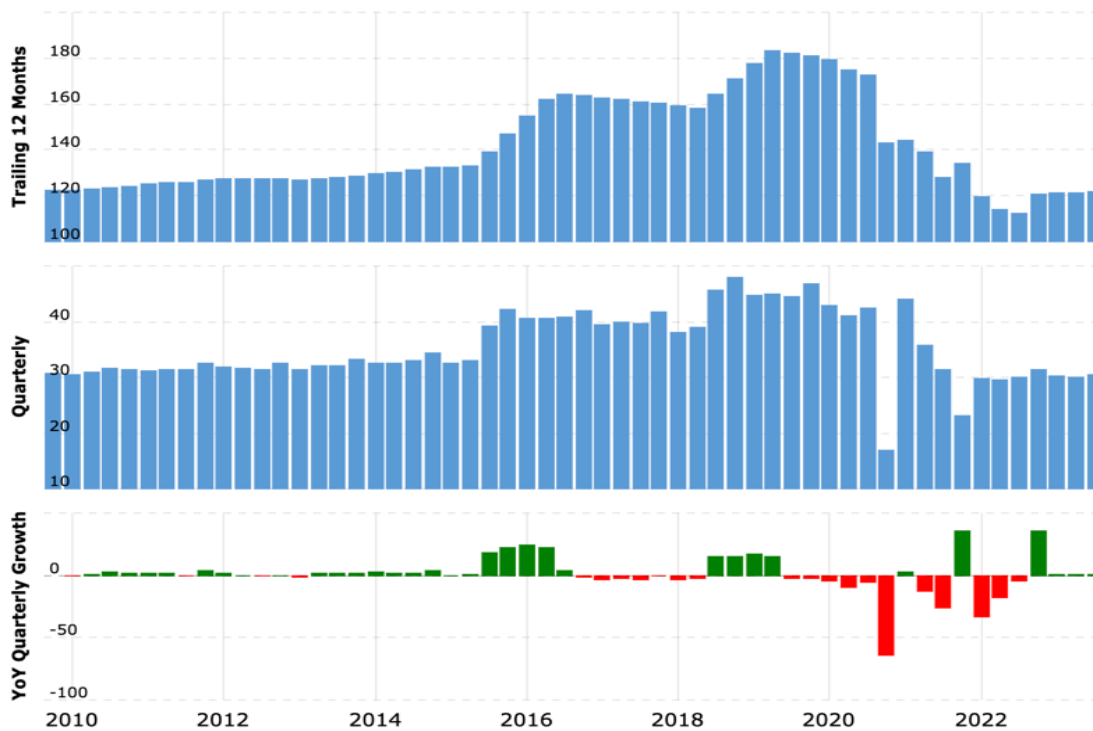


Exhibit 5 –AT&T Net income time series between 2010 and 2022.

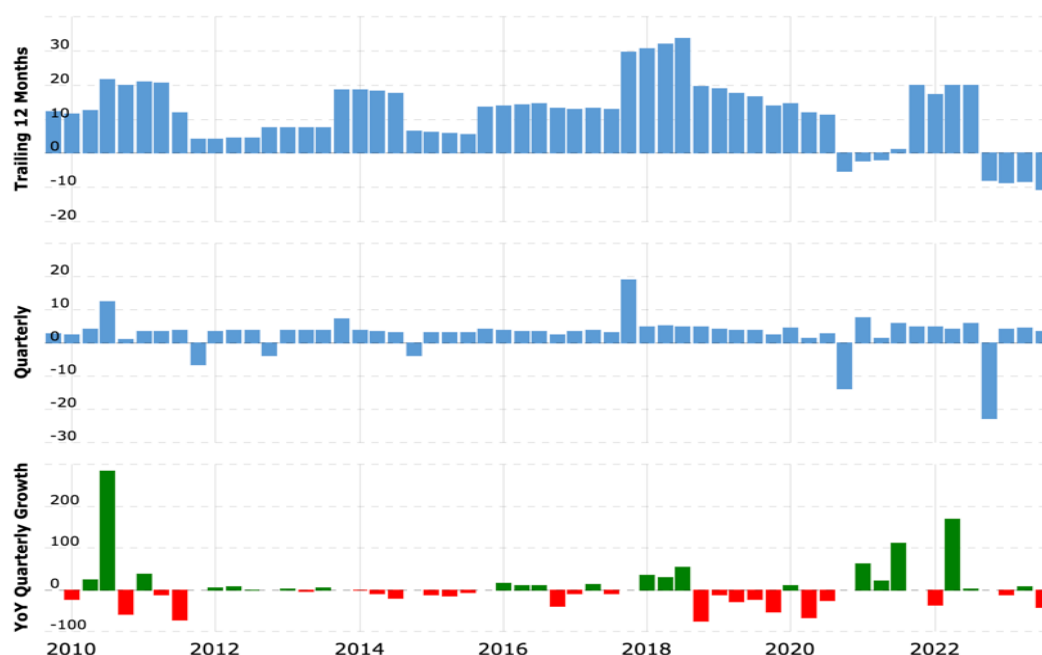


Exhibit 6 – Time Warner Total Revenues, Operating & Net Income 2013-2017.

	Year Ended December 31,				
	2017	2016	2015	2014	2013
	(millions, except per share amounts)				
<b>Selected Operating Statement Information:</b>					
Total revenues	\$ 31,271	\$ 29,318	\$ 28,118	\$ 27,359	\$ 26,461
Operating income	7,920	7,547	6,865	5,975	6,268
Net income	5,244	3,925	3,832	3,827	3,691
<b>Amounts attributable to Time Warner Inc. shareholders:</b>					
Income from continuing operations	\$ 5,247	\$ 3,915	\$ 3,796	\$ 3,894	\$ 3,354
Discontinued operations, net of tax	—	11	37	(67)	337
Net income	<u>\$ 5,247</u>	<u>\$ 3,926</u>	<u>\$ 3,833</u>	<u>\$ 3,827</u>	<u>\$ 3,691</u>

Exhibit 7 – Time Warner Net debt between 2016 and 2017.

