

VALUE CREATION IN AN M&A TRANSACTION:  
A CASE STUDY APPROACH

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A CASE STUDY APPROACH

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## ABSTRACT

*This thesis investigates the various factors that contribute to a successful merger or acquisition through the case studies of companies in various industries since 1999. The thesis first provides a brief history of mergers and acquisitions and discusses the various considerations behind mergers and acquisitions. Each case study is evaluated on a framework that incorporates strategic logic, organizational factors, and financial considerations to arrive at the relative success of each merger. The four case studies discussed are: Exxon and Mobil (1999), America Online and Time Warner (2000), Disney and Pixar (2006), and Sirius and XM Radio (2007). Ultimately, the thesis highlights the importance of sound strategic logic, a vision for future industry trends, similarity and ease of incorporating assets across companies while mitigating distracting external factors, such as the requirements to be met by government agencies, and internal factors, such as cultural compatibility.*

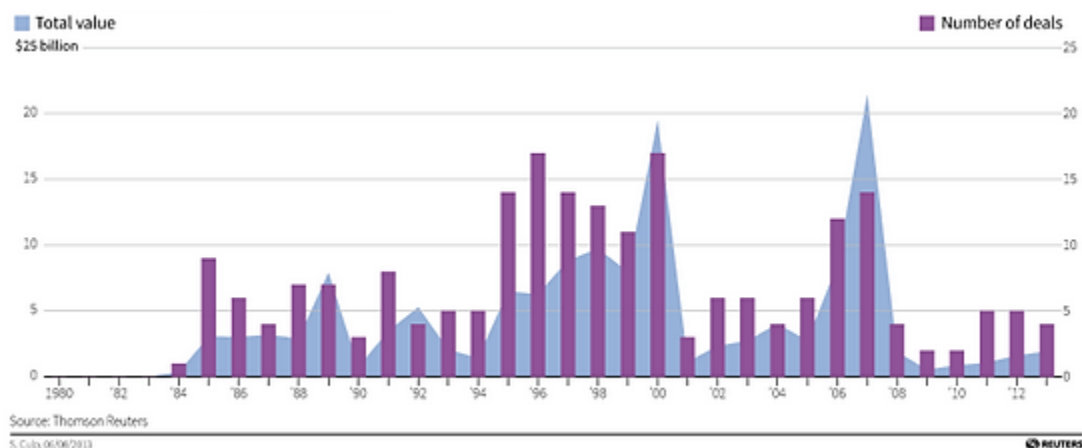
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## INTRODUCTION

Mergers and Acquisitions (M&A) transactions have played an increasingly important role in financial markets in the past decades, and the transactions certainly have received plenty of attention by media and academic circles. Companies have completed thousands of M&A transactions that have both positively and negatively affected the course of business strategy for companies of all sizes and industries.

In the past half-century, the United States has experienced a number of waves of merger activity, each characterized by a different type of purpose behind the deals. Refer to the Figure 1 below for a visual depiction of these waves since 1980 (Agarwal and Jaffe 2003).



**Figure 1 – Number and Value of Top 200 Deals by Year (Source: Thomson Reuters)**

In the 1960s, the main strategy for businesses was to achieve a diversified conglomerate, where the merging or acquiring of completely different and unrelated businesses would ideally add value through management expertise or financial resources. However, this sort of strategy has largely fallen out of favor, and the 1980s saw a transition to transactions known for hostile takeovers, in which acquirers would merely

buy businesses for their assets and sell them off for more than the company's enterprise value with all parts together. In the 1990s, companies adopted a more strategic approach to acquisitions, focusing on finding those companies that would enhance operations and create economies of scale and scope. Since 2004, a wave of consolidation in the form of mergers and acquisitions transactions has occurred in many industries, especially telecom and software (Berk and DeMarzo 2013).

Academia has been trying to arrive at how successful these transactions have been in the past, and the breadth of existing research speaks to the widely complicated nature of understanding all types of issues when considering an acquisition (Buono 2005). Many authors have assessed the ultimate success and results of these deals on the basis of adding to and maximizing shareholder wealth, and while this is no doubt an important metric in evaluating a transaction's efficacy, at times, not all parties are truly better off from the transaction (Beck and Demarzo 2013).

Among many discussions, academic writers have concluded that many mergers have not yielded the full promise of benefits understood in the initial packaging of the deal, and the negative outcome is attributed to the ultimate strategic rationale, the incompatibilities of corporate cultures, and even paying too much for the target company (Larsson and Fickelstein 1999). While these are all important considerations to a transaction to understand why equity value is not maximized, researching how transactions have positively or negatively affected an industry's environment and all stakeholders involved would create a more comprehensive picture (Sang and Ollinger 2006). To understand the true value added by mergers and acquisitions would require a

deep investigation of how all stakeholders have been affected – firm employees, suppliers, customers, and society as a whole (Deng, Kang and Low 2013).

This research investigates the various factors companies consider when deciding to undergo M&A, and if the new entity post-transaction is better off as a result of the transaction; in addition, the research gathers a sense for what quantitative and qualitative factors ultimately contribute to the success of mergers. As a whole, this research aims to develop a comprehensive understanding of what causes and constitutes a successful merger from the perspective of all parties, and when a merger or acquisition does not reach its initial vision, this research hopes to uncover the main drivers towards those consequences.

The research utilizes a case study approach to evaluate mergers spanning different industries and different time periods. The first case study evaluates the merger between Exxon and Mobil in 1999 (XOM), the second evaluates the merger between America Online (AOL) and Time Warner (TWX), the third evaluates the transaction of Disney (DIS) acquiring Pixar, and the fourth evaluates the merger between Sirius (SIRI) and XM Radio. The merger between AOL and Time Warner was intentionally chosen since this transaction suffered the highest goodwill impairment of any transaction in history due, in part, to AOL's overvaluation. The other three mergers are viewed as successful both by management and a consensus of media providers.

## **LITERATURE REVIEW**

### **Definition of Mergers & Acquisitions**

Mergers and acquisitions are a part of what is referred to as the “market for corporate control” (Berk and DeMarzo 2013). When one firm obtains another's assets,

there is typically a buyer, also referred to as the “acquirer” or “bidder,” and a “seller,” known as the target firm (Berk and DeMarzo 2013). There are two primary means through which ownership and control of a public corporation can change: either 1) a company can buy the target firm (i.e. an acquisition), or 2) the target firm can merge with another firm to create a new, separate entity (i.e. a merger). In both cases, the acquiring entity must purchase stock or existing assets of the target either for cash or something of equivalent value (such as shares or other financial assets) (Hoang and Lapumnuaypon 2014). Using the model in Figure 2, M&A transactions encompass a broad range of different meanings, most associating them with the “narrow concept” listed in Figure 2 (Nakamura 2005). Mergers are commonly listed as either “merger by absorption” or “merger by establishment.” The former occurs when a company buys all the stocks of one or more companies and the company is completely taken over and the latter occurs when two or more firms merge to create a new entity, dissolving the others in the process (Hoang and Lapumnuaypon 2005).



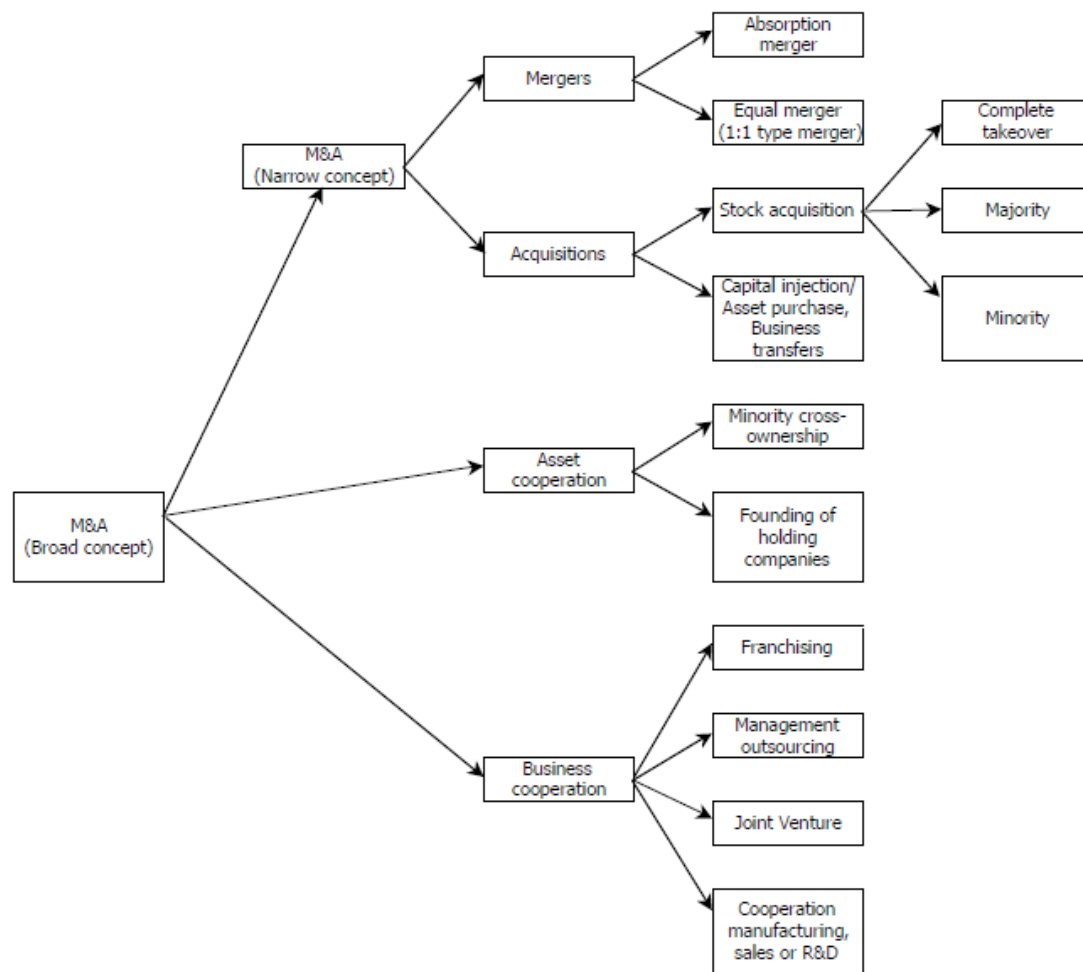


Figure 2 – M&A Framework (Nakamura 2005)

