AT&T Joins U.S. Pay-TV Overhaul With $48.5 Billion DirecTV Deal

By Alex Sherman and Scott Moritz - May 19, 2014

AT&T Inc. (T) plans to buy DirecTV for $48.5 billion, gaining more than 38 million video subscribers at home and in Latin America and stepping up an acquisition-fueled overhaul of the $110 billion U.S. pay-TV industry.

AT&T will pay $95 for each share of DirecTV, split between $28.50 in cash and the equivalent of $66.50 in stock, the companies said yesterday. That’s 10 percent more than DirecTV’s closing price on May 16. Including net debt, the deal values the largest U.S. satellite-TV company at $67.1 billion.

Randall Stephenson, chief executive officer of AT&T since 2007, is embarking on the company’s largest takeover in eight years to bulk up after competitors Comcast Corp. (CMCSA) and Time Warner Cable Inc. (TWC) announced their own merger, accelerating consolidation across the communications industry. The purchase gives AT&T a national satellite-TV provider to combine with its existing packages of wireless, phone and high-speed Internet service.

“Strategically, this makes a lot of sense for AT&T,” said Jan Dawson, an analyst with Jackdaw Research in Provo, Utah. Gaining a satellite-TV provider “lets them go national with a video offering that matches their wireless reach.”

AT&T fell 1.6 percent to $36.14 at 9:34 a.m. in New York. DirecTV declined 2.6 percent to $83.94, after closing at $86.18 on May 16.

Bolstering Broadband

The agreement was approved by both boards, and the companies expect the deal to close within 12 months, pending regulatory review and approval from DirecTV’s shareholders. To help with antitrust approval in Latin America, AT&T said it plans to divest its 8 percent stake in America Movil SAB. (AMXL)

DirecTV, which doesn’t have its own phone service or a competitive Internet offering, was under pressure to find a partner as more viewers go online for video and the pool of traditional pay-TV customers shrinks in the U.S.

With the transaction, AT&T said its high-speed broadband network will cover 70 million customer locations. That was one of the reasons for the deal because it helps customers watch TV on any device, DirecTV CEO Mike White said in a phone interview.
“Randall and I have had a relationship for a number of years,” White, 62, said. “Over the last year, things began to change with technologies -- AT&T started to be able to offer more broadband and better broadband. With it comes a continuing evolution for mobile video.”

**Deal Financing**

In the joint phone interview, Stephenson, 54, highlighted DirecTV (DTV)’s relationships with content providers and head start in setting up a package of Internet-delivered channels similar to a pay-TV bundle, known as over-the-top service.

DirecTV will still be based in El Segundo, California, and its service will be available on a standalone basis for at least three years after the acquisition closes.

The companies said the deal will add to free cash flow and earnings per share within 12 months of closing, and cost savings will top $1.6 billion on an annual basis.

AT&T plans to finance the cash portion of the deal with cash on hand, the sale of non-core assets, committed financing facilities and opportunistic debt market transactions. AT&T had a market value of about $191 billion as of May 16 and had total debt of about $80 billion and cash and equivalents of $3.6 billion at the end of March.

Including debt, the acquisition is AT&T’s third-largest deal on record, behind the purchase of BellSouth for $83 billion in 2006 and the deal for Ameritech Corp., which closed in 1999, according to data compiled by Bloomberg.

**‘Industry Redefining’**

The deal is also the third-largest for the communications industry in the past year, ranking after Verizon Communications Inc.’s $130 billion deal for the rest of its U.S. wireless venture and the pending $68 billion purchase of Time Warner Cable, the data show.

At the $67.1 billion deal value, which includes debt, AT&T is paying 8.15 times DirecTV’s earnings before interest, taxes, depreciation and amortization in the 12 months through March, according to data compiled by Bloomberg. That’s in line with a median multiple of 8.11 times trailing 12-month Ebitda for cable and satellite companies over $1 billion in the past five years, the data show. Comcast offered about 8.6 times Ebitda for Time Warner Cable, the data show.

Comcast’s plan to acquire Time Warner Cable will create an even bigger provider of both TV and Internet in the U.S. In March, AT&T’s Stephenson called the Time Warner Cable takeover an “industry-redefining deal.”

**Regulatory Approval**

One of the main questions about the potential deals is whether regulators will allow them. Comcast’s takeover of Time Warner Cable hasn’t been approved yet. A merger of DirecTV and satellite-TV rival Dish Network Corp. (DISH) was blocked more than a decade ago. AT&T, the second-biggest U.S.
mobile-phone carrier, had to abandon a purchase of Deutsche Telekom AG’s T-Mobile U.S. unit in 2011 in the face of antitrust opposition.

Unlike Comcast’s acquisition of Time Warner Cable, AT&T’s purchase of DirecTV would eliminate a choice for pay-TV customers in some markets because AT&T’s U-verse landline video service competes with DirecTV. DirecTV has 20.3 million U.S. customers, while AT&T’s U-verse TV service had about 5.7 million customers at the end of the first quarter.