Balance at December 31, 2016	\$ 22,800
Cash provided by operations from continuing operations	(5,094)
Capital expenditures	656
Premium paid and costs incurred on debt redemption	1,087
Dividends paid to common stockholders	1,265
Investments and acquisitions, net of cash acquired, including available-for-sale securities	707
Proceeds from the exercise of stock options	(206)
Other investment proceeds, including available-for-sale securities	(367)
All other, net	275
Balance at December 31, 2017	<u>\$ 21,123</u>

Exhibit 8 - AT&T Market Share.

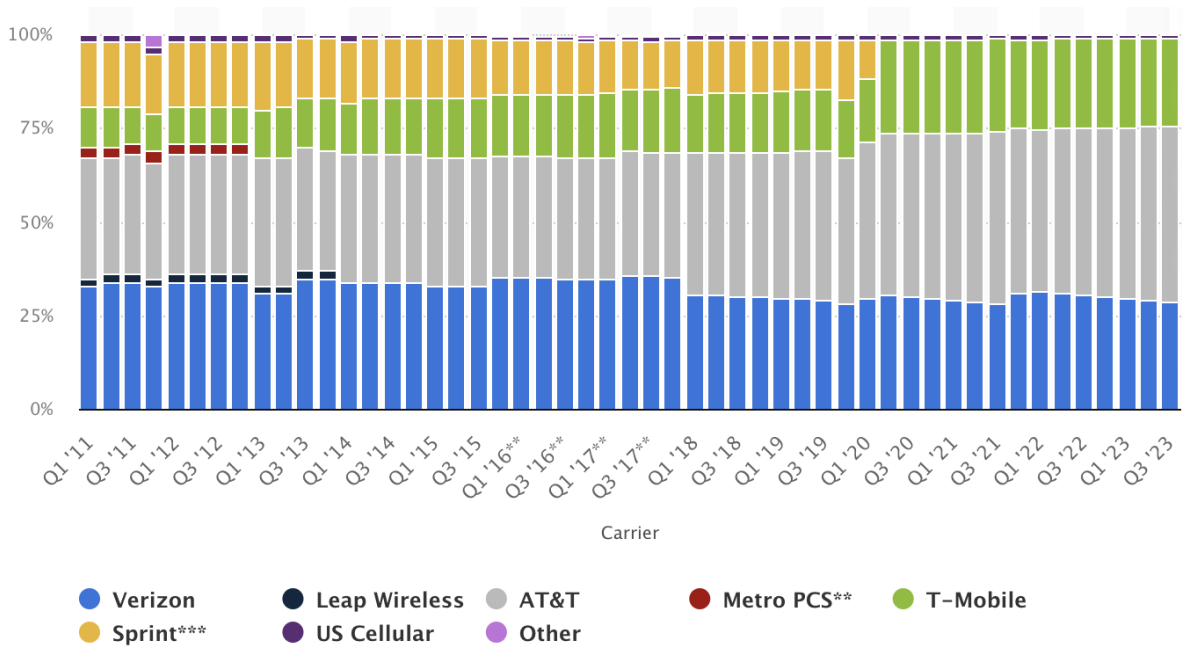
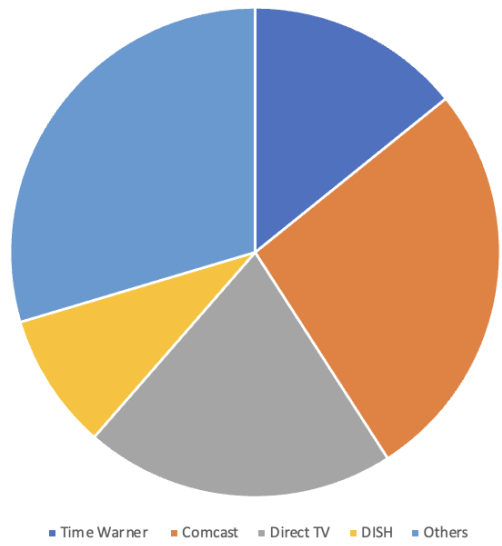


Exhibit 9 - Market Share Repartition in Media & Entertainment Industry.

Market Share Ripartition in Media & Entertainment Sector



*Exhibit 10 – Statistical Abnormal Return of Mergers based on Payment Method.*

payment method	Days	N	CAAR	Patell Test	CDA test	CSEctErrt
total	(-60,-2)	1383	6.43%	15.404	12.462	9.768
	(-1,+1)	1383	22.02%	237.442	189.26	28.999
	(+2,+20)	1382	-0.34%	-0.884	-1.149	-1.839
cash only	(-60,-2)	898	7.96%	15.272	11.606	8.992
	(-1,+1)	898	25.99%	217.697	168.12	24.33
	(+2,+20)	897	-0.60%	-1.434	-1.534	-3.293
stock only	(-60,-2)	168	2.88%	2.2212	2.129	1.611
	(-1,+1)	168	9.18%	38.539	30.107	6.86
	(+2,+20)	168	0.44%	0.486	0.57	0.456
alternative	(-60,-2)	78	4.08%	2.5	2.08	1.93
	(-1,+1)	78	20.96%	64.09	47.44	10.86
	(+2,+20)	78	0.49%	1.1012	0.441	0.581
combination	(-60,-2)	239	3.95%	4.173	3.693	3.445
	(-1,+1)	239	16.46%	80.272	68.212	15.925
	(+2,+20)	239	-0.17%	-0.333	-0.283	-0.488

*Exhibit 11 – Necessary Data for WACC Estimation.*

## **WACC Estimation**

Beta equity/Beta levered	0,360
Risk-free Rate	3,50%
Market Risk Premium	6,00%
Beta Debt	0,05
Beta unlevered	0,302
Cost of Debt	3,80%
Cost of Equity	5,66%
Haircut	2,00%
Tax rate	35,00%
<b>WACC Post tax</b>	<b>6,92%</b>

Exhibit 12 – Football field Chart of Time Warner Valuation.