In an acquisition, companies may seek to acquire significant shares of stock or assets of the target company, meaning that there are two types of acquisitions: assets acquisitions and share acquisitions (Chunlai, Chen and Findlay 2003). In the former, a company can purchase all or part of the company's assets and the target would simply remain as a legal entity after the transaction, whereas share acquisitions involve a scale of ownership, ranging from 1) a complete takeover (100% of target's issued shares), 2) majority (50-99%), and 3) minority (less than 50%) (Berk and DeMarzo 2013). The AOL and Time Warner merger is a classic example of a share acquisition, in which

shareholders of Time Warner were given new shares (valued in excess of their current Time Warner holdings) of AOL Time Warner in exchange for their old shares.

### **Classification and Types of Mergers & Acquisitions**

While discussion centers on the more narrow view of mergers and acquisitions as described above, different transactions have different implications depending on the positioning of the parent company with respect to the target company. If the target company and acquirer are in the same industry, this sort of merger is understood as a horizontal merger, in which a rival in the acquirer's industry is purchased. The first trend of horizontal mergers occurred in the period between 1887-1904 that led to the creation of monopolies (Subeniotis 2011). Horizontal mergers nowadays are particularly common in sectors such as pharmaceuticals, automobile and petroleum. The merger of Pfizer and Warner Lambert in 1999 for \$89 billion dollars provides a good example. In this case, being able to drive research and development synergies to expand upon revenues allows for both firms to unlock value (Banal-Estañol 2007). The case studies investigate the horizontal mergers with Exxon and Mobil, Sirius and XM Radio, and Disney and Pixar, and the three transactions achieved great success for their ability to optimize cost structures and attain economies of scale and scope.

Conversely, if the target's industry buys or sells to the acquirer's industry, it is considered a vertical merger. These usually occur as a strategy to reduce uncertainty and transaction costs by taking more ownership of the supply and value chain and benefiting from those economies of scope. To an extent, within the AOL Time Warner merger, AOL benefitted from the ability to use Time Warner's existing revenue streams to push through their products, but as a whole, vertical integration needs to improve a company's

control over their cost structure and supply chain. Lastly, if the target and the acquirer operate in unrelated industries, then the deal would be considered a conglomerate merger. The merger between AOL and Time Warner allowed the combined company to diversify its revenue streams, but at the time, the merger was seen as one of related diversification as opposed to a conglomerate merger. Conglomerate mergers, while popular in the 1960s, have generally fallen out of favor with shareholders because of the difficulty in creating value when combining two unrelated businesses (Subeniotis 2011).

Deals can also vary depending on the payment that target shareholders would receive as compensation for their shares. When target shareholders receive stock, the deal is considered a stock swap, since the target shareholders are receiving new stock in either the acquirer's firm or the newly merged firm in exchange for their old stock. The consideration paid to target shareholders can be very complex. Negotiated items can include, among other considerations, who would run the new company, the size and composition of the new board, the location of the headquarters, and even the name of the new company (Berk and DeMarzo 2013).

M&A can also be classified as "friendly" or "hostile" depending on how the transaction is undertaken. If the transaction is undertaken in a friendly manner, the board of the target company agrees to the transaction. On the contrary, a hostile deal is one that pits the offer against the wishes of the target since the board of the target refuses the offer (Berk and DeMarzo 2013). All of the mergers observed in the case studies were friendly mergers. Studies show that hostile mergers can invite a host of many undesirable costs, such as litigation, and thus has the potential to be far more expensive than if the merger

or acquisition had been approved by the board of directors and management up front, assuming a depressed stock price is not driving the takeover (Krishnan 2012).

There is also a geographical component to transactions that should be considered. A cross-border M&A transaction involves two firms located in different countries. Consequently, in domestic M&A transactions, firms involved originate from one country and operate in that economy and country (Berk and DeMarzo 2013). While still a domestic merger, the implications of the geographical component were especially important with the Exxon and Mobil merger, since both companies' spheres of influence were stronger around different areas of the globe, and their ability to leverage a newly expanded network unlocked considerable value.

### **Market Reaction to a Takeover**

In most U.S. states, the law necessitates that when current shareholders of a target firm are required to sell their shares, that they should collect fair value for those shares. However, "fair value" in itself is a difficult concept to define, and thus any price management would purchase a target could be justified as long as incremental revenues and cost savings justify the purchase price. "Fair value" alone could suggest that the value of the target should be exclusive of any value that arises from the merger itself; during an acquisition, however, most acquirers pay a considerable premium, which is the percentage difference between the acquisition price and the fair value or pre-merger price of the shares. Usually, target shareholders experience about a 15% gain on their stock price when the announcement of the transaction is made (Berk and DeMarzo 2013).

## **Considerations for Mergers & Acquisitions**

Literature on M&A has dedicated much time and effort towards understanding the rationale and true motives behind why companies undergo these transactions. If the acquirer must pay a premium for the target and still satisfy the requirement that the investment be a positive net present value (NPV) opportunity, how is this done? An acquirer is expected to add economic value as a result of the transaction, usually done through cost and revenue synergies (Hoang and Lapumnuaypon 2005).

Cost-reduction synergies are more common and easier to achieve because they generally translate into layoffs of overlapping employees and eliminating otherwise redundant processes and resources. For instance, the merger between Microsoft and Nokia yielded an immediate headcount reduction of 13,000 (Nadella 2014). Additionally, at the time of the merger, Sirius and XM were grossly unprofitable and faced considerable pressure to scale their platforms or face insolvency. Much of the motivation of that merger included accelerating the scaling of a combined platform in which redundancies could be eliminated.

If the merger created possibilities to expand into new markets or gain more customers, then the merger partners would predict synergies that enhance revenue. For example, when Delta and Northwest airlines announced their merger agreement in April of 2008, they forecasted \$200-300 million in revenue-enhancement synergies since different flight options would bring in more customers and more customer loyalty (McMullan 2008). Additionally, AOL believed that they could achieve revenue synergies by offering their products to existing Time Warner cable customers and increase revenue

streams by having access to a whole new segment of customers with their “new age” media content.

Economies of scale and scope are two additional reasons that many CEOs cite as rationales for acquiring companies. A large company can enjoy economies of scale, or savings from producing goods in high volume that are simply not available to smaller companies. For example, Stride Rite’s acquisition of sports shoemaker Saucony in 2005 was in large part to reduce Saucony’s manufacturing costs because due to its larger size, Stride Rite could negotiate superior manufacturing contracts in China (Kooker 2005). The transactions with Exxon and Mobil and Sirius and XM both enjoyed greater economies of scale post-merger, since the combined companies were able to spread their fixed costs over higher volume.

Economies of scope are those savings that come from combining marketing and distribution of different types of related products as well as through research, production, and other operational avenues. Many analysts believe that Kraft’s decision in 2009 to purchase the British chocolate maker Cadbury was motivated by a desire to expand Kraft’s snack foods into emerging markets where Cadbury already had a large presence (Merced and Nicholson 2010). Disney was able to leverage the brands created under Pixar’s roof to create new revenue streams by marketing those branded products at amusement parks and other channels to add incremental revenue.

Firms often need expertise in particular areas to compete more effectively. Faced with this situation, a firm can enter the labor market and attempt to hire personnel with the required skills. However, hiring experienced workers with the appropriate talent might be difficult with an unfamiliar, new technology. Thus a more efficient solution

may be to purchase the talent as an already functioning unit by acquiring an existing firm (Berk and DeMarzo 2013). For example, in 2000, Paris-based AXA bought Sanford C. Bernstein, a Wall Street private partnership, to gain expertise and a preexisting client base in the U.S. asset management market (Winter 2000). This motivation was also observed with Disney's acquisition of Pixar, since Disney felt that Pixar's competency with 3-D animation led the industry, and as such, Disney felt that bringing Pixar's human capital in-house would assist in Disney's ability to maintain the best positioning within the animation entertainment industry.

The benefits of diversification are frequently cited as a reason for a conglomerate merger. The justification of these benefits comes in three forms: direct risk reduction, lower cost of debt or increased debt capacity and liquidity enhancement. Risk reduction, however, is criticized since investors can achieve this on their own by holding a portfolio of investments across many different industries. It is thought of as cheaper for investors to achieve risk reduction through portfolio diversification than for firms to dive in and try to achieve diversification through risk pooling themselves (Berk and DeMarzo 2013). Certainly, all four mergers observed in the case studies cited direct risk reduction as a motivation for the merger, since the combined structure would be inherently less risky due to the scale of production or a current platform.

