# AT&T'S BID FOR TIME WARNER

**John Marsh**
**Woody Richardson**
**University of Mary Washington**

*On October 22, 2016 AT&T announced an agreement to buy Time Warner for over $85 billion. The agreement was met with surprise and a fair bit of skepticism. Only two years earlier in 2014, executives at Time Warner advised shareholders to reject an offer of $89 billion from 21st Century Fox as undervaluing the organic growth prospects of the company. Furthermore, AT&T was already highly leveraged. In 2015, AT&T acquired DirectTV for $48.5 billion in cash and stock – a deal that AT&T was still digesting. There were also concerns as the disastrous merger of AOL and Time Warner was still fairly fresh (2009). The AT&T-Time Warner deal was still subject to regulatory approval, and although some had spoken out against the deal, regulators did approve a similar merger of Comcast and NBC Universal back in 2011. With these concerns about the price, strategic fit, debt load, and regulatory approval, many were skeptical of the deal's efficacy.*

## INTRODUCTION

On October 22, 2016 AT&T announced that executives at Time Warner had agreed to sell the company for $85.4 billion. The deal came as somewhat of a surprise because of the fallout of 21st Century Fox's failed bid for Time Warner in 2014. Despite an initial offer of $80 billion, and signals that it was willing to raise its offer to $89 billion, executives at Time Warner advised shareholders that the deal undervalued the company and that they expected more from Time Warner's organic growth prospects. Executives and shareholders at Fox thought that Time Warner was asking too much, so Fox withdrew the deal shortly thereafter (Peers & Hagey, 2014). So, it came as somewhat of a surprise when two years later executives at Time Warner recommended the acceptance of an $85 billion offer from AT&T.

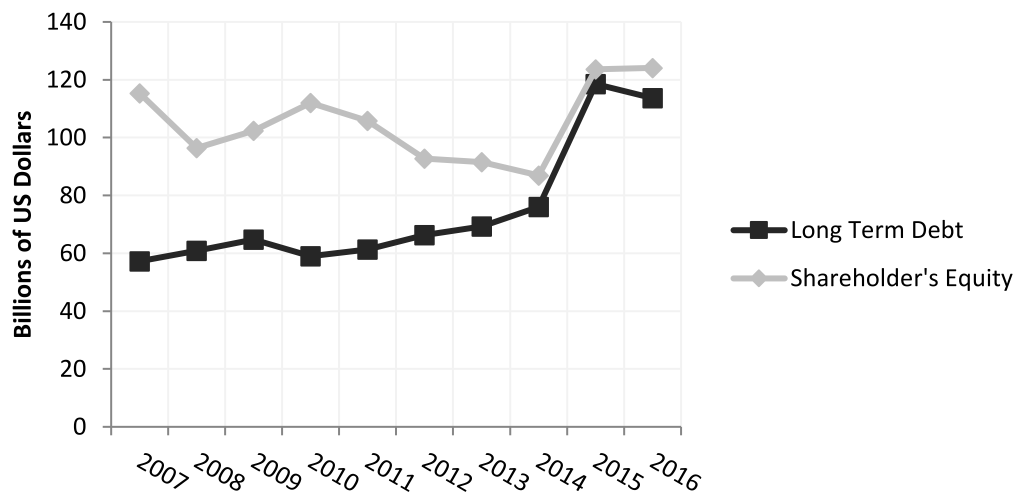
## AT&T

AT&T, formerly known as SBC Communications Inc. (SBC), became an independent publicly-traded telecommunications service provider in 1984 as a result of the anti-trust consent decree breaking up AT&T Corp. SBC was one of several regional holding companies providing local telephone service as a part of the holding company, AT&T Corp. In 1984, SBC mainly operated in five southwestern states. It expanded its operations through the years through a series of mergers: Pacific Telesis Group (1997), Southern New England Telecommunications Corporation (1998), and Ameritech Corporation (1999) which expanded its coverage into 13 states. In 2005, SBC changed its name to AT&T Inc. and in 2006 it increased its landline coverage to 19 states after merging with BellSouth. More importantly, it gained BellSouth's stake in AT&T Mobility (formerly Cingular Wireless). In 2015, AT&T acquired DirectTV, a major supplier of digital television entertainment in North and South America for $48.5 billion (AT&T, 2015). The Time Warner deal would be AT&T's biggest yet. As AT&T's CEO, Randall Stephenson, observed "In this industry, if you can achieve scale, and manage scale and complexity, it's a massive competitive advantage." (Gryta, 2016) Stephenson went on to say, "A big customer pain point is paying for content once but not being able to access it on any device, anywhere. Our goal is to solve that." (Knutson, 2016).