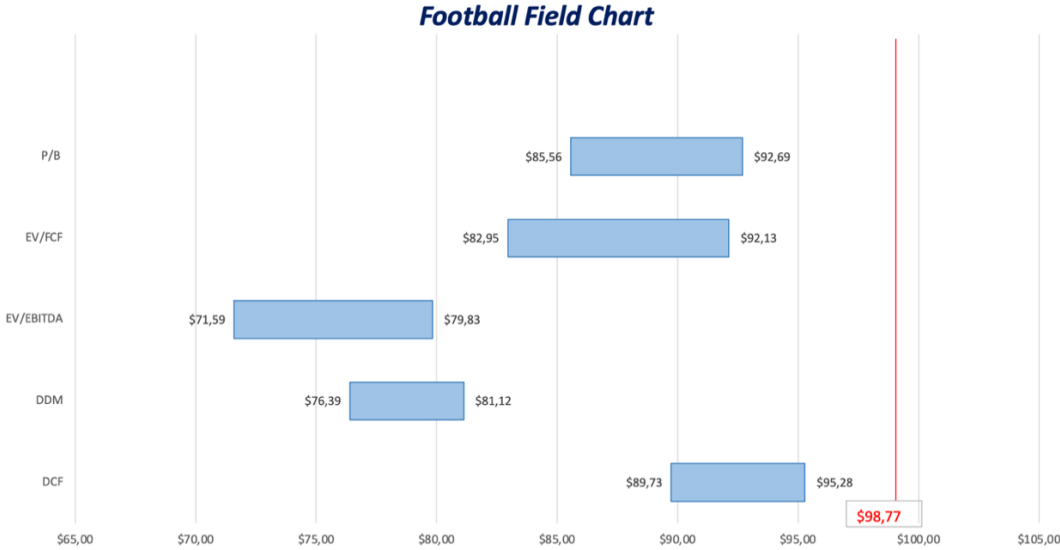
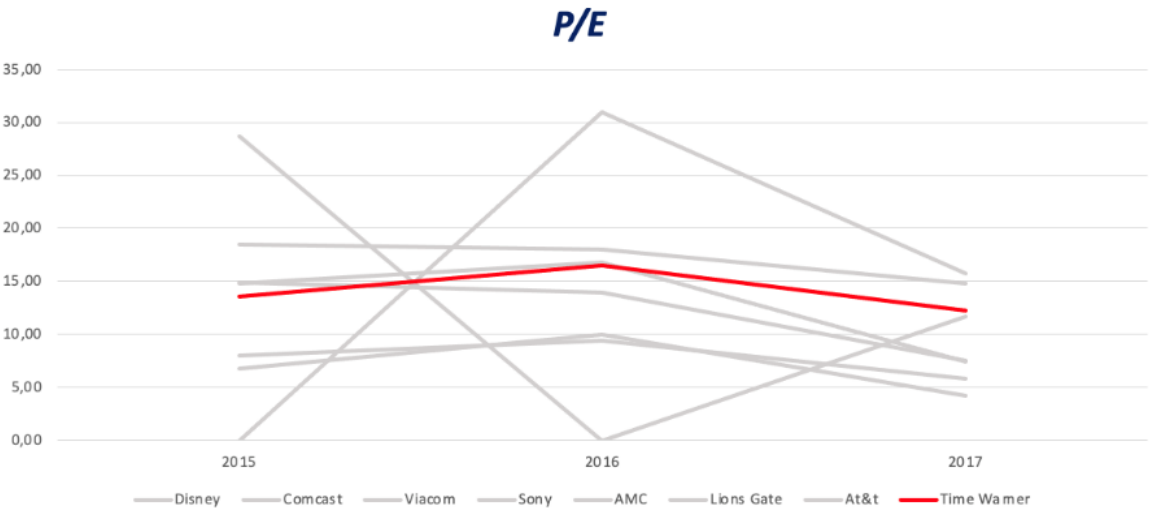


Exhibit 13 – Revenues Synergies’ NPV per Time Warner’s share.

**NPV of Synergies per share**

Present Value of Synergies	2.048,680 \$
Present Value of Terminal Value	4.933,759 \$
Shares outstanding	780,00
<b>NPV of synergies per share</b>	<b>8,952 \$</b>

Exhibit 14 – P/E Multiple comparison between Time Warner and its competitors.



## Additional Exhibits for Students:

### Time Warner Consolidated Statement of Cash Flows t in 2017.

**TIME WARNER INC.**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**  
Year Ended December 31,  
(millions)

	2017	2016	2015
<b>OPERATIONS</b>			
Net income	\$ 5,244	\$ 3,925	\$ 3,832
Less Discontinued operations, net of tax	—	(11)	(37)
Net income from continuing operations	5,244	3,914	3,795
Adjustments for noncash and nonoperating items:			
Depreciation and amortization	694	669	681
Amortization of film and television costs	9,162	8,324	8,030
Asset impairments	16	43	25
(Gain) loss on investments and other assets, net	(367)	(131)	31
Equity in losses of investee companies, net of cash distributions	191	324	161
Equity-based compensation	227	277	182
Deferred income taxes	(1,010)	236	328
Premiums paid and costs incurred on debt redemption	1,087	1,008	72
Changes in operating assets and liabilities, net of acquisitions:			
Receivables	(704)	(1,201)	(112)
Inventories and film costs	(9,574)	(8,774)	(8,526)
Accounts payable and other liabilities	624	631	(200)
Other changes	(496)	(637)	(616)
Cash provided by operations from continuing operations	5,094	4,683	3,851
Cash used by operations from discontinued operations	(15)	(17)	(8)
Cash provided by operations	5,079	4,666	3,843
<b>INVESTING ACTIVITIES</b>			
Investments in available-for-sale securities	(1)	(9)	(41)
Investments and acquisitions, net of cash acquired	(706)	(1,228)	(672)
Capital expenditures	(656)	(432)	(423)
Other investment proceeds	367	309	143
Cash used by investing activities	(996)	(1,360)	(993)
<b>FINANCING ACTIVITIES</b>			
Borrowings	4,270	3,830	3,768
Debt repayments	(5,001)	(3,304)	(2,344)
Proceeds from exercise of stock options	206	172	165
Excess tax benefit from equity instruments	—	88	151
Principal payments on capital leases	(39)	(14)	(11)
Repurchases of common stock	—	(2,322)	(3,632)
Dividends paid	(1,265)	(1,269)	(1,150)
Other financing activities	(1,172)	(1,103)	(260)
Cash used by financing activities	(3,001)	(3,922)	(3,313)
<b>INCREASE (DECREASE) IN CASH AND EQUIVALENTS</b>	1,082	(616)	(463)
<b>CASH AND EQUIVALENTS AT BEGINNING OF PERIOD</b>	1,539	2,155	2,618
<b>CASH AND EQUIVALENTS AT END OF PERIOD</b>	\$ 2,621	\$ 1,539	\$ 2,155

Time Warner Consolidated statement of Comprehensive Income in 2017.