Yet, interestingly, studies show that deal size influences the true premium that companies pay for M&A deals. Compelling evidence demonstrates that there is a negative relationship between offer premiums and the target size of the firm; when comparing the relative size of targets, acquirers of larger targets pay less as a percentage of common stock valued days before merger announcement to the stock price paid during

the merger than for smaller deals of the same industry (Alexandridis 2013). For deals that are intensely complicated, reports show that 61% of merger deals worth at least \$500 million end up being costly for shareholders. The overpayment for smaller firms can occur for a number of reasons, including excessively confident managers that overestimate their ability to extract acquisition benefits and thus overpay (Ferris, Jayaraman and Sabherwal 2013). CEO overconfidence can be attributed to a number of different factors and biases, such as CEO inexperience with managing transactions and the self-attribution bias. CEOs often lack transaction experience and thus have a smaller pool of wisdom upon which she or he could draw. Secondly, the self-attribution bias reveals that overconfident CEOs believe they have superior decision-making abilities and are more capable than their peers (ibid.). This sort of overconfidence was especially evident with Time Warner's management holding the belief that AOL's competitive advantage was strong and defensible when undergoing the merger.

To further address why larger acquisitions face lower premiums, there are other supported theories that reveal the phenomenon. For instance, the high value-at-stake associated with buying large firms could result in a more accurate valuation and make management more hesitant to offer heftier premiums given the deal size (Alexandridis 2013). Additionally, since these deals are so complex in nature, management would be less likely to make a generous offer due to the uncertainty of acquiring these synergies (ibid.). With larger acquisitions, fewer potential buyers are involved and thus would not result in the driving up of price. Based on empirical research, the average offer premium paid for targets in the top tercile is 30% lower than for those in the bottom tercile (ibid.).

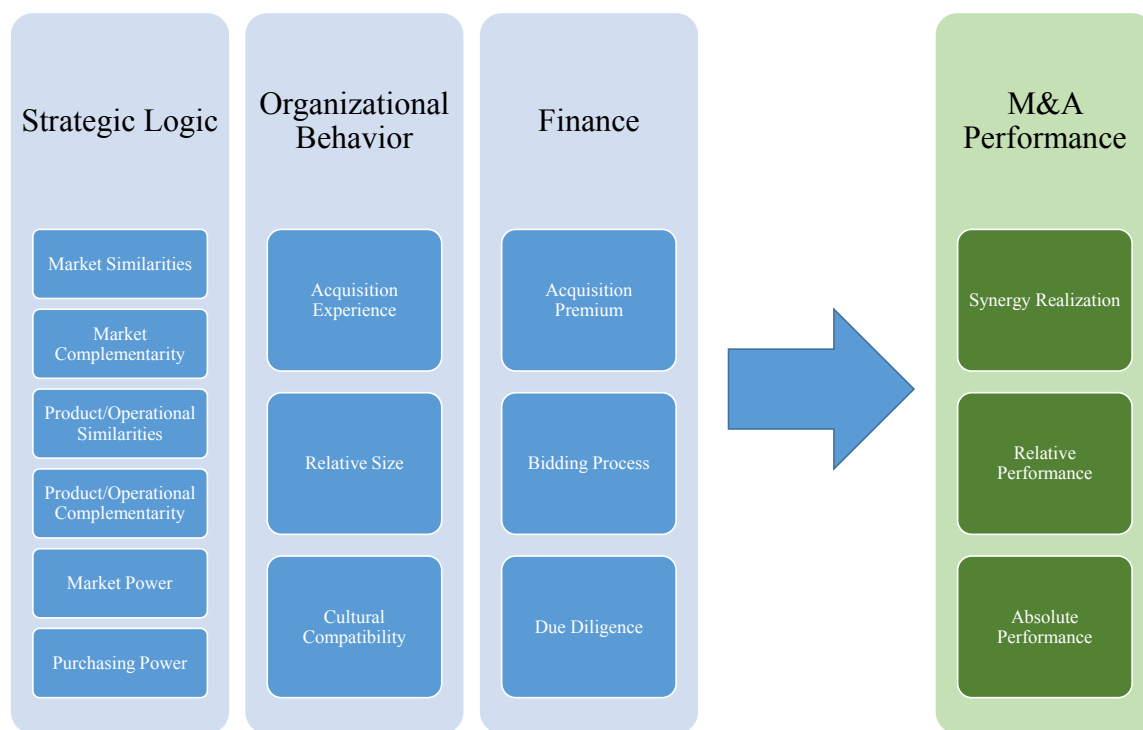


Lastly, it is important for companies to consider overall organizational fit with the target company. Since M&A transactions create complex environments for human resource management, there are considerable repercussions to having a section of a company that is not lockstep with the overall vision of the parent company. Studies by Larsson and Finkelstein in 1999 reveal that the presence of complementary operations increased the likelihood of success by improving synergy realization, and organizational integration was the single most important factor in explaining synergy realization, even to the extent that M&As with high combination potential were significantly more successful when coupled with high organizational integration than when integration efforts were less forceful. While discussed in the case studies, organizational fit was a huge headwind for the AOL and Time Warner merger, and proved to be an obstacle for the Exxon and Mobil transaction. Lastly, mergers and acquisitions that were dependent on gains from combining similar production and marketing operations tended to elicit more resistance from employees than M&A focused on realizing complementary benefits. Therefore, it is important to consider the overall organizational impacts of these mergers in light of how a company can unlock the true realm of synergies (Larsson and Finkelstein 1999).

### **RESEARCH METHODOLOGY**

As stated in the introduction, four transactions, between Exxon and Mobil in 1999 (XOM), AOL and Time Warner in 2001 (TWX), Disney and Pixar in 2007 (DIS), and Sirius and XM in 2007 (SIRI), are analyzed through a case study approach. Analysis involves a framework devised by Straub, Borzillo, and Probst found in the journal “Advances in Mergers and Acquisitions” evaluating the important dimensions to M&A

performance. Figure 3 details the key factors that are analyzed in determining the overall success of the merger.



**Figure 3 (Straub 2012)**

Additionally, the analysis includes an extensive narrative about 1) the rationale of the merger 2) considerations by both the acquiring company and the target company 3) external industry and economic factors driving the acquisition. In context of the literature foundation above, the case studies analyze how the results of these transactions fit with the findings of previously established research and explain variations in the data accordingly. Additionally, the case studies evaluate stock performance and operational performance historically for both the parent and target companies and observe how the merger's combined effects positively or negatively influenced the course of business thereafter.

## CASE STUDIES

### **TIME WARNER AND AMERICA ONLINE**

#### **Background**

At the time of the AOL Time Warner merger, the thought was that dot-coms could do no wrong. With a very richly valued stock price, AOL sought to take advantage of the market's frothy valuation to diversify and "combine old media and new media." AOL was a web services media technology company, offering a variety of interactive online services. The firm generated revenue through providing internet portals, communication software, and internet informational products. Time Warner was the world's largest media and entertainment company, their principal business to create and distribute branded information and entertainment. The firm classifies their business into cable networks, publishing, music, filmed entertainment, cable, and digital media. The two firms sought to combine the digital platform and established online infrastructure of AOL with the strong media content generation of Time Warner to deliver the strongest, most innovative platform in the industry (Bloomberg 2015).

#### **Strategic Rationale**

According to the AOL Time Warner SEC filing (S-4), the two companies believed that combined, the new company would offer the world's preeminent, fully integrated media and communications company. Specifically, the following reasons reflect what the companies believed to be the reasons that the merger would prove successful:

1. Potential for stronger operating and financial results by expanding the current infrastructure of AOL and increasing the channels of Time Warner's media,

ultimately accelerating growth of both subscription and advertising/e-commerce revenues while increasing prospects for new business.

2. Anticipated increased subscriber growth through cross-promotion between Time Warner's brands and the content of AOL as well as efficiency in marketing across different platforms and distribution systems, including cable, publishing, and interactive services.
3. With respect to operating synergies, AOL believed that the combined company would benefit from potential cost synergies from the merger by achieving a streamlined advertising system and providing companies a centralized location for their online and print, broadcast media advertising campaigns. Also, cost efficiencies could be achieved through launching and operating interactive extensions of Time Warner brands.
4. AOL was weakly positioned to transition to the broadband-based internet platform due to cable providers' bundling strategy, so Time Warner would assist the transition.

### **Market and Product Similarity**

AOL and Time Warner both generated content for the use by consumers, AOL serving both individuals and firms through marketing, advertising, entertainment, communications, and e-commerce with an online focus. Time Warner also served both individuals and firms through these functions, so the two firms together reasonably could combine many aspects of their business to achieve cost synergies when offering their products on one seamless platform.

### **Market and Product Complementarity**

While both companies focused on media content generation, they did so to completely different audiences. AOL, as a digital platform, focused more on the online users to engage its subscribers. Time Warner, however, used more conventional means, and were involved in traditional media spaces, such as in print and cable television. Thus, the intention of blending the “old” media with the “new” appeared to offer a complementary way to achieve revenue synergies with respect to economies of scope.

### **Market and purchasing power**

With a market cap of around \$120 billion at the time and considered the second largest cable company in the United States, Time Warner certainly had a large presence in the media outlets the corporation served. AOL had dominated the narrowband internet market, but after cable companies began tying their services together, offering their own broadband, consumers saw the standalone AOL service as double-paying, and immediately cancelled their services. Thus, AOL had little power to sustain its rapid growth without an entrance into the cable conduit (Rubinfeld and Singer 2001).

