AOL buyout of Time Warner: merger frenzy sweeping corporate America

A reporter
14 January 2000

The combination of America Online (AOL) and Time Warner, announced Monday by executives of the two companies, is the largest corporate merger in US history. The transaction was valued at $183 billion on the day it was made public, with AOL offering $166 billion in stock for Time Warner's assets and agreeing to assume the media conglomerate's $17 billion in debts.

The takeover is a watershed in many ways. It is the first time that one of the new corporate giants created by the Internet boom has used the sky-high value of its stock to acquire an older Fortune 500 company—and not just any large company, but one of the central pillars of corporate America. Time Warner is the largest media monopoly in the United States, controlling magazines with a combined circulation of 130 million, CNN and other cable television networks, as well as Warner Brothers studio and Warner Music.

The new AOL Time Warner would be the fourth largest company in the United States, as measured by stock market valuation, worth $342 billion, trailing only Microsoft, General Electric and computer network maker Cisco Systems. From the standpoint of assets, revenues and profits, however, the merged company would be further down the list. The two companies together employ 82,000 people, with revenues of $33.6 billion last year and combined profits of $930 million. The combined company's stock market valuation is more than 350 times its current annual profits.

AOL used its enormous stock market valuation to make itself the senior partner in the merger, despite the fact that it has only 12,000 employees and $4.8 billion in revenues, compared to Time Warner's 70,000 employees and $26.8 billion. AOL stockholders will control 55 percent of the shares in the merged company, compared to 45 percent for Time Warner stockholders, and AOL founder Steven Case will be chairman of the combined firm.

While AOL in effect converted a substantial portion of its paper value into control of real assets, Time Warner stockholders received a huge premium on the current market price of their stock, getting 1.5 shares of AOL Time Warner for each share they now own. On the day of the announcement of the merger, the deal offered the prospect of a 71 percent premium, with AOL offering stock valued at $110 for each share of Time Warner, then selling at $64.75. Even when AOL's stock plunged later in the week, the deal still represented a bonanza for big stockholders such as CNN founder Ted Turner, whose shares in Time Warner jumped from $7 billion to $10 billion overnight.

This premium could prove costly down the road, as AOL is compelled to make payments on the combined company's debts and meet unrealistic market expectations about continued growth. According to one accounting analysis, the deal overvalues Time Warner by a staggering amount, and could saddle the combined company with depreciation and debt payments that will wipe out prospective profits for years to come.

Such long-term considerations are ignored today under conditions of the Internet bubble, in which speculators buy AOL stock not for expected earnings and dividends, but in the hope that its stock price will continue its stratospheric rise—up 50,000 percent since the company entered the stock market in 1992.

The AOL Time Warner merger is only the latest of a seemingly endless series of corporate combinations and takeovers fueled by the rising stock market. The 15 largest merger deals in the history of capitalist finance have all taken place in the 21 months since the merger of Travelers Group and Citicorp in April 1998. That

$73 billion deal was the largest in history at the time, but now has fallen to seventh place. Some of the biggest names in corporate America have been taken over, including Citicorp, Mobil, Ameritech, Sprint, GTE, Amoco and Warner-Lambert.

Unlike the merger and takeover frenzy of the 1980s, the current wave of consolidation is not based on junk bonds and other borrowing devices. Instead, corporations have acquired other corporations simply by issuing new stock, which has been readily bought up by the market—a total of $1.5 trillion in the last year, double the level of 1997.

Whereas in 1991 stock and cash were used in roughly equal amounts in corporate takeovers, in 1999 stock was four times the value of cash in such deals. In 1988 fewer than 2 percent of large deals were paid for entirely in stock. By 1998, that number had risen to 50 percent.

The AOL acquisition of Time Warner has the most ominous implications for the more free access to information which was once the principal promise of the Internet. A joint statement by Consumers Union, the Media Access Project and the Center for Media Education, warned: "Consumers do not want to be beholden to a giant media-Internet dictatorship, even if it promises to be a benevolent one." AOL enjoys a position as the leading Internet service provider approaching the monopoly of Microsoft in the field of software or IBM in mainframe computers: 54 percent of all US households with Internet access get to the web through AOL.

Now this dominant position in Internet access is to be combined with the media empire of Time Warner, which accounts for 21 percent of all print advertising dollars and a huge share of US movie production and music and book publishing. Time Warner is also the second largest cable television operator, which is expected to give AOL its first big opportunity in broadband—the supplying of Internet access over high-speed telephone and cable lines which can transmit movies and music efficiently.

AOL is currently not able to use any US cable systems, but it will now have access to the 13 million subscribers of cable systems owned by Time Warner. The company has been engaged in a public brawl with AT&T, the biggest cable TV operator, in which AOL has sought a federal government mandate requiring "open access" to cable lines for Internet service providers. Meanwhile, AOL itself has refused similar demands for access to its subscribers by Microsoft, Yahoo! and other operators of Internet portals who offer instant messaging services and "buddy" lists.

The monopolization of the Internet was well under way even before the latest merger. Already the top 100 web sites attract nearly half of all page views, and web users spend almost 20 percent of their online time visiting only the top 10 sites.