TIME WARNER INC.  
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME  
Year Ended December 31,  
(millions)

	2017	2016	2015
Net income	\$ 5,244	\$ 3,925	\$ 3,832
Other comprehensive income, net of tax:			
Foreign currency translation:			
Unrealized gains (losses) occurring during the period	178	(121)	(289)
Reclassification adjustment for losses realized in net income	—	—	5
Change in foreign currency translation	178	(121)	(284)
Securities:			
Unrealized gains occurring during the period	1	—	1
Reclassification adjustment for losses realized in net income	1	—	—
Change in securities	2	—	1
Benefit obligations:			
Unrealized losses occurring during the period	(98)	(21)	(26)
Reclassification adjustment for losses realized in net income	29	67	22
Change in benefit obligations	(69)	46	(4)
Derivative financial instruments:			
Unrealized gains (losses) occurring during the period	(94)	58	88
Reclassification adjustment for (gains) losses realized in net income	56	(47)	(83)
Change in derivative financial instruments	(38)	11	5
Other comprehensive income (loss)	73	(64)	(282)
Comprehensive income	5,317	3,861	3,550
Less Comprehensive loss attributable to noncontrolling interests	3	1	1
Comprehensive income attributable to Time Warner Inc. shareholders	\$ 5,320	\$ 3,862	\$ 3,551

# Time Warner Consolidated Balance Sheet in 2017.

**TIME WARNER INC.**  
**CONSOLIDATED BALANCE SHEET**  
(millions, except share amounts)

	2017	2016
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and equivalents	\$ 2,621	\$ 1,539
Receivables, less allowances of \$896 and \$981	9,401	8,699
Inventories	2,401	2,062
Prepaid expenses and other current assets	796	1,185
Total current assets	15,219	13,485
Noncurrent inventories and theatrical film and television production costs	8,275	7,916
Investments, including available-for-sale securities	3,924	3,337
Property, plant and equipment, net	2,707	2,510
Intangible assets subject to amortization, net	585	783
Intangible assets not subject to amortization	7,006	7,005
Goodwill	27,776	27,752
Other assets	3,717	3,178
Total assets	\$ 69,209	\$ 65,966
<b>LIABILITIES AND EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	\$ 7,916	\$ 7,192
Deferred revenue	711	564
Debt due within one year	5,450	1,947
Total current liabilities	14,077	9,703
Long-term debt	18,294	22,392
Deferred income taxes	1,584	2,678
Deferred revenue	468	486
Other noncurrent liabilities	6,375	6,341
Redeemable noncontrolling interest	35	29
Commitments and Contingencies (Note 17)		
<b>Equity</b>		
Common stock, \$0.01 par value, 1.652 billion shares issued and 780 million and 772 million shares outstanding	17	17
Additional paid-in capital	145,077	146,780
Treasury stock, at cost (872 million and 880 million shares)	(47,074)	(47,497)
Accumulated other comprehensive loss, net	(1,437)	(1,510)
Accumulated deficit	(68,208)	(73,455)
Total Time Warner Inc. shareholders' equity	28,375	24,335
Noncontrolling interest	1	2
Total equity	28,376	24,337
Total liabilities and equity	\$ 69,209	\$ 65,966

A Work Project, presented as part of the requirements for the Award of a Master's degree in  
Finance from the Nova School of Business and Economics.

# **Shaping the Media Landscape: Analyzing the Industry effects of AT&T's acquisition of Time Warner**

NICHOLAS ZINI

Work project carried out under the supervision of:

Pranav Desai

15/01/2024

## **Abstract**

In the last months of 2016, AT&T publicly revealed its proposal to acquire Time Warner, marking a significant vertical integration in the telecommunications and media sector. AT&T sought to strengthen its market influence, raising concerns from the Department of Justice (DOJ). Despite DOJ's lawsuit, a federal court approved the acquisition. This case study delves into the industry's first major vertical integration, examining DOJ's concerns regarding its possible impact on competition and consumers.

## **Key Words:**

- *Competition*
- *Vertical Integration*
- *Costs*
- *Consumers*

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## **The Merging Companies**

AT&T holds the title of the world's telecommunications giant, offering a diverse array of wireless and landline telecommunication services. Additionally, it functions as a provider of diverse video programming channels via DirecTV Now and DirecTV.

On the other hand, Time Warner is a prominent media entity engaged in the ownership and production of video content through subsidiaries like Turner Broadcasting System, CNN and HBO. Notably, Time Warner distributes its video content to multichannel video programming distributors (MVPDs), encompassing several competitors of AT&T.

## **Vertical Integration in the Professional Video Production and Distribution Pipeline**

Vertical integrations involve the merging of two or more companies operating in separate stages of the supply chain, this means that a vertically integrated firm will incorporate formerly contracted-out activities within its own operations. The primary objective of vertical integration is to substitute external market transactions with internal exchanges carried out within the confines of the firm. This achievement can be attained through progressive integration into a downstream market or regressive integration into an upstream market. Specifically, the value chain connected to the development and broadcasting of professional video content is organized into three distinct levels (*Exhibit. 1*): studios responsible for content production, television entities specialized in the aggregation of content, and distributors tasked with delivering content to consumers. Each of these layers exhibits efficiencies in scale, significant fixed expenditures, and distinctive product characteristics.

This implies that nearly all suppliers possess the capacity to establish prices exceeding marginal costs and participate in competitive price discrimination. Additionally, the products within each

layer complement those in other layers, establishing a strong interdependence among suppliers at different levels, as they rely on each other for complementary inputs.

Production studios create television programs and films, exercising control over the distribution timing and methods for this content. The prominent film studios encompass 21<sup>st</sup> Century Fox, Walt Disney, Time Warner, Sony, Viacom, and NBCUniversal. Television networks compile content into a sequential broadcast that may consist of TV shows, movies, and commercials. Given their roles and attributes, the substantial vertical integration between studios and premium networks is not a surprise. Indeed, Time Warner consists of three divisions: Warner Bros. Entertainment, the preeminent film and television studio on a global scale; Turner Broadcasting System, which possesses important cable networks such as TBS, TNT, CNN; and HBO, the premier premium cable network.