### **Vision for Future Market Developments**

AOL at the time was the market leader of the dial-up infrastructure with respect to accessing the internet, and during the merger, only 3% of internet users had access to broadband. AOL’s business model, originally based on payment for usage and thus for a monthly subscription, was on the brink of collapse. Without the foresight of Time Warner or AOL management to understand this moving trend in internet access, the merger was bound to be doomed (McGrath 2015).

### **Stated Risk Factors**

The risk factors offered by management within the S-4 spoke mostly to the risks inherent in their own analysis of the transaction, and specifics regarding externalities or exogenous events were not discussed. Instead, the factors listed reflected the uncertainty of their estimates and with achieving their lofty synergy goals shown in the analysis offered by the investment banks for both parties.

### Acquisition Experience

According to the S-4, both business have shown the ability to integrate processes of major business combinations over time. AOL had previously undergone a number of M&A transactions, its more famous ones including its largest competitor CompuServe, instant messenger Mirabilis, web browser Netscape, and a number of others, with values up to \$4.2 billion (Bloomberg 2015). Time Warner had also undergone significant M&A activity since 1980. Figure 4 below lists key transactions that have occurred up until the point of the AOL merger in which Time Warner was the sole acquirer.

Announce Date	Target Name	Seller Name	Announced Total Value (mil.)	Payment Type	TV/EBITDA
1/10/2000	Historic TW Inc		\$186,236	Stock	30.48
3/17/2000	AOL Europe	Bertelsmann SE & Co KGaA	6,554	Cash	
11/24/1998	Netscape Communications Corp		5,922	Stock	
7/25/2001	IPC Magazines UK Ltd	Cinven Ltd	2,378	Undisclosed	21.92
12/22/1999	MapQuest Inc		887	Stock	
3/23/2001	AOL France SNC	Vivendi SA	727	Stock	
3/23/2001	AOL Europe	Vivendi SA	676	Cash	
2/1/1999	Moviefone Inc		388	Stock	
5/21/1998	Mirabilis Ltd		287	Cash	
6/14/2000	TiVo Inc		200	Undisclosed	
11/24/1997	Kiva Corp		173	Stock	
11/11/1998	Atweb Inc		168	Stock	
7/23/2001	Amazon.com Inc		100	Stock	
11/26/2001	Word Entertainment Ltd	Ryman Hospitality Properties Inc	84	Cash	
6/8/2001	Business 2.0 magazine	Future PLC	67	Cash	
3/29/1995	BOOKLINK TECHNOLOGIES INC.	ModusLink Global Solutions Inc	38		
6/12/2000	Mviva	Carphone Warehouse Group PLC\Old	25	Cash	
5/18/2001	Infointeractive Corp		24	Cash	
1/7/1998	Personal Library Software Inc		15	Cash and Debt	
7/29/1993	Home office property		8	Cash	
4/30/1997	DIGITALSTYLE & PORTOLA COMM		2	Stock	

Figure 4 - TWX Acquisitions

**Relative Size**

Both AOL and Time Warner have considerable scale in both of their operations. Between 1995 and 1999, AOL's revenues grew from \$425 million to \$4,777 million, becoming profitable in 1999 with \$638 million in profits. Additionally, the cash on AOL's balance sheet stood in excess of \$2,655 million and total assets were \$10,789 million. Time Warner's revenues grew from \$16,294 million to \$27,333 million and net income grew from \$301 million to \$1,948 million. Additionally, cash on the balance sheet was \$1,284 million and total assets were \$51,239 million. With respect to the merger, since AOL's stock price was valued higher than that of Time Warner's, AOL would own 55 percent of the new company and Time Warner 45 percent. The board, however, would have an equal representation of both parties.

**Cultural Compatibility**

The management of both companies have recognized a long-standing history of collaboration between the two companies, including cross-promotion and marketing activities between the two companies. The two management teams also expressed a shared vision of the combination of traditional and new media. Also both teams expressed a consumer and marketing focus, a new media interactive service orientation and a sense of social commitment and responsibility. However, according to Fortune magazine, the aggressive and – according to some – arrogant AOL people “horrified” the more staid and corporate Time Warner side. Collaboration and assured synergies failed to emerge as shared contempt came to shade their relationships (McGrath 2015).

With respect to the merger itself, Mr. Boggs, an executive of Time Warner recalled how he saw AOL in a “much less favorable light, much more opportunistic,

made up of folks who were really trying to merely exploit the market they were in as opposed to developing something that was enduring” compared to seeing his own company as one with “a vision and a set of values” (Arango 2011).

### **Acquisition Premium**

AOL purchased Time Warner for 162 billion, the deal valuing Time Warner at about \$108 a share, an approximately 67 percent premium over its previous stock price of \$64.75 (Sutel 2000).

### **Bidding Process**

Due to its frothy valuation, AOL and its management sought to make an acquisition to take advantage of its artificially high stock price. There were no other known firms seeking to make an acquisition of Time Warner, making AOL the only bidder.

### **Synergy Realization**

Both managements believe that the estimated EBITDA synergies would be around \$1 billion for the first full year of operations, producing an EBITDA growth rate of approximately 30% in that first year. The companies further asserted that the combined company would have a revenue base in excess of \$40 billion and EBITDA around \$11 billion including synergies, in the first full year.

Unfortunately, a few months after the deal closed, the dot-com bubble burst and the economy went into a recession. Advertising dollars disappeared, only in part due to the recession, and AOL was forced to take a goodwill write-off of nearly \$99 billion. The total market cap went from around \$226 billion to \$20 billion.

### **Absolute Performance**



The table below details the performance of AOL Time Warner equity stock from the perspective of TWX equity. In 2002, the Return on Assets (ROA) of Time Warner showed consistent growth prior to the development of the recession. In 2007, Time Warner's revenues took a nosedive from their Time Warner Cable spinoff and the PE ratio changed to reflect lower growth expectations. Time Warner would continue to pursue more of a "pure-play" strategy, divesting itself of its businesses that are not a part of their core competencies. To this point, AOL was spun off from Time Warner in 2009. The stock price according to Figures 5 and 6 reflects investors' positive sentiment surrounding Time Warner's pursuit of the pure-play strategy.

Metric	2002	2003	2004	2005	2006	2007	2008
ROA	2.22	2.74	2.17	5.13	3.29	-10.81	2.75
Revenue	39,563.0	42,089.0	42,401.0	43,690.0	46,482.0	26,516.0	25,388.0
EPS	-65.46	1.77	2.22	1.71	4.71	3.54	-11.23
EV/EBITDA	10.9x	12.6x	11.3x	10.2x	7.1x	5.3x	10.9x
PE Ratio	32.1x	27.4x	49.8x	27.2x	14.2x	13.0x	15.2x

Figure 5 (Source: Bloomberg)

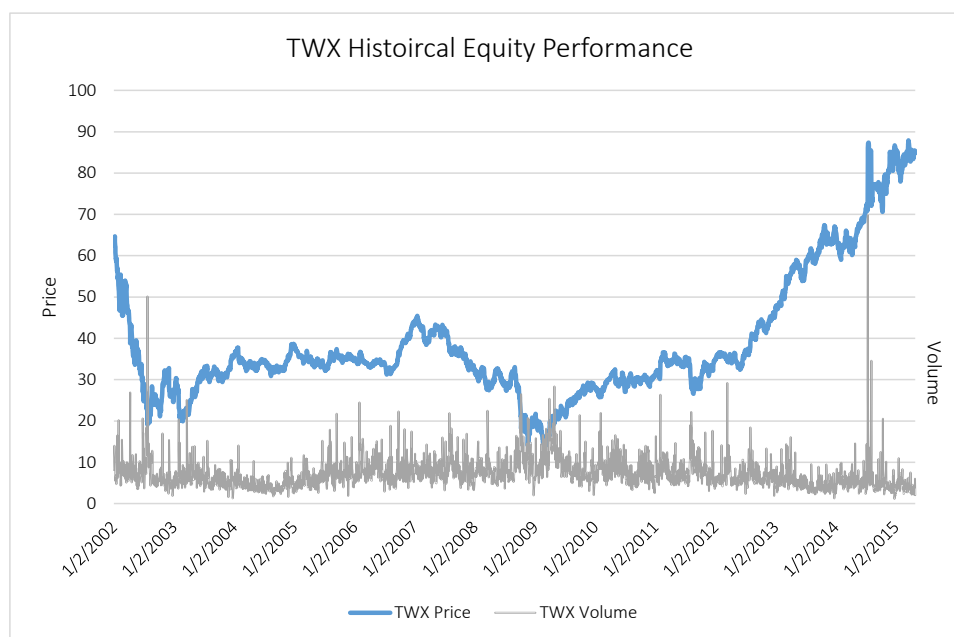


Figure 6 (Source: Bloomberg)

## Relative Performance

As evidenced by the impressive goodwill impairment of 98.7 billion that occurred in the fiscal year of 2002, the success of the merger was doomed from the start. Due to the peculiar nature of this acquisition, in which the acquirer was grossly overvalued and did not have a sustainable market position in its industry, it is difficult to assess the opportunity cost of the transaction, since acquiring any other media conglomerate would have yielded similar results.

### **Concluding Remarks**

While there are many reasons why this merger has been widely recognized as one of the largest flops in M&A history, a few key points, especially the lack of strategic vision and cultural incompatibility doomed the success of this merger. The management of Time Warner were too hasty to dive into a business model that had largely been untested, and these dot-com companies had only been around for a few years and were burning through cash at an alarming rate. AOL suffered from a “transient advantage,” in its industry, having a competitive advantage that would be quickly eroded (i.e. slow dial-up replaced by broadband). There was massive uncertainty that a seemingly good idea of merging old and new media together would be attainable, let alone profitable. Additionally, Time Warner management’s overconfidence and unwillingness to play devil’s advocate led to biases in their decision-making process and they lacked the expertise to know where a market – that they knew little about – was heading in the immediate future.

