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Disney, Struggling to Regain Glory, Gets \$48.7 Billion Bid From Comcast; Driving Force Behind Offer: Technology Tears Up Old Business Models; Rocky History of Big Mergers

Julia Angwin, Martin Peers and Anne Marie Squeo. **Wall Street Journal**. (Eastern edition). New York, N.Y.: Feb 12, 2004. pg. A.1

Author(s): Julia Angwin, Martin Peers and Anne Marie Squeo
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Abstract (Article Summary)

Comcast's bid also raises questions about the health of the cable industry as new technologies such as satellite threaten it. After all, analysts say, why would Comcast want to weigh down its fast-growing cable assets for fairly mature media properties. "Comcast is also signaling something about its core cable business," says Henry Ellenbogen, analyst at T. Rowe Price, which owns shares in Comcast and Disney. Currently, he says, "cable is in the sweet spot of its product cycle," but the question is whether the cable industry can sustain the growth it has gained from new products such as digital television, and high-speed Internet access.

Big Entertainers A look at major media conglomerates
 Comcast Headquarters: Philadelphia Employees: 59,000 Annual revenue (in billions): \$18.35 Market capitalization (in billions): \$70.00 Major businesses: Cable and broadband Internet services, SportsNet, E! Entertainment Television, The Golf Channel
 Disney Headquarters: Burbank, Calif. Employees: 112,000 Annual revenue (in billions): \$27.06 Market capitalization (in billions): \$56.42 Major businesses: ABC, ESPN, Miramax, Walt Disney Studios, theme parks
 Viacom Headquarters: New York Employees: 122,770 Annual revenue (in billions): \$26.59 Market capitalization (in billions): \$72.02 Major businesses: CBS, MTV, Paramount Pictures, Blockbuster, Simon & Schuster, Nickelodeon, Infinity Radio News Corp.
 Headquarters: Sydney, Australia Employees: 36,900 Annual revenue (in billions): \$17.47 Market capitalization (in billions): \$52.69 Major businesses: DirecTV, Fox, 20th Century Fox, HarperCollins, Times of London, Fox News Channel
 Time Warner Headquarters: New York Employees: 80,000 Annual revenue (in billions): \$39.57 Market capitalization (in billions): \$77.74 Major businesses: America Online, HBO, Time Inc., Turner Broadcasting, Time Warner Cable, Warner Bros.
 Entertainment Sources: the companies; DJ Indexes (See related article: "Mouse Trap: Already on Defense, Eisner Faces Biggest Challenge Of Nearly 20-Year Reign Cable Giant's Huge Ambitions" -- WSJ Feb. 12, 2004)

Full Text (1891 words)

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Behind Comcast Corp.'s audacious bid for Walt Disney Co. is the powerful force of technology reshaping one company after another in media and communications. It is disrupting basic business models, plunging companies into new markets, creating new competitors and blurring the boundaries between industries.

In response, companies are scrambling to protect themselves in two ways. Some are bulking up. Several telecom companies, for instance, are circling AT&T Wireless, the No. 3 U.S. cellphone player, as the dissolving boundaries between long-distance, local, wireless and the Internet ignite new competition and drive down prices. Music companies, confronting a

surge of digital piracy, are in a wave of consolidation.

Others, seeing their old markets come under siege, are pushing into new ones. Eastman Kodak Co. recently began moving away from its traditional film business and into printers and other digital devices that have it competing with a new lineup of electronics rivals.

Comcast is doing both: A merger with Disney would turn it into one of the world's biggest media companies and give Comcast a new reach into movies and theme parks.

It's an intense response to the disruption Comcast faces from newly strengthened competition. The nation's biggest cable company, long used to monopolies in its regions, faces the growing threat of satellite television as an alternative. That threat is particularly acute as Rupert Murdoch's giant News Corp. completes its purchase of a controlling stake in DirecTV, the biggest U.S. satellite-TV player.

"A lot of transforming mergers are done by people who are very smart and correctly predict a shift in their business model or very desperate because their existing business model is evaporating in their face and the only solution is to buy someone else's business model," said Charles Nathan, a veteran New York merger lawyer at Latham & Watkins.

The central technological change driving all these shifts, under way for years and now accelerating, is the digitization of sounds, words and pictures -- allowing companies to transmit and manipulate them in new ways. The latest wave of corporate moves is reviving the question of whether content companies should also own distribution channels, and presenting new challenges to regulators and Congress.

Mitch Rubin, a money manager at Baron Asset Management, said that people have been debating for years which was more important, media content or the means to distribute it. Now, that debate has been rendered moot. "What this deal says is, it would be great if you had both. You can debate which is better, but if you have both it doesn't matter," Mr. Rubin said.

The rising stock market is throwing extra fuel onto these unstable industries. Many executives were surprised that Comcast would propose devouring Disney only 14 months after it purchased AT&T Broadband, the cable unit of AT&T, for \$51 billion. With that deal Comcast became the largest cable operator in the industry. Yet Comcast stock has risen 33% in the past 12 months, until its 8% drop yesterday. "Use it or lose it" is the investment bankers' adage to companies with rising share prices.

And yet recent technology-driven media megamergers haven't gone all that well. Former America Online Inc. Chairman Steve Case and former Time Warner Inc. Chairman Gerald Levin hoped the combination of their companies would help speed convergence of entertainment and technology. Instead, huge cultural differences between the companies, and a collapse in AOL's business, wrecked the promise of the merger and destroyed billions of dollars in stock-market value. Both Mr. Case and Mr. Levin have left the company.