The company's services and products were marketed under the AT&T, Cricket, DIRECTV, SKY, Iusacell, Unefon and Nextel Mexico brand names. The services and products offered included: wireless communications, data/broadband and Internet services, digital video services, local and long-distance telephone services, telecommunications equipment, managed networking, and wholesale services. See Table 1 (at the end of the case) for a breakdown of AT&T's sales by its business reporting segments (AT&T, 2015).

**EXHIBIT 1:**

**Growth in AT&T's Debt and Equity** (Source: Mergent Online, 2017)



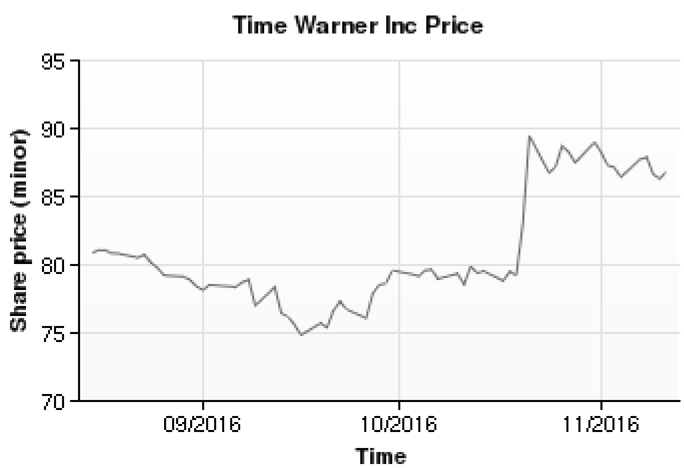

As some parts of the company grew so did its debt to cover the investments in expansion and acquisition. The Exhibit 1, shows that growth from 2007-2016. Detailed information can be found in AT&T's consolidated financial statements as shown in Appendix A.

## TIME WARNER

Time Warner was formed in 1990 through merger of Time Inc. and Warner Communications. It was the third largest TV content provider. In recent years, the company had positioned itself as a pure content provider including the spin -off of AOL, Time Warner Cable pay TV, and Time magazine (Time Warner, 2016). The company went through extensive restructuring, but still included much of former Warner's original assets including Warner Bros studios, the TBS, TNT, CNN, CW, and HBO networks, DC Comics, and a 10% stake in Hulu. Some analysts believed Time Warner's premium content brands made it the most attractive stand-alone media asset. The fact that it didn't have a controlling shareholder and its $28 billion in revenue in 2015 made the company all the more attractive (Ramachandran, Mattioli, & Hagey, 2016). The financial statements for Time Warner may also be found in the Appendix.

The acquisition announcement placed a significant premium over the current trading value for Time Warner. As shown below in Exhibit 2, shares of Time Warner's stock rose considerably on the acquisition offer.

**EXHIBIT 2:**
**Time Warner Increase Price** (Source: Mergent Online, 2017)




## CONCLUSION

Bringing a content provider (entertainment) together with a distribution network had been tried before, most notably, AOL and Time Warner in 2001 and Comcast's acquisition of NBCUniversal. Some analysts argued that the 2011 Comcast/Universal deal had exhibited few synergies (Smith, 2016). Consumer groups were skeptical of AT&T's bid for Timer Warner as well. Michael Copps, former FCC Commissioner and advisor to Common Cause, was quoted as saying "Allowing a communications behemoth like AT&T to swallow the Time Warner media empire should be unthinkable." (Eggerton, 2016) Indeed, the Justice Department had denied Comcast's 2009 purchase of Time Warner Cable from Time Warner stating it would have concentrated too much power in an internet gatekeeper. In 2011, AT&T's bid for T-Mobile was blocked also. AT&T countered that buying Time Warner was not monopolistic since they were buying a supplier (vertical, not horizontal integration) similar to the approved Comcast/Universal deal (Eggerton, 2016). The 2016 U.S. Presidential election also cast a shadow over the deal with both candidates expressing disapproval of the deal. On the campaign trail, Donald Trump stated "AT&T is buying Time Warner, and thus CNN, a deal we will not approve in my administration because it's too much concentration of power in the hands of too few." (Knutson, 2016)

The regulatory hurdles notwithstanding, there was still the question of the value of the deal. As of October 31, 2016 the shares of Time Warner were still trading below AT&T's offer price, insinuating that the deal might not go through. And the deal offer of $85 billion was significantly below 21st Century Fox's $89 billion bid two years ago. Did AT&T offer too much or did Time Warner accept too little?