## **EXXON AND MOBIL**

### **Background**

In late 1999, the \$81 billion merger between Exxon Corp. and Mobil Corp. combined two large and powerful rivals within the oil and gas industry. In a rapidly consolidating industry, this transaction represented the largest coalescence of the three “supermajors”

that included Royal Dutch/Shell and BP Amoco. Price pressure on crude oil, the need for greater efficiency, and new competitive threats were some of the driving reasons that drove Exxon to undergo this transaction. The merger brought together two pieces of the former Standard Oil Co., the Rockefeller managed giant that was forced apart by the Supreme Court decision in 1911 (Exxon-Mobil 1999).

### **Strategic Rationale**

When Exxon and Mobil announced the deal, low crude prices helped justify the need for greater efficiencies, since the low prices put a squeeze on company margins in upstream (exploration and production operations). Below are some of the reasons that were cited in the S-4 reflecting the strategic rationale:

1. Near-term operating synergies of 2.8 billion were expected through increases in production, sales, and efficiency, decreases in unit costs and overhead expense, and other benefits made possible by combining complementary operations. Specifically, examples of running with less administrative and overhead cost, eliminating excess capacity and redundant operations would all contribute to these synergies.
2. Exploration and production processes could be improved in key areas of production in the world, such Exxon's leadership with deep-water exploration in West Africa combined with Mobil's exploration acreage in Nigeria and Equatorial Guinea.
3. Additionally, proprietary technologies could begin to be shared and future R&D would allow for more productive yields due to more robust human capital management.

**Market and Product Operation similarity**

Since Exxon and Mobil were rivals, they both offered virtually indistinguishable products, and thus combining the two companies would be a form of horizontal integration. The benefits of the combined firm would be both achieving greater scale and eliminating redundancies.

**Market and Product Operation complementarity**

With respect to each geographic footprint, the two companies had spheres of influence in different areas of the world that would serve to complement each other well.

**Market and purchasing power**

Both Exxon and Mobil had considerable power over their buyers, and since they were both vertically integrated, this enhanced their ability to control their costs well. However, a key driver and input in this industry was the price of crude oil, and Exxon and Mobil both had virtually no control over volatile oil price fluctuations. Thus, the attained synergies would allow the company to weather oil price shocks better, since there would be a greater margin of safety.

**Vision for Future Market Development**

Exxon and Mobil both understood, as evidenced in the S-4, that there would be intensifying international/global pressures to compete, so achieving scale would be critical to compete on the basis of price.

**Stated Risk Factors**

There were a number of risk factors cited in the S-4 reflecting the challenges facing the success of the transaction, mainly centering on the opportunity cost of this merger and the possible more profitable, value-maximizing alternatives. Specifically, legal counsel stated

that the alternatives to the merger, such as pursuing a joint venture or other business combination could prove more feasible and yield greater benefits. The other stated reasons were not unique to this merger and centered on execution risk and external factors out of management control.

### **Acquisition Experience**

In 1998, Exxon showed itself to be more acquisitive, but had not undergone a transaction in which it was the sole potential acquirer since at least 1980. Before then, the company had not shown much – if any – experience with acquisitions, let alone one that was a multi-billion dollar deal. Yet, hindsight did not penalize Exxon since the execution was so flawless.

### **Relative Size**

Overall, Exxon's size and scale were more substantial than that of its rival Mobil, perhaps making the complexity of the transaction easier, since Exxon would carry far higher weight towards the strategic direction than for a merger of equals. For year-end 1998, Exxon's top line reached over \$115 billion compared to Mobil's \$51.8 billion, and net income for Exxon exceeded \$6 billion compared to Mobil's \$1.7 billion. Additionally, Exxon's total assets were \$92.6 billion compared to Mobil's \$42.7 billion.

### **Cultural Compatibility**

Known to the general public, Exxon used a stalking tiger in advertising whereas Mobil used a whimsical flying horse. Exxon, with a tiger representing its self-conceived power, was known to be notoriously tight-lipped and conservative, whereas Mobil, like its mascot, is more open, both to the public and new ideas. Certainly, the managers thought their assets were a good match together, but even a third-party investment banker offered

that cultural integration could be an issue. Perhaps the biggest point of differentiation was with public relations; Exxon, with its Valdez oil spill in 1989, viewed a good day as staying out of the news, whereas Mobil wore its image on its sleeve. Additionally, Mobil appeared to be more risk-loving and took on ventures that would tend to lead the frontier of new techniques or geographies; Exxon, in contrast, had layers of bureaucracy and corporate approval that had to be adhered to prior to undergoing a new project (Liesman and Sullivan 1998).

### **Acquisition Premium**

Exxon paid a 26.4% premium for Mobil's stock, valued roughly a week before the merger was officially undergone, paying a total of \$58.7 billion for the transaction.

### **Bidding Process**

Exxon was the only bidder in this process, especially since there would not be another player of Exxon's size or relative similarity to achieve this acquisition.

### **Relative Performance**

In Figure 7 below, the historical prices of Chevron and BP are compared to those of Exxon Mobil. In the years immediately following the acquisition in the early 2000's, Exxon performed in line or outperformed its peers, but BP's stock price remained stagnant and then fell likely due to the oil spill in the Gulf of Mexico. Exxon's relative stock performance indicates that it has performed well relative to its peers despite the expensive and costly measures of merging the two companies.

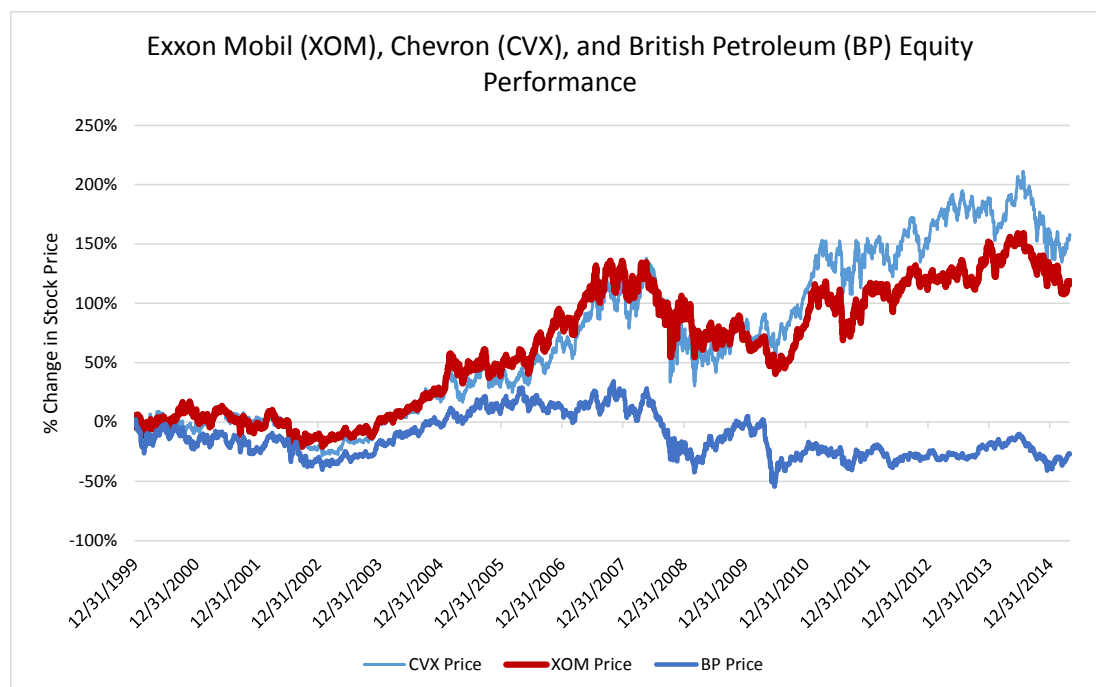


Figure 7 (Source: Bloomberg)

### Absolute Performance

By many, the merger between Exxon and Mobil is considered to be one of the most successful of all time, with a number of outcomes showing the impressive results post-transaction. For instance, there was ten percent improvement in refinery energy efficiency since 2002 and 45,000 net oil-equivalent barrels per day of additional production from higher operational reliability. Figures 8 and 9 below illustrate the high-performing metrics and stock price and how it reflects the effects of a positive merger.