Vivendi Universal SA went a similar route. When Vivendi SA of France bought Universal Music Group's parent company, Seagram Co., in late 2000, Vivendi's then-chairman, Jean-Marie Messier, predicted the new company would enable transmission of Universal music across a wireless Web service to mobile phones and hand-held computers. He predicted this would enable Universal's content to be available to global consumers anytime, anywhere. The idea didn't get very far before Mr. Messier changed his strategy to do more acquisitions. The resulting debt load almost crushed the company and led to Mr. Messier's ouster in 2002.

Comcast says it's going to avoid the mistakes of others. "This is not AOL Time Warner. This is not Vivendi Universal. This deal makes sense using old-fashioned numbers," says Steven Rattner, managing principal at Quadrangle Group LLC, who is advising Comcast on the deal.

Comcast's bid also raises questions about the health of the cable industry as new technologies such as satellite threaten it. After all, analysts say, why would Comcast want to weigh down its fast-growing cable assets for fairly mature media properties. "Comcast is also signaling something about its core cable business," says Henry Ellenbogen, analyst at T. Rowe Price, which owns shares in Comcast and Disney. Currently, he says, "cable is in the sweet spot of its product cycle," but the question is whether the cable industry can sustain the growth it has gained from new products such as digital television, and high-speed Internet access.

In telecom and Internet access, Comcast is competing with such behemoths as Verizon, which isn't going to stand idly by

and let Comcast take its business away. Verizon already has announced plans to move into the content business through a marketing pact with DirectTV that provides discounted TV and phone service in Rhode Island. Verizon also is cutting its rates for Internet access to stave off Comcast's inroads in the Internet sector.

That helps explain Comcast's need to extend its arms into content. Putting all its bets on new services such as the Internet and telecom won't necessarily lead to strong profit growth. On the other hand, control of unique content could enable Comcast to better compete with News Corp. and give it an additional weapon to fight Verizon and other telecommunications companies.

A big question is whether bulking up and reaching into new markets will stand regulatory and Congressional scrutiny. One reason deals spanning industries are appealing to CEOs and their investment bankers is they face fewer antitrust hurdles than transactions with overlapping brands and services. A deal combining the biggest long-distance phone company with the second-biggest long-distance company, for instance, would almost certainly be rejected out of concern such concentration could lead to higher consumer prices. However, a deal involving a long-distance company and a cable company or Internet company isn't as problematic because it doesn't eliminate a major rival, antitrust attorneys said.

In general, antitrust enforcers are leery of bringing lawsuits involving vertical integration, or the combination of companies along the same distribution chain, unless they can prove a key rival would be shut out. "It's more difficult to demonstrate where the competitive harm is and there's also a stronger argument for synergies and efficiencies," said Blair Levin, a managing director at Legg Mason and a former chief of staff at the Federal Communications Commission.

That's why, despite intense political opposition to News Corp.'s purchase of DirecTV, the deal went through, as did Time Warner's purchase of Turner Broadcasting years ago. Similarly, a Comcast-Disney combination probably wouldn't be stopped on regulatory or antitrust grounds.

But it is widely expected to turn into "the lens for which all the other issues are viewed," noted Mr. Levin of Legg Mason, citing the mounting congressional and regulatory attention on broadcast indecency, rising cable rates and media consolidation. Just yesterday, no fewer than four hearings -- three in Congress and one in a Philadelphia appeals courtroom -- took place on these subjects.

Lawmakers said they would hold hearings to investigate the deal's impact on competition. Sen. John McCain, the Arizona Republican who is chairman of the Senate Commerce Committee, said he'd continue to monitor the situation, "but I believe that further media consolidation in the industry is troubling."

In a joint statement, Sen. Mike DeWine, an Ohio Republican, and Sen. Herb Kohl, a Wisconsin Democrat -- both of the Senate Judiciary antitrust subcommittee -- said that vertically structured combinations such as Comcast-Disney "may well pose a risk to competition in the marketplace of ideas and diversity of news, information and entertainment." They went on to say that this deal is just part of a pattern where "consolidation leads only to more consolidation as media companies attempt to keep up with the increasing size requirements of their industry."

Comcast CEO Brian Roberts said as much in his letter to Disney Mr. Eisner: "Given the landscape that has evolved in our industry over the past few years, the creation of integrated content and distribution companies is essential to increasing the level of competition," wrote Mr. Roberts.

The deal would face months of scrutiny by the Justice Department as well as the FCC. "We'd have to take a close look at the combination," said Commissioner Michael Copps. "Serious questions are raised . . . with regard to the nexus between distribution and content."

But there's precedent to suggest that it would pass muster with minor concessions. The main issue is one that these overseers only recently faced when they approved News Corp.'s acquisition of DirecTV, namely preventing the distribution outlet from withholding or unnecessarily boosting the price for programming.

Indeed, Comcast's overture wouldn't be possible if a federal appeals court in February 2002 hadn't struck down a ban on one company owning both a cable system and a broadcast TV station in the same market. The FCC's decision not to appeal that ruling cleared the way for combinations such as Comcast-Disney.

(MORE)

Mr. Murdoch yesterday played down the competitive implications of a Disney-Comcast merger. Speaking on a conference call with reporters, he said it would simply lead to a third big vertically integrated player, alongside his company and Time Warner. News Corp. and Comcast would be "pretty equally positioned."

"We will have just as much ability to pressure them as they us," he said, noting that DirecTV right now pays Disney's ESPN more than \$300 million a year. "There would be a lot of money going back and forth."

Earlier this week, Mr. Murdoch's deputy at DirecTV, Chase Carey, outlined an ambitious strategy to boost the number of subscribers at the satellite unit by 25% during the next three years. Part of Mr. Murdoch's plans is to take advantage of his entertainment empire to repackage Fox programming.

Dennis Berman contributed to this article.

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