## REFERENCES

AT&T Inc. *Form 10-K 2016.* Retrieved from SEC EDGAR website http://www.sec.gov/edgar.shtml

AT&T Inc (NYS: T). (n.d.). Company Financials. Retrieved March 25, 2017, from http://www.morningstar.com/.

Eggerton, J. (2016). AT&T Calls Collect. *Broadcasting & Cable*, *146*(38), 8-10.

Gryta, T. (2016, October 22). The AT&T-time warner talks: Deal-making CEO reshapes AT&T. *Wall Street Journal*, p. A6.

Knutson, R. (2016, Oct 22). AT&T, verizon make differing bets as wireless growth stalls; AT&T turns to television with its $80 billion agreement to buy time warner, while verizon bets on silicon valley with deals for AOL and yahoo. *Wall Street Journal (Online)* Retrieved Nov. 11, 2016.

Time Warner Inc (NYS: TWX). (n.d.). Company Financials. Retrieved March 25, 2017, from http://www.morningstar.com/.

Time Warner Inc (NYS: TWX). (n.d.). Company Financials. Retrieved March 25, 2017, from http://www.mergentonline.com/.

Ramachandran, S., Mattioli, D., & Hagey, K. (2016, October 22). The AT&T-time warner talks: Talks signal start of a new merger dance. *Wall Street Journal*, p. A6.

Smith, G. (2016). Where the Future's AT(&T). *Bloomberg Businessweek*, (4497), 22-23.

**TABLE 1**
**AT&T Operating Segments**

| | Consolidated Operating Revenue (in billions of U.S. Dollars) | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| Business Solutions Segment | | | |
| Wireless Service | $31.85 | $30.69 | $30.18 |
| Fixed Strategic Services | 11.39 | 10.46 | 9.30 |
| Legacy Voice and Data | 16.36 | 18.47 | 20.23 |
| Wireless equipment | 7.78 | 7.95 | 7.04 |
| Other | 3.62 | 3.56 | 3.86 |
| Entertainment Group Segment | | | |
| Video entertainment | 36.45 | 20.27 | 6.83 |
| High-speed internet | 7.47 | 6.60 | 5.52 |
| Legacy voice and data services | 4.83 | 5.91 | 7.59 |
| Other | 2.53 | 2.51 | 2.29 |
| Consumer Mobility Segment | | | |
| Wireless service | 27.54 | 29.15 | 30.85 |
| Equipment | 5.66 | 5.92 | 5.92 |
| International Segment | | | |
| Video entertainment | 4.91 | 2.15 | - |
| Wireless service | 1.91 | 1.65 | - |
| Equipment | 0.47 | 0.30 | - |