Metric	2000	2001	2002	2003	2004	2005	2006
ROA	12.07	10.49	7.75	13.16	13.71	17.90	18.49
Revenue	206,083	186,808	178,909	213,199	263,989	328,213	335,086
EPS	2.29	2.25	1.63	2.48	3.73	5.16	6.38
EV/EBITDA	9.4x	9.4x	10.4x	8.5x	7.1x	5.6x	6.3x
PE Ratio	17.6x	17.5x	20.7x	16.0x	12.9x	10.5x	11.7x

Figure 8 (Source: Bloomberg)

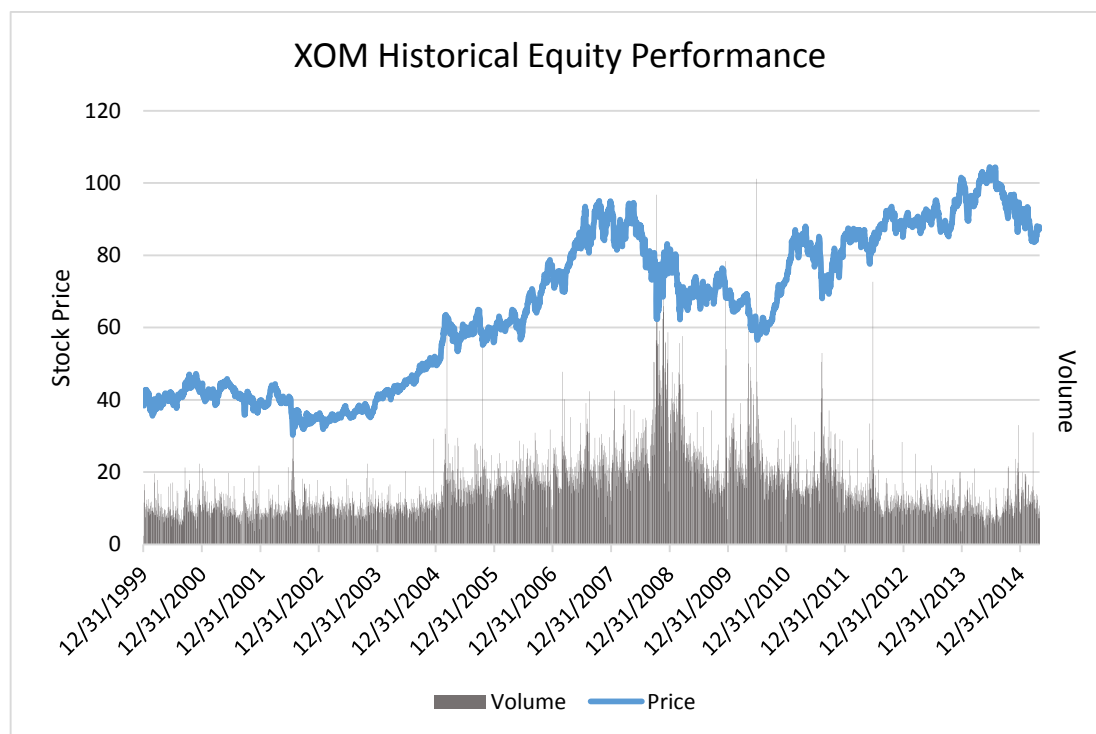


Figure 9 (Source: Bloomberg)

Post-merger, the ROA of the combined company took some time to show more promising results, but since 2003, the companies together have achieved a superior return on total assets, demonstrating superior efficiency achieved from scale and likely many of the strategic rationales presented prior to the merger. Additionally, 2003-2006 showed impressive revenue growth and EPS growth, expounding upon the success of the merger. The multiples did lower, perhaps due, in part, to lower growth expectations.

### Concluding Remarks

With sound strategic logic and a good marriage of assets, the Exxon Mobil merger proved to be a success despite apparent cultural differences. The first couple years post-merger did not show significant financial impact, perhaps, in part, due to the general macroeconomic environment in 2001. Certainly, years later, the merger proved to be wildly successful, as evidenced by the climbing stock price. While Exxon did pay a



significant premium above Mobil's stock price prior to the merger, the combined company was able to unlock value that would help overcome the outlay required for the acquisition. The key point to be taken here is that the merger was able to overcome a large factor, cultural differences, through sound strategic logic and market and product similarity.

## **SIRIUS SATELLITE RADIO AND XM SATELLITE RADIO**

### **Background**

In the early 2000s, the only two providers of satellite radio were gathering footing, and neither of the two businesses were profitable. Sirius was a satellite radio provider within the United States, offering numerous channels, spanning sports, news, talk, entertainment, traffic, weather and data content to over 7 million subscribers. XM was a rival of Sirius, offering 170 channels of similar content to that of Sirius. The two companies sought to merge hopefully to become profitable within the satellite radio segment of the radio entertainment industry.

### **Strategic Rationale**

Both Sirius and XM cited a number of potential strategic benefits to undergoing the merger of the two satellite radio companies, including the following below:

1. Cost synergies ranging from 3 to 9 billion dollars, achieved through line items such as sales and marketing, subscriber acquisition, R&D, general administrative expenses, product development, content, and programming operating infrastructure. More long-term, as more infrastructure would be laid to reach more customers and the business grows, greater cash flow would be achieved having both companies under one roof.

2. Better competitive positioning in the audio entertainment industry in the United States, since it was a rapidly evolving segment of the entertainment sector. Being able to achieve more cost synergies would allow the combined company to charge competitive prices that would compete better with mobile phone streaming, AM and FM radio, and other emerging subscription-based audio entertainment companies.
3. Revenue growth through both advertising economies of scope and greater programming choices would be achieved with the combined company, adding more value to current and future customers. The combined company would expect to charge customers in an “a la carte” format, which would provide customers more choices with lower prices. Consolidating redundant programming would be an additional cost savings as well.

#### **Market and Product Operation Similarity**

Both Sirius and XM were rivals, and thus operated in the same segment of the audio entertainment industry. Thus, their products were virtually identical, with minor variations in content provided by programming choices and offerings. Ultimately, the merger would allow the elimination of considerable redundancies and help the combined company achieve profitability.

#### **Market and Product Operation Complementarity**

Although the two companies provided their services nationally, each company had better regional presences than the other, so the economies of scope with respect to advertising and programming would help both the top and bottom lines of the combined company.

#### **Market and Purchasing Power**

As a monopoly within the satellite radio space, the combined company would have considerable pricing power for those individuals who seek to enjoy satellite radio offerings. However, the management teams had effectively argued that their business fell into the broader sector of audio entertainment. Although the combined company would not face pricing pressures by rivals, they would face intense pressure of substitutes and thus would limit their ability to charge impressive premiums to current and future customers.

### **Vision for Future Market Development**

With the benefit from hindsight, it appears Sirius and XM's shared vision for the importance of achieving operational synergies paid off in the competitive audio entertainment industry. At first, criticism was harsh, especially in light of how the severe recession of 2008 provided an intense headwind on current and future earnings; however, the company turned profitable in 2010 in part to its newfound ability to operate more efficiently in a hypercompetitive market (Kharif 2008).

### **Stated Risk Factors**

Sirius and XM stated a number of risk factors that could have adversely affected the success of the merger, but the most apparent was that of the regulatory uncertainty of passing the merger through the Federal Trade Commission and all involved regulatory bodies. Other stated reasons were not unique to this merger, such as the distractions that the transaction could bring to the management teams while the deal is in process. Additionally, the risk factors disclosed the indebtedness of XM, and, with the benefit of hindsight, this was a substantial risk, but the lifeline from cable pioneer John Malone's

Liberty Media provided a \$400 million loan to Sirius, allowing the company to live another day (Eule 2013).

### **Acquisition Experience**

Bloomberg's database revealed no transactions in which Sirius has been the acquirer, so the management teams could not benefit from previously working through unforeseen difficulties of the merger process.

### **Relative Size**

Sirius and XM Radio, at the time of the merger, were of relatively similar size, with Sirius achieving around \$575 million in subscriber revenue and a net loss of \$1.1 billion and XM Radio achieving subscriber revenues of 825 million and a net loss of \$731 million. At the time of the merger, Sirius had a combined \$1.68 billion in total assets and XM had \$1.81 billion.

### **Cultural Compatibility**

Within the S-4, there was language that described the transaction as a "merger of equals," implying fairness in all aspects of the deal, resource sharing, and responsibilities among other things. Literature points to the danger of defining a transaction as a merger of equals, building the expectation of distributive equality (every aspect of the merger equal), integrative equality (each side will gain some areas and lose in others) (Drori 2011). Accordingly, Sirius was known as more aggressive and risk-taking compared to its

rival, XM, so the merging of two different cultures likely contributed to the initial lag in synergies immediately following the merger (Kharif 2007).

### **Acquisition Premium**

As a part of the transaction, XM shareholders would get 4.6 shares of Sirius stock for each share of XM that they own. At deal close, the premium paid was near 22 percent, relative to the XM stock price a week before the merger announcement (Ellis and La Monica 2007).

### **Bidding Process**

Sirius was the only player in this acquisition, which means that they did not have to compete with any other bidders that could have resulted in an even higher acquisition premium.

### **Synergy realization**

Certainly, as profits turned positive in 2010, and with ample free cash flow, more than 900 million in 2013, the company could now begin paying back its debts and repurchase stock. Additionally, gross margins and operating margins have expanded considerably since the merger, the combined company achieving 27.5% operating margin in 2013.

### **Relative Performance**

Since the transaction merged the two players in this industry, it is difficult to compare the relative performance post-merger. However, observing historical stock prices of a competitor seen in Figure 10, Pandora, which streams music live via different platforms to the same consumers, the stock price of Sirius XM has outperformed Pandora, in part because Sirius has achieved more scale and become more profitable compared to Pandora.