Ultimately, video programming reaches consumers through distributors. Traditional distributors, consist of cable entities (e.g., Comcast, Charter Communications), direct broadcast satellite firms (e.g., Dish Network, and AT&T-owned DirecTV), broadband service providers (e.g., Google Fiber, RCN), and telecom companies (e.g., AT&T, Verizon).

### **The merged Company**

It is now easy to understand why this acquisition led to such interest: by merging Turner and HBO, with DirecTV and Time Warner, the transaction aims to form the exclusive major vertically integrated company across all three tiers of the value chain. As shown in *Exhibit. 2*, the resulting entity would hold the top-ranking film studio, the leading premium channels and the largest MVPD in the United States.

## **The bright side of vertical mergers**

Vertical mergers bring operational efficiencies, cost savings, and improved coordination by integrating supply chain stages.

The primary efficiency impacts of vertical mergers arise from improved vertical coordination and the realization of economies related to scope. These integrations frequently prove to be a more effective approach for coordinating activities than distant contractual arrangements, allowing companies to lower costs and enhance quality. In fact, a possible consequence of these mergers is the elimination of double marginalization (EDM): a phenomenon occurring when both upstream and downstream firms in a supply chain add a markup to the price, resulting in cost savings and potentially lead to lower prices for consumers. EDM would be economically comparable to a decrease in the merged firm's marginal cost associated with providing MVPD services.

However, achieving success is contingent on effective execution and adaptability to market dynamics. Regulatory scrutiny is instrumental in preventing anticompetitive practices, particularly given the potential for controlling supply chains to lead to vertical monopolies. This has the potential to adversely impact competition within the sector.

## **Ability-Incentive-Effect framework**

The majority of vertical theories of harm involve the merged entity excluding competitors, increasing costs for rivals, or facilitating horizontal collusion.

In the domain of antitrust analysis, the ability-incentive-effect (AIE) framework serves as a pivotal conceptual model for evaluating the competitive implications of vertical mergers.

This framework encompasses three integral components. First, the "ability" dimension scrutinizes the merged entity's capacity to wield anticompetitive practices, focusing on factors like market power and control over critical resources. The "incentive" aspect delves into the

economic motivations propelling the merged entity toward anticompetitive behaviour, assessing financial incentives for actions such as market dominance and price increases. Lastly, the "effect" dimension anticipates the overall impact of the merger on competition and consumer welfare, evaluating changes in market dynamics, pricing structures, and the competitive landscape. By systematically dissecting the ability, incentive, and effect of a merger, this framework provides a structured methodology to discern whether a vertical merger poses substantial risks to competition and consumer well-being, ensuring a thorough analysis of both economic motivations and the practical capabilities of the merged entity.

## **Concerns**

According to the Department of Justice, the anticipated merger was predicted to lead to a significant reduction in competition through two interconnected ways:

1. empower Turner and HBO to impose elevated prices on content for AT&T's competitor distributors and consequentially consumers due to their post-merger association with AT&T.
2. prevent AT&T's competitor distributors from utilizing Time Warner divisions as a promotional tool to draw in and retain customers.

The main argument from the Department of Justice was based on the expected increase in the cost of acquiring content. In simpler terms, the merged AT&T and Time Warner company might have less motivation to license their content to other companies that aren't vertically integrated. The idea here is that a company that's fully integrated in both creating and distributing content can afford to turn down deals with competitors because the profits from selling content downstream (to consumers) make up for the money lost from not licensing to other companies

upstream (other distributors). This theory assumes that the integrated company can strategically choose when and how to deal with non-integrated players to benefit itself.

### **Negotiations of Affiliate fees**

The concern about HBO and Turner potentially enforce elevated prices for content to competitors it's mainly attributable to the fact that networks engage in negotiations with video programming service providers to determine the conditions and terms under which their programming will be offered to these providers.

In the overwhelming majority of discussions between major programmers and MVPDs, there is a positive outcome resulting in mutual trade benefits. The key financial term in the majority of these agreements is the per-subscriber, per-month fees (PSPM) that the provider of video programming needs to pay to the network for each viewer granted access to the content provided by the programmer. Another important condition comprehends the fraction of MVPD's subscribers that have access to the broadcast.

Turner content, as per the year before the acquisition, is distributed by the majority of MVPDs, with over 85% of their consumers that have access to this content. Of this, 24.4 million are those of DTV.

This suggests that in the post-merger period, the combined company will continue to trade with competitors; the important aspects are the terms on which these contents will be available to Direct TV rivals.

This apprehension is justified by the crucial role that a video distributor's ability to compete on price plays in its operations profitability, primarily determined by the costs associated with acquiring the essential rights to distribute video programming. Moreover, this increase in prices may limit the ability of these competitors to offer competitive pricing or diverse content portfolios, potentially diminishing their market appeal and subscriber base; in fact, the greater

the expenses incurred by a video distributor in obtaining these rights, the higher the possibility that the prices imposed on consumers for its video distribution service increase.

### **DOJ's Predictions**

The Department of Justice's assessment of the anticipated impact of the merger on licensed prices for rival MVPDs predicts a surge of more than \$0.76 per subscriber per month exclusively for Turner content. This projection is a weighted average across various MVPDs, with subscriber counts determining the weights. This surge signifies a substantial rise in the weighted average fee paid by MVPDs from the year preceding the acquisition's finalization, which stood at \$4.70 PSPM. The overall increase would translate into a monthly total fee surge exceeding \$48.9 million and an annual increase of \$586.6 million. (*Exhibit. 3 and Exhibit. 4*)

On the other hand, the DOJ estimates that the elimination of double marginalization would create an incentive for the combined company to lower its prices, resulting in a projected \$1.20 reduction in DirecTV's marginal cost for Turner content.

### **TEACHING NOTE**

#### **Synopsis**

On June 15, 2018, AT&T officially announced the acquisition of Time Warner. This action represented a notable advancement in the changing dynamics between telecommunications and media. AT&T sought to secure a competitive edge by being the first to introduce vertical integration within the industry. Students tasked with analyzing this particular aspect of the deal should focus on the theory behind vertical integrations and its relevance to the Media and Entertainment sector. Additionally, they should delve into the concerns raised by the Department of Justice (DOJ), aiming to assess the practical implications of this uneasiness.