Source: AT&T, 2016

## APPENDIX A – Consolidated Financial Statements

**Annual Income Statements** (all number in millions)

| | AT&T | | | Time Warner | | |
|---|---|---|---|---|---|---|
| Fiscal Year Ending | 12/31/16 | 12/31/15 | 12/31/14 | 12/31/16 | 12/31/15 | 12/31/14 |
| Total Revenue | $163,786 | $146,801 | $132,447 | $29,318 | $28,118 | $27,359 |
| Costs of Goods Sold | 38,276 | 35,782 | 60,611 | 16,376 | 16,154 | 15,875 |
| Gross Profit | 125,510 | 111,019 | 71,836 | 12,942 | 11,964 | 11,484 |
| Indirect Operating Costs | | | | | | |
| Selling General & Admin. | 74,955 | 64,218 | 39,697 | 5,123 | 4,824 | 5,190 |
| Depreciation & Amortization | 25,847 | 22,016 | 18,273 | 190 | 189 | 202 |
| Other Operating Expense | 361 | - | 2,120 | 160 | 85 | 581 |
| Total Indirect Operating Costs | 101,163 | 86,234 | 60,090 | 5,473 | 5,098 | 5,973 |
| Operating Income | 24,347 | 24,785 | 11,746 | 7,469 | 6,866 | 5,511 |
| Non-Operating Income / Expenses | | | | | | |
| Interest Income (Expense) | -4,910 | -4,120 | -3,613 | -1,161 | -1,163 | -1,169 |
| Other Non-Operating Income | 277 | -52 | 1,652 | -830 | -134 | 490 |
| Total Non-Operating Income | -4,633 | -4,172 | -1,961 | -1,991 | -1,297 | -679 |
| Earnings Before Tax | 19,714 | 20,613 | 9,785 | 5,478 | 5,569 | 4,832 |
| Taxation | 6,479 | 7,005 | 3,442 | 1,281 | 1,651 | 785 |
| Minority Interests | 357 | 342 | 294 | -1 | -1 | 0 |
| Equity Earnings | 98 | 79 | 175 | -283 | -123 | -153 |
| Discontinued Operations | | | | 11 | 37 | -67 |
| Net Income | $12,976 | $13,345 | $6,224 | $3,926 | $3,833 | $3,827 |
| Dividends Paid | ($11,797) | ($10,200) | ($9,552) | ($1,269) | ($1,150) | ($1,109) |
| Contribution to Retained Earnings | $1,179 | $3,145 | ($3,328) | $2,657 | $2,683 | $2,718 |
| Number of Shares (Basic) | 6,168 | 5,628 | 5,205 | 781 | 815 | 863 |
| Earnings per Share (Basic) | $2.10 | $2.37 | $1.19 | $5.01 | $4.69 | $4.42 |

Source: Morningstar Online, 2017.

**Annual Balance Sheets** (all number in millions)

| | AT&T | | | Time Warner | | |
|---|---|---|---|---|---|---|
| Fiscal Year Ending | 12/31/16 | 12/31/15 | 12/31/14 | 3/31/16 | 3/31/15 | 3/31/14 |
| Assets | | | | | | |
| Cash & Equivalents | $5,788 | $5,121 | $8,603 | $1,539 | $2,155 | $2,618 |
| Short Term Investments | 5,788 | 5,121 | 8,603 | 1,539 | 2,155 | 2,618 |
| Accounts Receivable | 16,794 | 16,532 | 14,527 | 8,699 | 7,411 | 7,720 |
| Inventories | | | | 2,062 | 1,753 | 1,700 |
| Prepaid Expenses | 1,555 | 1,072 | 831 | | | |
| Other Current Assets | 14,232 | 13,267 | 8,067 | 1,185 | 1,194 | 1,142 |
| Total Current Assets | 38,369 | 35,992 | 32,028 | 13,485 | 12,513 | 13,180 |
| Gross Property Plant & Equip | 319,648 | 306,227 | 282,295 | 6,955 | 6,919 | 6,793 |
| Accumulated Depreciation | 194,749 | 181,777 | 169,397 | 4,445 | 4,323 | 4,138 |
| Net Property Plant & Equip | 124,899 | 124,450 | 112,898 | 2,510 | 2,596 | 2,655 |
| Intangible Assets | 1,674 | 1,606 | 250 | 3,337 | 2,617 | 2,326 |
| Long Term Investments | 222,067 | 225,278 | 136,655 | 35,540 | 35,667 | 35,738 |
| Other Assets | 16,812 | 15,346 | 10,998 | 11,094 | 10,455 | 9,360 |
| Total Assets | $403,821 | $402,672 | $292,829 | $65,966 | $63,848 | $63,259 |
| Liabilities | | | | | | |
| Accounts Payable | 25,021 | 24,003 | 18,186 | 3,052 | 3,075 | 3,125 |
| Accrued Expenses | 11,204 | 11,495 | 8,935 | 3,364 | 3,401 | 3,660 |
| Current Debt | 9,832 | 7,636 | 6,056 | 1,947 | 198 | 1,118 |
| Other Current Liabilities | 4,519 | 4,682 | 4,105 | 1,340 | 1,328 | 1,301 |
| Total Current Liabilities | 50,576 | 47,816 | 37,282 | 9,703 | 8,002 | 9,204 |
| LT Debt & Leases | 113,681 | 118,515 | 76,011 | 22,392 | 23,594 | 21,376 |
| Pensions & OPEB | 33,578 | 34,262 | 37,079 | 954 | 908 | 928 |
| Deferred LT Liabilities | 60,128 | 56,181 | 37,544 | 3,164 | 2,806 | 2,519 |
| Minority Interests | | | | 31 | 29 | 0 |
| Other Liabilities | 22,723 | 23,227 | 18,543 | 5,387 | 4,890 | 4,756 |
| Total Liabilities | $280,686 | $280,001 | $206,459 | $41,631 | $40,229 | $38,783 |
| Shareholders' Equity | | | | | | |
| Common Share Capital | 6,495 | 6,495 | 6,495 | 17 | 17 | 17 |
| Additional Paid-In Capital | 89,604 | 89,763 | 91,108 | 146,780 | 148,041 | 149,282 |
| Retained Earnings | 39,695 | 39,005 | 35,796 | -74,965 | -78,827 | -82,378 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Other Equity | -12,659 | -12,592 | -47,029 | -47,497 | -45,612 | -42,445 |
| Total Equity | 123,135 | 122,671 | 86,370 | 24,335 | 23,619 | 24,476 |
| Total Liabilities & Equity | $403,821 | $402,672 | $292,829 | $65,966 | $63,848 | $63,259 |

