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Will AT&T/Time Warner Ruling Accelerate M&A?

June 15, 2018

Key Takeaways

- The market's positive reaction to the AT&T/Time Warner decision paves the way for other vertical deals.
- The decision does not necessarily offer a direct readthrough for horizontal mergers currently on the table, such as the Sprint/T-Mobile tie-up, Disney/Fox or Comcast/Fox's horizontal component.
- Going forward, competition in media will focus on two main things: global scale in content and direct-to-consumer relationships.

More Mergers Likely in Media, Health Care and Other Industries

The long-awaited ruling on the AT&T/Time Warner merger trial has arrived, and the court's decision to deny the government's request to block the deal has big implications for the cable, telecommunications and media industries as well as other sectors. Not counting the delay and legal costs of the trial, it is hard to imagine a better outcome for AT&T and Time Warner: not only did the judge rule in favor of the deal, he also imposed no conditions for it, and went out of his way to convince the Department of Justice (DOJ) not to appeal his decision.

One major implication is that, given vertical mergers have historically not been challenged, and the government chose to challenge this one and failed, it will probably be a long time before the government chooses to challenge another vertical merger, which involves companies in related industries which are different parts of the value chain and do not compete with each other.

At the same time, the decision does not necessarily offer a direct readthrough for horizontal mergers currently on the table, such as the Sprint/T-Mobile deal. The DOJ might even be more willing to challenge Sprint and T-Mobile, looking to recover from its defeat against AT&T and Time Warner. In addition to being a horizontal merger under review by the DOJ, the Sprint/T-Mobile combination must be approved by the FCC, which can bring its own set of challenges. FCC involvement is related to the wireless licenses ownership being transferred in the Sprint/T-Mobile transaction, something that AT&T and Time Warner were able to avoid. The FCC, remember, can appoint an administrative law judge, who can stall the process and hold a deal in limbo indefinitely. Scrutiny by the FCC effectively ended Comcast's attempt to buy Time Warner Cable in 2015.

If ultimately accepted by Fox's board, Comcast's recently announced bid for Fox would certainly get considerable DOJ attention. This potential transaction has similarities with both proposed AT&T/Time Warner and Disney/Fox deals. Like AT&T/Time Warner, Comcast/Fox is vertical in nature, insofar as Comcast cable would be adding its distribution business to Fox's content. And like Disney/Fox, it is horizontal in nature, as it would merge content assets of Comcast's NBCUniversal and Fox.

Meanwhile, several similar vertical mergers in the health care sector are currently in front of regulators, in particular Cigna's bid to acquire Express Scripts and CVS's to buy Aetna. The market treated the AT&T/Time Warner trial outcome as a green light for other vertical deals: the following day CVS, Aetna and Express Scripts shares each jumped more than 3%.

Ruling Acknowledges New World Order in Media

Perhaps the bigger, and more complex, story is the ruling's acknowledgment, from a regulatory perspective, of a tectonic shift in media. The traditional pay TV model of video content distribution via cable and satellite is giving way to over-the-top (OTT) video, where new content aggregators such as Google, Hulu and Amazon are putting together video packages delivered over a broadband pipe, wired or wireless, on a nationwide, and increasingly global, basis. Some of the language in the ruling reflects Judge Leon's recognition of this, and of the lines blurring between facilities-based providers (cable, direct broadcast satellite (DBS) and wireless), traditional media owners (Fox, Disney, Time Warner) and the not-so-new but globally scaled edge players such as Netflix, Amazon, Facebook and Google.

We give Judge Leon a lot of credit for recognizing and taking into consideration these changes. The DOJ's assumptions in bringing the case to court were rooted in a narrowly defined old-world view of the market and reflected an outdated regulatory framework. The ruling confirms how the competitive landscape is changing rapidly. It is becoming a game of largely unregulated dominant global Internet platform players and a swiftly consolidating set of more traditional participants that are still regulated according to what some consider an outdated framework.

Going forward, competition in media will focus on two main areas: global content and intellectual property ownership on one hand and direct-to-consumer relationships on the other. Large OTT players have been spending massive amounts of money on content — YouTube has committed $10 billion, Netflix $8 billion, Amazon $6 billion.[1] Equally important is the ability to bring that content directly to the consumer globally, and to collect and monetize user data in the process. Disney's and Comcast's bids for Fox assets are perfect examples of this twin strategy: pull back content from Netflix, own and create internally as much content as possible and establish a direct relationship with the consumer.

It's not certain whether the AT&T/Time Warner ruling represents a meaningful step for traditional media companies in their struggle with the growing influence of Facebook, Apple, Amazon, Netflix and Google. Execution will be crucial, but it is certainly possible new, larger combined traditional media players will be better equipped to maintain their relevance. Meanwhile, the bigger tech companies — Apple and Amazon in particular — could very well be acquirers of media assets. Shares of content providers AMC Networks and Discovery, for example, rose sharply following the ruling.

A new way of thinking of the pay TV market as a more broadly defined landscape of competitors that includes both traditional pay TV operators (cable and DBS) and OTT providers will have other consequences as well. In this landscape some deals that have been considered impossible in the past — for example, a merger of two DBS platforms such as DISH and DirecTV — may be not so elusive in the present or not-so-distant future.

[1] Source: Company data and Morningstar estimates.

About the Author

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- 22 years of investment industry experience
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