## **Pedagogical Objectives**

To adequately equip master's in finance students for this case study, it would be advantageous for them to have a good comprehension of valuation concepts in Financial Statement Analysis, along with familiarity with profitability analysis processes. Additionally, a clear understanding of vertical integrations and the related theories of harm will be beneficial.

To guarantee students acquire a thorough understanding, the educational goals should encourage critical and strategic thinking. The pedagogical objectives of this case study comprehend:

### ***1. Vertical integration analysis***

- Reflect on the ability-incentive-effect theory and apply it to the AT&T/Time Warner case.
- Comprehend profitability analysis considerations, recognizing the implications of vertical integration for market dynamics and competition.

### ***2. Effects on downstream customers***

- Evaluate the potential consequences of the acquisition on consumer welfare.

## **Raising rival's costs**

Commence the discussion by encouraging students to investigate whether AT&T has the ability to raise its rivals' costs. Subsequently, prompt them to elaborate on whether AT&T has the motivation to undertake such actions and, if so, how the company might go about it.

They should refer to the above mentioned ability-incentive-effect framework.

Regarding the ability to harm, the students are expected to conduct some reflections regarding the importance of the "input" acquired by AT&T. The fundamental question regards the

significance of the acquired input for downstream rivals. Specifically, it assesses whether the competitiveness of these adversaries would be considerably compromised if they were deprived of access to the input or confronted with elevated prices for it. This investigation considers two key aspects: the current and anticipated future reliance of downstream rivals on the acquired input and the potential escalation in costs or decline in quality they might experience without access to or with higher prices for this input. The central economic investigation revolves around the availability of viable alternatives for the input in question among downstream rivals. Second, regarding the incentive, the pivotal question is whether diminishing the strength of these lower-tier competitors would boost the financial gains of the merged firm, primarily through redirected sales to end consumers.

Third, with focus on the effects, they should evaluate whether the acquisition will generate significant efficiencies, encompassing those resulting from the elimination of double marginalization (EDM).

### **Application to the acquisition**

Having clear in mind the functioning of this theory, the students are now expected to conduct qualitative considerations regarding the ability and the incentive of raising rivals' cost from AT&T.

In the AT&T/Time Warner case, the relevant product is the distribution of video content to households and the "relevant input" are both Turner and HBO contents, each under the ownership of Time Warner.

The central issue raised by the government is that the company might raise costs for rival MVPDs by imposing higher fees for Turner and HBO. Put simply, the theory suggests that before the merger, in the moment Turner licensed its content to a generic MVPD as Dish or Comcast, Turner had some additional costs that impacted its pricing in the typical way

(advertising revenue generated by Turner functions as a negative marginal cost linked to additional subscribers). Post-merger, the integrated company would encounter an additional expense when licensing Turner Content to Dish, this because providing Dish with access to Turner Content might attract subscribers away from DirecTV. This extra cost would lead the merged entity to increase the price it charges to its competitors for the Turner Content. As a result, the heightened cost for Turner content would undermine Dish by raising its costs.

After these considerations, the students should be able to conclude that AT&T might have both the incentive and the power to raise rival's costs. AT&T gains an advantage because it directly competes with Comcast and Dish, and their competition becomes less intense if their costs are increased.

## **Dish Analysis**

The objective of this analysis is to evaluate the key characteristics of the multichannel video programming distributors operations profitability, with an emphasis on assessing the potential impact of anticompetitive behaviour from the merged company on the financial performance of competitors. The analysis spans from 2016 (the year of the acquisition announcement) through 2019 (the year following the acquisition). While recognizing that the potential effects of the acquisition may manifest over a more extended timeframe, there should already be discernible indicators for the year subsequent to the acquisition.

In an effort to conduct this analysis, students should have a foundation of financial analysis, particularly in ratio analysis. Bearing in mind that ratios facilitate the diagnosis of a company's economic and financial performance, it's important to acknowledge that they are not without their fair share of limitations. The more ratios are scrutinized, the more comprehensive the understanding of the company, reducing the likelihood of forming an inaccurate picture.

In order to achieve this, Dish profitability, one of the major competitors of Direct TV and consequently AT&T, will be analysed.

The reasoning behind the decision of focusing on Dish is supported by the fact that it can be one of the companies most affected by this transaction, in fact, as we can read in the competition section of its 2019 annual report referring to the acquisition of Time Warner by AT&T, “*These transactions may affect us adversely by, among other things, making it more difficult for us to obtain access to certain programming networks on non-discriminatory and fair terms, or at all. In October 2018, AT&T removed its HBO channels from our DISH TV and Sling TV programming lineup, as we and AT&T have been unable to negotiate the terms and conditions of a new programming carriage contract*”. Still, “*The cost of programming represents the largest percentage of our overall costs*”.

In order to conduct this analysis, the students should be provided with some information related to the studied company and its business, together with its income statements: as of 2019, DISH Network Corporation is a major satellite television provider in the United States. Operating as a direct-broadcast satellite service provider, Dish offers a wide range of television channels and interactive TV services. The company's business includes the distribution of satellite signals, customer equipment provision, and content delivery, positioning itself as a key competitor to industry giants like AT&T. With a view to better understand the company and its operations, the students can use the annual reports provided by the organization.

To get a full grasp at the company and understand the weight of each caption to its overall return, students are expected to figure out the main drivers behind each cost and revenue. As observable in *Exhibit.5* most of the costs end up being % of revenues. Given that Dish's revenue and profit have historically relied heavily on Pay-TV programming and that both HBO and Turner have traditionally been core components of cable and satellite TV packages, integral to the pay TV industry, the heightened challenges in obtaining HBO and Turner content might

have had an impact in the declining subscriber related revenue observed from 2016. (*Exhibit.*

6) With that, the gross margin of the company slightly decreased, meaning that the firm's ability to generate profit from each sales decreased. Considering that gross margin depends on the costs of the production process of the company and on the price charged, the acquisition may have played a significant role in the decrease of this ratio's value.

These conclusions offer a broad perspective on the repercussions experienced by Dish as a result of the acquisition, acknowledging that other factors may have also played a significant role in this scenario.