Source: Morningstar Online, 2017

**Annual Balance Sheets** (all number in millions)

| | AT&T | | | Time Warner | | |
|---|---|---|---|---|---|---|
| Fiscal Year Ending | 12/31/16 | 12/31/15 | 12/31/14 | 3/31/16 | 3/31/15 | 3/31/24 |
| Operating Activities | | | | | | |
| Net Income | $13,333 | $13,687 | $6,518 | $3,925 | $3,832 | $3,827 |
| Adj.from Inc to Cash | 31,447 | 25,439 | 29,507 | 10,739 | 9,338 | 9,235 |
| Change in Working Capital | (3,022) | (1,768) | (1,761) | (9,344) | (8,838) | (7,600) |
| Other Operating Cash Flows | (2,414) | (1,478) | (2,926) | (637) | (481) | (1,781) |
| Cash Flow from Operations | $39,344 | $35,880 | $31,338 | $4,683 | $3,851 | $3,681 |
| Investing Activities | | | | | | |
| Purchase/Pty Plant & Equip | (22,408) | (20,015) | (21,433) | (432) | (423) | (474) |
| Sale(Purchase) of Invest. | | | | (9) | (39) | (5) |
| Proceeds/Pty Plant & Equip | (2,313) | (30,676) | 4,982 | 0 | 0 | 2,664 |
| Other Investing Cash Flows | 506 | 1,547 | (1,886) | (919) | (531) | (802) |
| Cash Flow from Investing | ($24,215) | ($49,144) | ($18,337) | ($1,360) | ($993) | $1,383 |
| Financing Activities | | | | | | |
| Change in Debt | (683) | 23,926 | 5,617 | 512 | 1,413 | 2,326 |
| Change in Equity | (366) | (126) | (1,578) | (2,062) | (3,316) | (4,987) |
| Payment of Dividends | (11,797) | (10,200) | (9,552) | (1,269) | (1,150) | (1,109) |
| Other Financing Cash Flows | (1,616) | (3,818) | (2,224) | (1,103) | (260) | (173) |
| Cash Flow from Financing | ($14,462) | $9,782 | ($7,737) | ($3,922) | ($3,313) | ($3,943) |
| | | | | (17) | (8) | (190) |
| Net Increase/Decrease in Cash | | | | | | |
| Change in Cash | 667 | (3,482) | 5,264 | (616) | (463) | 802 |
| Opening Cash | 5,121 | 8,603 | 3,339 | 2,155 | 2,618 | 1,816 |
| Closing Cash | 5,788 | 5,121 | 8,603 | 1,539 | 2,155 | 2,618 |
| Supplemental Information | | | | | | |
| Depreciation & Amor. (CF) | $25,847 | $22,016 | $18,273 | $8,993 | $8,711 | $8,773 |
| Net Purch/ Pty Plant & Equip | ($22,408) | ($20,015) | ($21,433) | ($432) | ($423) | ($474) |

Source: Morningstar Online, 2017