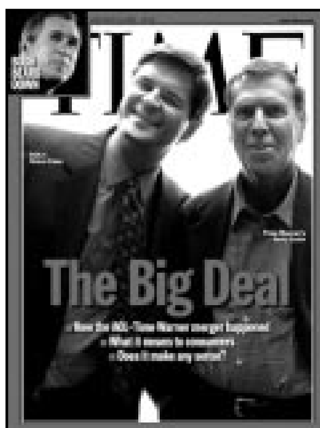
Happily Ever After?

The “most transformational event” turns Wall Street on its ear, two giants into one and the future into an alluring promise

By DANIEL OKRENT

How big was it? In northern Virginia on Friday night, Jimmy Lynn, an AOL marketing executive, got an inkling that something was happening. “I usually go to the Redskins games with a guy from the mergers and acquisitions group,” Lynn explained. When the friend canceled—for the Redskins’ first playoff game in seven years—Lynn knew it was not just something, but *really* something. In downtown Manhattan early Monday, the 7:30 a.m. daily research call emanating from the fifth-floor conference room of Merrill Lynch headquarters was handled by analysts Henry Blodget and Jessica Reif Cohen. Traders who had nearly run off the road when they had heard the news on their car radios crammed the room; 1,000 more around the world were connected by telephone. Like everyone else on Wall Street, Blodget and Reif Cohen had been taken totally by surprise. They used words like brilliant and huge—but they were at a loss to explain to their colleagues what it actually meant.



America Online acquired Time Warner in the largest merger in American corporate history.

It was on Tuesday afternoon, the day after the deal was announced, that the influential Silicon Valley venture capitalist Roger McNamee summed up the object of all this attention: “Let’s be clear,” he said. “This is the single most transformational event I’ve seen in my career.”

Just what exactly was transformed? America Online, the newbie-friendly smiley face of the Web that just three years ago was an operational mess, had engineered the largest merger in American corporate history. Time Warner, the immense media conglomerate that had sprung from the loins of the magazine you are now reading—having failed to beat the Internet upstarts with its own efforts—had decided to surrender to them for the best price it could get, about $162 billion in AOL stock. The companies valued the combination at $350 billion.

For Time Warner chief executive Gerald Levin and AOL boss Steve Case, the common experience of groping through a rapidly mutating economy made this deal in some ways inevitable. In AOL, Case had built a brand, a customer base and (by Internet standards) healthy profits. But he faced a future that may see Internet access become a commodity, and he lacked access to the leading source of broadband—the fat, fast pipes of cable television that could carry vast amounts of Internet content. And Case didn’t have much in the way of content either. Time Warner’s cable-television system, the country’s second largest, owned plumbing aplenty to distribute AOL’s services. The company also had the proprietary content—magazines, books, movies, music, programming—to send down the pipes.

Yet Levin’s company had remained inextricably mired in its own past, a dinosaur lurching its way through a world that would soon belong to swifter creatures, almost pathetically unable—like all the major media companies—to make the Great Leap Forward into the new Internet economy. The company’s stock price had plateaued in a year

in which Net stocks soared, and there was little excitement about the plans being developed in its recently hatched digital division, despite projected outlays this year of $500 million. "We had a big uphill job as a corporation" to catch up with the established Internet players, notes Time Warner vice chairman Ted Turner. Levin was even contemplating "an internal takeover" of CNN to make it the company's digital division, separate from the rest of the Turner networks.

Both Case and Levin were faced with what corporate strategists call a "make or buy" dilemma. Case must have contemplated that at some point Wall Street would come to its senses and that AOL's helium-supported Internet valuation would be punctured and deflate. Better spend those Net-flated dollars now—buy. Levin, with his stock price sputtering, didn't have the currency to pay the price of admission on the Internet. The company, in fact, could neither "make" nor "buy," which left it with but one option—sell.

Winning over Wall Street will require a prolonged process of—pick your noun—either education or spin. Music-business executive Danny Goldberg, a former head of Warner Bros. records, says the merger both "validates the Internet and validates the value of content." But it also forces the invention of a new currency to reflect it; as the AOL and TWX stock prices yo-yoed up and down last week, it was clear that investors had no idea how to put a price tag on something that was neither an Internet highflyer nor an old-economy cash-flow locomotive. AOL lost about 20% of its value before recovering to $63. Time Warner leaped 58% on the news, then settled at $82, up 26% for the week. In the nobody-knows-anything world of Wall Street, one analyst was predicting a 50% increase in AOL's stock price between now and next fall when the deal is expected to close, another was predicting a continuing slump, a third meaninglessly narrowed the medium-term price target to "between $55 and $90," and the last little analyst cried all the way home. "The Street has no historical reference," says one of the dealmakers.

For consumers, the combination represents, in its barest terms, the potential for getting whatever they want—books, movies, magazines, music—whenever they want it, whatever way they choose, whether on a TV, a PC, a cell phone or any of the myriad wireless devices that are hurtling toward the marketplace. They can even get it on—drum roll—paper. Is there a compelling reason that one company has to provide all of this? No. It will be up to AOL Time Warner to prove its case to consumers.

That's the tantalizing potential of the AOL-Time Warner merger, the notion that two very different companies can combine to create something unimaginable only yesterday. Ten years ago, a Time Warner manager went to one of the company's senior executives with a proposition. This small but promising online business on whose board he sat, run by this terrific guy Steve Case, was in desperate need of cash. For $5 million, Time Warner could own 11% of it. "If we did that," the boss replied, meaning if he conceded that the digital distribution of content was going to succeed, "then everything we have done here since 1923 could be thrown out the window."

To see that, he may have been a wise man, though a horrible stock picker (that $5 million would be worth $15.6 billion at Friday's market close). But that was then, and this is tomorrow. ■

HOW AOL DEFIED THE SKEPTICS

1989 AOL begins operation.

1992 AOL goes public, opening at $11.50 a share on the NASDAQ.

1993 Steve Case becomes CEO. AOL begins ubiquitous marketing campaign.

1994 Reaches 1 million subscribers.

1995 Joins with German media firm Bertelsmann AG to expand AOL to Europe.

1996 Converts from an hourly rate to a flat rate of $19.95 a month; increased usage causes dial-up logjams.

1997 Curtails marketing to focus on network traffic-jam issue. Agrees to offer refunds to customers who got busy signals.

1999 Acquires MovieFone and Netscape Communications.

2000 Agrees to merge with Time Warner.

Questions

1. What motivated Steve Case and Jerry Levin to merge their respective companies?

2. Why does Wall Street have no historical reference for the AOL-Time Warner merger?