White and Stephenson confirmed AT&T will offer both U-verse and DirecTV in markets where the products overlap. If this becomes a regulatory issue, AT&T could theoretically stop offering U-verse TV and only offer DirecTV along with U-verse broadband, but no decisions have been made because the companies didn’t feel the need to offer this condition yet, according to a person familiar with the matter.

**America Movil**

To facilitate antitrust approval in Latin America, AT&T will sell all of its L and AA shares in Carlos Slim’s America Movil, and its designees to America Movil’s board will tender their resignations immediately. A press official for America Movil declined to comment.

Stephenson said he visited recently with Slim to discuss his plan to do the deal and reaffirmed they had a strong relationship.

America Movil is a direct competitor to DirecTV in countries including Brazil and Colombia. DirecTV’s Latin America operation includes Mexico, where it has a minority stake in Sky Mexico, controlled by Grupo Televisa SAB, one of America Movil’s biggest rivals.

Selling the stake in America Movil will reduce AT&T’s earnings by about 5 cents a share, according to the statement. AT&T now projects 2014 per-share earnings growth at the low end of its earlier forecast for a “mid-single digit” increase.

**‘Unprecedented Concessions’**

Stephenson said that he’s offering “unprecedented concessions” to help ease the regulatory review process. One of those concessions is freezing prices for three years for DirecTV’s TV service and wireline IP broadband service.

“There are sensitive areas for sure but they are all manageable,” he said in the interview. “We think this will pass regulatory muster.”

AT&T won’t owe a breakup fee to DirecTV if the deal is blocked by regulators on antitrust grounds, the CEOs said in the phone interview. In AT&T’s failed effort to acquire T-Mobile, the company paid $3 billion in cash plus wireless frequencies and a roaming agreement.

DirecTV will pay AT&T a breakup fee of $1.445 billion if it instead agrees to be sold to another company, the pay-TV provider said in a filing today. Both companies may call off the combination if
it’s not completed by May 18, 2015, according to the filing. That deadline may be extended to Nov. 13 of next year under certain circumstances, DirecTV said.

AT&T said it will commit to abiding by the principles of net neutrality for three years, meaning it won’t block websites or selectively speed up or slow down Internet traffic.

‘Merger Mania’

Consumer groups have already started speaking out against the merger.

“The captains of our communications industry have clearly run out of ideas,” Craig Aaron, CEO of advocacy group Free Press, said in a statement. “Instead of innovating and investing in their networks, companies like AT&T and Comcast are simply buying up the competition. These takeovers are expensive, and consumers end up footing the bill for merger mania.”

DirecTV will give AT&T a pay-TV business that’s expanding in Latin America. It has 18.1 million subscribers there, including Sky Mexico, of which it owns 41 percent.

DirecTV is also getting U.S. customers to pay increasingly higher monthly bills by offering exclusive content such as the National Football League Sunday Ticket package and products such as Genie, a multiroom digital video recorder.

Sunday Ticket

DirecTV’s White said today that the company has been in talks with the NFL and is still confident it will renew its deal for NFL Sunday Ticket. The takeover could hinge on those negotiations, according to a regulatory filing today. If the Sunday Ticket rights aren’t renewed on the terms discussed between AT&T and DirecTV, then AT&T can call off the merger, the filing shows.

DirecTV generated $2.6 billion in free cash flow last year, cash that AT&T can use going forward to help support dividend payments. AT&T pays a quarterly dividend of 46 cents a share.

When the deal closes, DirecTV shareholders will own 14.5 percent to 15.8 percent of AT&T stock, on a fully diluted basis, based on the current number of AT&T shares outstanding.

DirecTV had also drawn merger interest from Dish Network Chairman Charlie Ergen, people with knowledge of the matter said in March. While a DirecTV merger is tempting, the satellite-TV rival is too expensive to pursue, Ergen said this month on a conference call to discuss first-quarter earnings.

DirecTV Rally

A deal with DirecTV shows that AT&T has turned its attention back to the U.S. market since the Time Warner Cable takeover was announced. AT&T had previously explored wireless opportunities in Europe, such as acquiring Vodafone Group Plc.

Stephenson said in the statement that DirecTV is the best option for AT&T because it brings the top
brand in satellite-TV and a fast-growing business in Latin America. He declined to comment on Vodafone when asked about the U.K. company in an interview.

DirecTV shares were already up 25 percent this year.

One of the biggest beneficiaries of DirecTV’s rally this year is Warren Buffett’s Berkshire Hathaway Inc., thanks to a stake built by his deputy stock pickers at about half last week’s price. Berkshire had about 34.5 million shares as of March 31, a regulatory filing showed last week.

Goldman Sachs Group Inc. and Bank of America Corp. served as financial advisers for DirecTV, while Weil, Gotshal & Manges LLP, Jones Day and Wiltshire & Grannis LLP acted as legal advisers. AT&T was advised by Lazard Ltd.

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