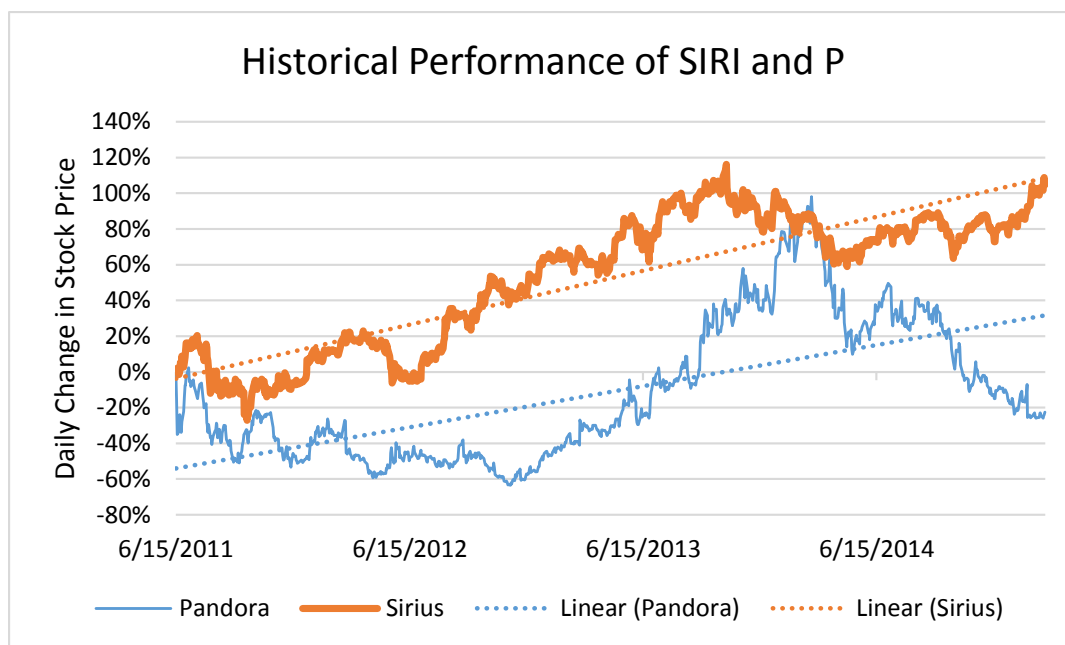


Figure 10 (Source: Bloomberg)

### Absolute Performance

According to Figure 11 below, the equity performance of Sirius XM Holdings dropped precipitously in the year following the merger, as there were talks about possible insolvency if no one could step forward and offer a cash investment to keep the combined company afloat. However, after John Malone invested in the company, the stock performance was strong and the company achieved profitability in 2010, with EPS reaching just around a penny (Figure 12).

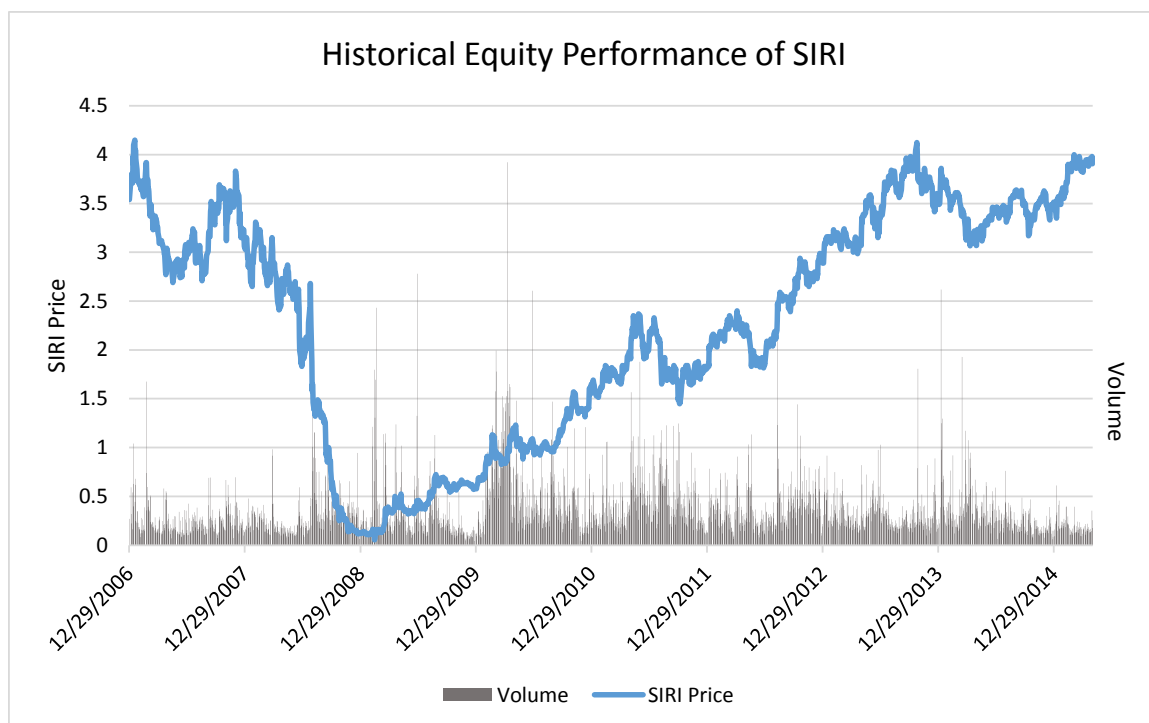


Figure 11 (Source: Bloomberg)

Metric	2008	2009	2010	2011	2012	2013	2014
ROA	-116.09	-4.66	0.59	5.74	41.96	4.21	5.73
Revenue	1,664.0	2,472.6	2,817.0	3,014.5	3,402.0	3,799.1	4,181.1
EPS	-2.45	-0.15	0.01	0.11	0.55	0.06	0.09
EV/EBITDA	--	9.4x	12.3x	9.6x	14.9x	19.2x	17.0x
EV/Sales	2.0x	2.0x	3.2x	3.0x	5.0x	6.5x	5.6x

Figure 12 (Source: Bloomberg)

## Concluding Remarks

The merger between Sirius and XM is one of delayed gratification, and perhaps a bit of luck. If not for the faith of John Malone, investors would never have seen the success of the merger come to fruition. The strategic logic behind the merger was sound, since the two companies separately were not profitable and together they could save on costs and achieve scale much more quickly. The organizational factors did not appear to cause any headwinds, but the asset-similarity of the two companies and the shared competencies ultimately helped the two companies rise out of the waters of potential insolvency.

## **THE WALT DISNEY COMPANY AND PIXAR, INC.**

### **Background**

Disney, looking to expand upon its strong asset portfolio of animated brands, sought to acquire Pixar, the animated studio led by Steve Jobs in a deal worth \$7.4 billion. The merger brought together Disney's historic franchise of animated characters (e.g. Mickey Mouse, Donald Duck) with Pixar's stable of cartoon hits, including the two "Toy Story" films, "Finding Nemo," and "The Incredibles." Ultimately, Disney and Pixar would be able to collaborate without the barriers that come with two different sets of shareholders. In addition, Disney would benefit greatly from Pixar's animation techniques, a key growth driver across the animation industry, according to CEO Robert Iger (La Monica 2006). Both management teams concluded that aligning Pixar permanently with Disney, as opposed to working separately or in a partnership, would provide the most future success.

### **Strategic Rationale**

The filed S-4 stated many reasons for the merger between the two animated film companies, certainly achieving both economies of scope and cost synergies. The specific reasons cited in the filing included:

1. Revenue expansion through synergies borne from Pixar's ability to leverage Disney's distribution channels, including theme parks and network and cable television outlets; additionally, combining Disney and Pixar brands would allow the combined company to exploit full market potential.
2. Cost reductions associated with Pixar no longer paying distribution fees to a third party if it had remained an independent company, and any other expenses associated with operating as an independent public company.



3. Pixar's shareholders would experience the benefits of Disney's much more robust, diversified earnings stream and integrated portfolio of entertainment assets, thereby mitigating some of the possible risks Pixar has faced in the past by concentrating on a single line of business.
4. Due to the great success of Pixar's animation films, each movie had generated over \$3 billion in revenues, landing the firm as a large player in this market segment. Disney, therefore, could not afford to let Pixar fall into the hands of another competitor or simply rely on the possibility of partnership arrangements for future films.

#### **Market and Product Operation Similarity**

Disney operated in a number of different areas within the consumer discretionary sector, its segments including media networks, parks and resorts, studio entertainment, and Disney consumer products. Pixar, on the other hand, was a pure-play animation content generator, and at the time of the merger, was a rival of Disney in the animation film business. Thus, Pixar's market and product operation similarity was high with Disney's film segment, and economies of scope would allow for Pixar's brands to achieve higher incremental revenues using Disney's distribution channels (e.g. resorts and stores).

#### **Market and Product Operation Complementarity**

As stated above, the two companies operate in the same industry, so the existing (and future) brands of Pixar created with animation film would serve to broaden the portfolio of assets Disney could leverage in all of its revenue channels.

**Market and purchasing power**

Due to the size and scale enjoyed by Disney, the company benefited from its strong brand portfolio to achieve higher margins with all of its business segments. Pixar and Disney both could demand premiums for their animated film products since they have shown such strong historical performance.

**Vision for Future Market Development**

Disney certainly realized that their performance was slowing in the studio entertainment segment, posting a 15% decline in revenue and 69% decline in profits in 2005 and modest recoveries in 2006, so a new lifeblood of talent in this area would be a boon to future success. Naturally, a driver in the animation film industry was continuing to attract creative talent that would lend itself to the creation of blockbuster films that dominate the box office. Thus, Disney played a wise strategic move to acquire a strong player in this space to ensure that they could continue not only to grow revenues and profits in this segment, but also to ensure the continued success of building brands from the animation studios.