Being difficult to assess the effective values of the cost related to the acquisition of content, the students should switch their attention to the subscriber acquisition costs.

This because subscriber acquisition cost measures are frequently employed by those assessing traditional companies in the pay-tv industry. These costs encompass various expenses linked to acquiring Dish TV subscribers, including acquisition advertising, direct sales efforts, and commissions, among other factors. It's possible to notice that they increase in the year of the acquisition, together with a decrease in Dish-tv subscribers of -12% from the year of the announcement to the completion of the acquisition. (*Exhibit.7*)

In part, this can be attributable to the possible loss of appeal that Dish might face after the shrinkage of the communications canals with networks like HBO and Turner.

After these considerations, students should be able to conclude that the acquisition of Time Warner by AT&T and its preclusion to important networks like HBO and Turner might had an impact to the profitability of Dish. Despite this, more in deep analysis and over an extended timeframe should be conducted to draw clearer conclusion on this item. Anyway, Dish data related to the subscribers can provide the students important insights for the analysis.

## Consumers Welfare

The logical follow-up examination comprehends a consideration on how the merger might impact downstream consumers. The students here are expected to provide considerations related to the elimination of double marginalization concept: as a first aspect, EDM is applicable solely to sales conducted by the downstream merging firm that utilize input from the upstream merging firm, and this is definitely the case of AT&T with Time Warner.

Then, it is crucial to contemplate and factor that due to this effect the merger might lead the integrated firm to reduce its own downstream price.

This reduction is motivated by the potential to attract additional customers who currently lack access to HBO and Turner content. This, in turn, can contribute to increased profits for the combined firm's upstream activities.

On the other hand, students are expected to understand that the limited pro-competitive effect in this case stems from the fact that Turner and HBO content is already accessible to the majority of MVPD subscribers, as stated in the text. A decrease in prices for DirecTV would, exert only a limited influence on households with access to this content. Consequently, the incentive generated by eliminating double marginalization, estimated by the DOJ as a \$1.20 reduction in DTV's marginal cost for solely Turner content, is relatively small within the AT&T/Time Warner merger. In fact, by applying the \$1.20 per subscriber per month term to the 24.4 million DTV subscribers with Turner content, the projected monthly savings for DTV amount to around \$29.3 million.

This merger stands out as atypical in this crucial aspect of vertical mergers. Hence, the probable unfavourable effect on MVPD subscribers in the United States, caused by the heightened fees charged to competing MVPDs for the Turner Content, is expected to outweigh the advantages derived from eliminating double marginalization for these subscribers. (*exhibit.8*)

In fact, AT&T's MVPD rivals would probably transfer a portion of the increased programming fees for Turner content post-merger to their subscribers, resulting in elevated subscription fees. Despite this, the rate of change for cost decreases resulting from EDM in AT&T may differ from the rate of cost increases anticipated for AT&T's rivals due to the merger, contingent on the nature of downstream competition among MVPDs and the level of competition in regional markets.

## **Conclusions**

In conclusion, this case study serves as a valuable tool for students to delve into the Department of Justice's reservations surrounding the AT&T acquisition of Time Warner. By exploring the intricacies of vertical integration theory, using the relevant ability-incentive-effect framework, and recognizing the main factors influencing the profitability of companies in professional video production and distribution, students are well-positioned to grasp the reasons behind the DOJ's concerns. This comprehensive understanding sheds light on the complexities of the AT&T-Time Warner merger, revealing the potential implications for competition and consumer welfare. As students navigate this case, they gain not only insights into a pivotal industry merger but also a deeper appreciation for the intricate intersections of business, regulation, and market dynamics.

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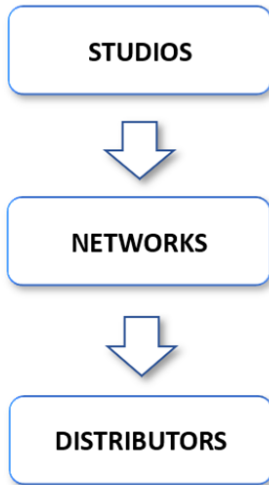
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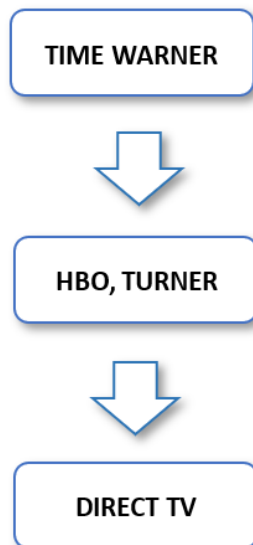
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## **APPENDIX**

*Exhibit.1 - Professional Video Production and Distribution Pipeline*



*Exhibit.2 – The Merging Company*



*Exhibit.3 – Prediction of the Monthly Fee Increases for MVPDs*

MVPD	Turner subscribers	PSPM increase in carriage fee	% increase in PSPM carriage fee	Total change in carriage fee per month (\$)
Comcast	18.669.042	\$0,89	19,9%	\$ 16.667.223
Charter	14.409.233	\$0,95	20,0%	\$ 13.743.575
Dish	10.420.924	\$0,73	16,6%	\$ 7.592.570
Verizon	4.381.643	\$0,18	3,7%	\$ 791.475
Cox	3.183.534	\$0,96	20,0%	\$ 3.070.567
Altice	3.400.015	\$0,47	9,7%	\$ 1.584.281
Mediacom	706.332	\$0,79	15,0%	\$ 557.140
Other MVPDs	7.446.731	\$0,55	10,5%	\$ 4.063.190
Sling (vMVPD)	1.168.737	\$0,55	10,3%	\$ 647.195
Playstation Vue(vMVPD)	297.496	\$0,55	8,6%	\$ 163.243
<b>TOTAL</b>	<b>64.083.687</b>	<b>\$0,76</b>	<b>16,2%</b>	<b>\$ 48.880.459</b>
Yearly impact				\$ 586.565.513

*Exhibit.4 – Predicted increase in monthly cost to consumers*

MVPD	Increase in monthly cost to consumers (\$, PSMS)	Increase in monthly cost to consumers (\$, monthly)
DTV	\$ -0,26	\$ -6.300.033
Comcast	\$ 0,46	\$ 8.518.582
Charter	\$ 0,56	\$ 8.091.395
Dish	\$ 0,60	\$ 6.262.127
Verizon	\$ 0,26	\$ 1.125.357
Cox	\$ 0,22	\$ 744.703
Altice	\$ 0,54	\$ 1.719.786
Mediacom	\$ 0,60	\$ 423.139
Other	\$ 0,44	\$ 3.282.323
Overall	\$ 0,27	\$ 23.867.378
Annual Impact		\$ 286.408.538

Exhibit.5 – Dish’s Cost Value drivers

Costs Value drivers				
	2016	2017	2018	2019
Period End Date	31-Dec-2016	31-Dec-2017	31-Dec-2018	31-Dec-2019
Total Revenue	15.212.302	14.391.375	13.621.302	12.807.684
Subscriber-related expenses	8.913.624	8.919.985	8.544.577	7.869.593
<b>% of sales</b>	<b>58,59%</b>	<b>61,98%</b>	<b>62,73%</b>	<b>61,44%</b>
<b>% of total costs</b>	<b>69,14%</b>	<b>69,55%</b>	<b>74,50%</b>	<b>72,00%</b>
Satellite and transmission expenses	710.719	658.017	576.578	447.811
<b>% of sales</b>	<b>4,67%</b>	<b>4,57%</b>	<b>4,23%</b>	<b>3,50%</b>
<b>% of total costs</b>	<b>5,51%</b>	<b>5,13%</b>	<b>5,03%</b>	<b>4,10%</b>
Cost of sales - equipment and other	133.902	95.116	145.604	192.821
<b>% of sales</b>	<b>0,88%</b>	<b>0,66%</b>	<b>1,07%</b>	<b>1,51%</b>
<b>% of total costs</b>	<b>1,04%</b>	<b>0,74%</b>	<b>1,27%</b>	<b>1,76%</b>
Subscriber acquisition costs	1.456.492	1.204.261	769.307	994.526
<b>% of sales</b>	<b>9,57%</b>	<b>8,37%</b>	<b>5,65%</b>	<b>7,77%</b>
<b>% of total costs</b>	<b>11,30%</b>	<b>9,39%</b>	<b>6,71%</b>	<b>9,10%</b>
General and administrative expenses	735.954	687.054	725.601	793.480
<b>% of sales</b>	<b>4,84%</b>	<b>4,77%</b>	<b>5,33%</b>	<b>6,20%</b>
<b>% of total costs</b>	<b>5,71%</b>	<b>5,36%</b>	<b>6,33%</b>	<b>7,26%</b>
Depreciation/Amortization	921.202	817.564	712.024	630.577
<b>% of sales</b>	<b>6,06%</b>	<b>5,68%</b>	<b>5,23%</b>	<b>4,92%</b>
<b>% of total costs</b>	<b>7,14%</b>	<b>6,37%</b>	<b>6,21%</b>	<b>5,77%</b>
Unusual Expense (Income)	21.148	443.083	(3.743)	483
<b>% of sales</b>	<b>0,14%</b>	<b>3,08%</b>	<b>-0,03%</b>	<b>0,00%</b>
<b>% of total costs</b>	<b>0,16%</b>	<b>3,45%</b>	<b>-0,03%</b>	<b>0,00%</b>
Total Operating Expense	12.893.041	12.825.080	11.469.938	10.929.291

Exhibit.6 – Dish’s subscriber related revenues

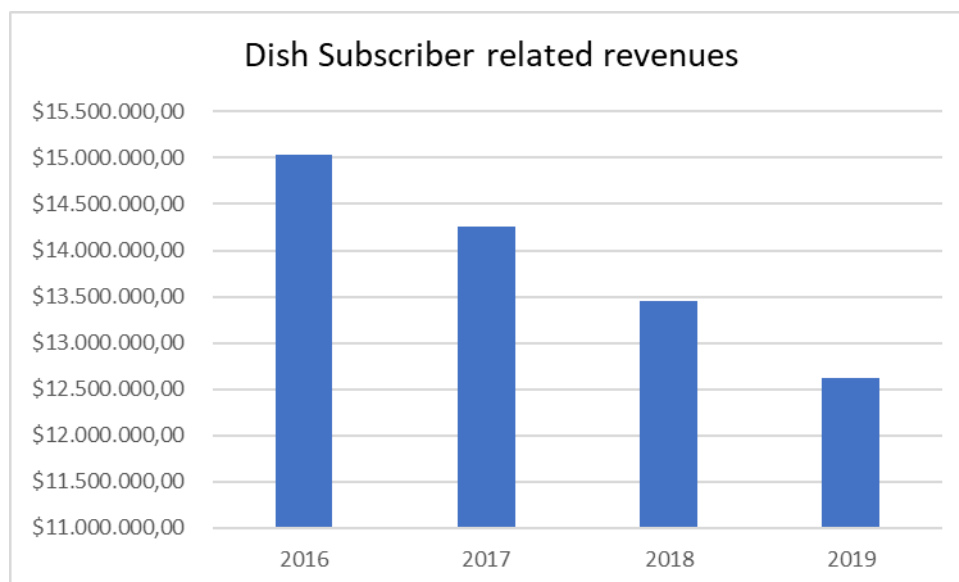


Exhibit.7 – Dish-Tv Subscribers

Dish-tv Subscribers				
	2016	2017	2018	2019
Other Data:				
Pay-TV subscribers, as of period end (in millions)	13.671	13.242	12.322	11.986
DISH TV subscribers, as of period end (in millions)	12.170	11.030	9.905	9.394
Sling TV subscribers, as of period end (in millions)	1.501	2.212	2.417	2.592
Pay-TV subscriber additions (losses), net (in millions)	(392)	(284)	920	(336)
DISH TV subscriber additions (losses), net (in millions)	(1.270)	(995)	(1.125)	(511)
Sling TV subscriber additions (losses), net (in millions)	878	711	205	175
Pay-TV ARPU	8.866	8.643	8.546	8.592
DISH TV subscriber additions, gross (in millions)	1.736	1.477	1.114	1.348
DISH TV churn rate	1.97%	1.78%	1.78%	1.62%
DISH TV SAC	832	751	759	822

Exhibit.8 - Predicted Net change for Turner Content due to the Acquisition