**Stated Risk Factors**

Disney and Pixar recognized a number of key risk factors that could adversely affect whether the merger would provide the stated strategic benefits believed by the two companies, but mainly focused on the integration of culture and processes. Specifically, the board of directors of Pixar expressed concern for the ability of Disney to maintain and preserve the culture and processes of Pixar, retain their human capital, continue to produce the strong, blockbuster films the company has produced historically and integrate animation systems of both companies effectively. Other factors stated would not

have been exclusive to this merger, nor would it have been a key unique driver to the transaction's success.

### Acquisition Experience

According to Figure 13 below, Disney has shown itself to be very acquisitive up until and after the point of the purchase of Pixar. Disney's experience with so many acquisitions has allowed itself to leverage that transitional experience towards the merger with Pixar.

Announce Date	Target Name	Announced Total		
		Value (mil.)	Payment Type	TV/EBITDA
12/5/2006	NASN	N/A	Undisclosed	
9/28/2006	Climax Racing Studio	N/A	Cash	
8/30/2006	Mobile2Win	0.39	Cash	
8/4/2006	WOEW-AM	40	Cash	
7/25/2006	United Entertainment Ltd	30.5	Cash	
7/25/2006	UTV Software Communications Ltd	13.98	Cash	19.49
1/24/2006	Pixar	5838.22	Stock	26.92
11/7/2005	Living Mobile	N/A	Undisclosed	
6/8/2005	Minds Eye Productions	N/A	Undisclosed	
4/19/2005	Avalanche Software LC	N/A	Undisclosed	
4/12/2005	Espn Classic Sport Ltd	N/A	Cash	
2/17/2004	Muppets & Bear in the Big Blue House Assets	N/A	Undisclosed	
3/7/2003	KENS-AM 1160 radio station	3.2	Undisclosed	
8/15/2002	WFDF-AM/Flint MI	N/A	Undisclosed	
11/6/2001	Little Einsteins LLC	N/A	Undisclosed	
7/23/2001	ABC Family Worldwide Inc	5200	Cash	
4/4/2001	BASS Inc	N/A	Undisclosed	
3/2/2001	D Wonderland Inc	45.94	Cash	
2/27/2001	US Weekly	N/A	Undisclosed	
1/29/2001	Walt Disney Internet Group	269.55	Stock	
12/6/2000	WHOO-AM in Orlando	5	Cash	
8/3/2000	Socccernet	N/A	Undisclosed	
6/29/2000	6 AM radio stations	N/A	Cash	
6/16/2000	Sportsticker Enterprises Lp	N/A	Undisclosed	
4/30/2000	pureskill.com Inc	N/A	Undisclosed	

Figure 13 - Disney Notable Acquisitions (Source: Bloomberg)

### Relative Size

From years 2001 to 2005, Disney's top line grew from roughly 25 billion to nearly 32 billion in revenues, and earnings per share (EPS) – calculated by dividing net income by shares outstanding – grew from \$0.11 to \$1.24 per share. Additionally, total assets grew from 43,810 million to 53,158 in the five year period. In contrast, Pixar's revenues grew

from slightly above 70 million to nearly 290 million (0.9% of Disney's total revenue), EPS grew from \$0.38 per share to \$1.29, and total assets grew from 523 million to 1.48 billion in this five year period.

### **Cultural Compatibility**

In the SEC (S-4) filing, Disney firmly stated its commitment to preserving the creative culture and processes that allowed Pixar to be successful since its first animated success "Toy Story" in 1997. Disney further added that Pixar would operate unabated to the cultural pressures of Disney and instead would benefit from the great number of resources newly available to Pixar.

### **Acquisition Premium**

While Disney paid a 4% premium to Pixar's stock price for the acquisition, according to chief investment officer Barry Ritholtz of a hedge fund focusing on media and technology stocks, "the question isn't did Disney pay too much but how expensive would it have been for Disney if Pixar fell into someone else's hands" (La Monica 2006).

### **Bidding Process**

While the merger failed in 2003 under the negotiation of Steve Jobs, the acquisition passed with a stock purchase in which 2.3 shares of Disney would be given to every shareholder of Pixar in exchange for their ownership.

### **Synergy realization**

This acquisition is widely considered a huge success in the media and entertainment industry as evidenced by the movies produced by Pixar producing in excess of \$4 billion of additional box office revenues in only five years compared to \$3.2 billion in the previous nine. It is uncertain whether Disney could have achieved many of the benefits of

the acquisition at a far lower cost by simply partnering with Pixar into the future, but it remains that the move was at the very least defensive.

### Relative Performance

With so many different businesses, Disney's peer groups are less obvious. Certainly, with a huge media and entertainment presence, 21st Century Fox and Time Warner would be good peer groups to capture the relative performance of Disney's equity post-merger.

### Absolute Performance

Due to the timing of the acquisition, the benefits of Disney's acquisition were difficult to see in the equity performance of the stock immediately following the merger. According to Figure 14, Disney's equity performance greatly improved post-recession and especially after 2011, fueled in part by Pixar movie hits. Post-recession, revenue, EPS, and ROA had all grown consistently, and multiples began to reach levels more similar to pre-recession levels (Figure 15).

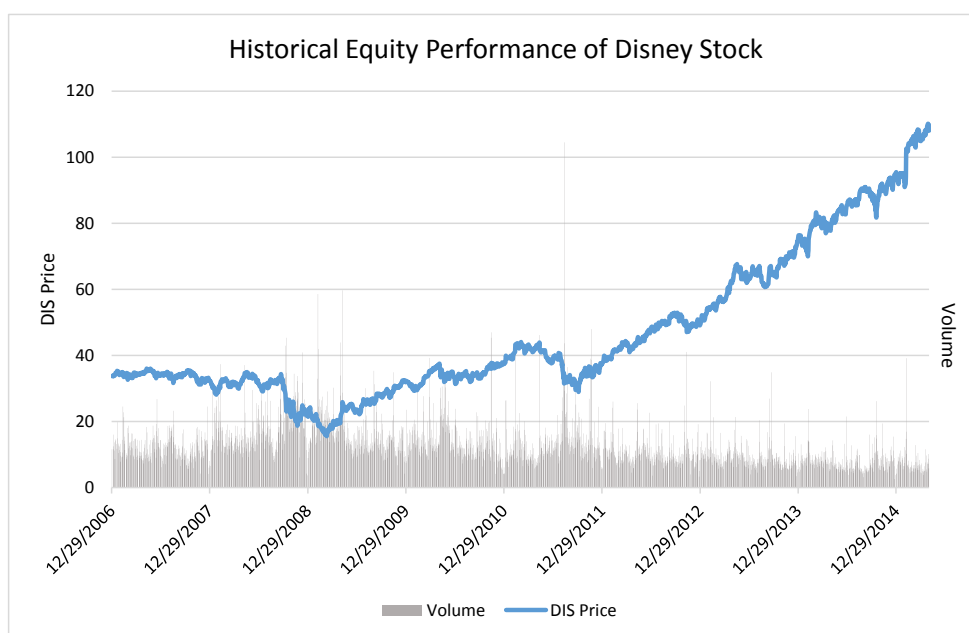


Figure 14 (Source: Bloomberg)

Metric	2008	2009	2010	2011	2012	2013	2014
ROA	7.75	7.17	5.27	5.99	6.80	7.73	7.86
Revenue	35,510.0	37,843.0	36,149.0	38,063.0	40,893.0	42,278.0	45,041.0
EPS	2.34	2.34	1.78	2.07	2.56	3.17	3.42
EV/EBITDA	9.6x	8.3x	8.6x	9.1x	7.2x	9.7x	11.4x
P/E	18.0x	14.4x	15.0x	16.1x	11.9x	17.0x	19.4x

Figure 15 (Source: Bloomberg)

### Concluding Remarks

The success of this merger rested in the fact that the two companies separately had performed well, and their cultures had also mixed well with prior collaborations. Additionally, the similarity of assets and strategic goals allowed for an almost seamless entrance of Pixar into the Disney umbrella. Although the merger had fallen through previously in 2003, Steve Jobs eventually acquiesced to sell off his stake in the company, and ultimately the two companies together have appeared to reap the benefits, Disney from enhanced animation and Pixar from their ability to sell their memorable brands through Disney's distribution channels.

### CONCLUSION

Overall, there are many important lessons to learn from evaluating the relative success of the discussed mergers including having a sound strategic rationale, having a full understanding of future industry trends, and having a similar enough culture and asset base to command either cost or revenue synergies going forward. With the AOL Time Warner merger, there existed a viable idea of combining old and new media, but Time Warner failed to realize that AOL was not well-positioned for the future of this industry, as dial-up would become a much less significant and used platform only months later. The other three mergers all had very similar markets served and their assets were easy to combine and they all had a good understanding of industry trends. Apart from avoiding a

rejection from the FTC, Sirius and XM knew the importance of defining their market more broadly than just satellite radio, and as such, they have become a profitable player in the audio entertainment industry years after the merger, benefitting from the synergies attained from being under one roof. Disney knew the importance of continuing to innovate in animation entertainment, so they brought on Pixar to sustain their relevance in this industry well into the future. Exxon and Mobil knew that together, they could achieve greater success internationally since their spheres of influence complemented each other. They could also achieve considerable scale together as one company. Lastly, the success of a merger might not appear for years later; Sirius and XM, in part by the luck of investor John Malone, were able to enjoy the benefits of the merger only years after the merger, and Disney and Pixar were especially able to experience the upside of the transaction after the Great Recession. It is difficult to point to one factor that causes the success or failure of a merger, but overall, the logic behind the merger, the ease of implementation, and the overall understanding of future markets are essential to any merger's or acquisition's success.

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