AT&T to Acquire DirecTV
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On May 18, 2014, AT&T announced a definitive agreement to acquire satellite TV provider DirecTV. AT&T will pay $95 per share in a cash and stock transaction valued at $48.5 billion (the total deal value is $67.1 billion when including AT&T's assumption of DirecTV's debt). DirecTV is the largest satellite TV provider and second largest pay TV provider in the United States with more than 20 million subscribers. DirecTV also serves 18 million customers in Latin America. AT&T and DirecTV combined serve 25.7 million pay TV subscribers and 16.5 million broadband subscribers in the United States.

While consolidation in the U.S. pay TV market is nothing new, this deal represents the second mega-merger, following Comcast's announced deal to acquire Time Warner Cable (TWC). Although AT&T's bid for DirecTV does not necessarily need to be viewed as a response to Comcast's move, the two are similar in that they result in pay TV and broadband service providers that dwarf many of their competitors. The AT&T/DirecTV combination will still trail the enlarged Comcast in terms of TV but will have an important edge associated with mobile subscribers and mobile network coverage.

There are a number of dimensions with respect to how this deal impacts both companies and the markets in which they compete.

- Nationwide reach. The U.S pay TV market is characterized by a mix of regional wireline providers (cable and telco TV) and nationwide providers (satellite TV). Even with Comcast's acquisition of Time Warner Cable, Comcast, the largest pay TV provider in the United States in terms of subscribers, will still be a regional player with no nationwide service footprint. AT&T, with its wireline U-verse service is similarly restricted within a physical network footprint. However, AT&T's wireless network gives the company nationwide reach for mobile services as well as new innovative offering such as the Digital Life home security service. DirecTV brings to AT&T similar nationwide reach for TV services which presents bundling opportunities, a nationwide addressable market for advanced services, and a key competitive edge over an enlarged Comcast.
- Bundling opportunities. On a nationwide basis, there are immediate opportunities for AT&T to drive bundled service opportunities across satellite TV and mobile services. Within AT&T's fixed line 22 State footprint, the opportunity to package and market a bundle including DirecTV satellite TV and high speed Internet based on ADSL2+ technology which AT&T brands "IP Broadband" emerges. Unlike the FTTN technology based on VDSL2 used for U-Verse, ADSL2+ is challenged when offering IPTV services. It is adequately suited to deliver over-the-top video content, but delivering multiple streams of HD requires more bandwidth than is typically available. Offloading the bandwidth capacity requirements for television, while at the same time being able to offer internet service in the 20 Mbps plus range in many markets – potentially creates a much more competitive bundle from a broadband perspective when facing cable offerings based on DOCSIS 3.0 technology delivering 50 Mbps + in most markets. In addition as part of this deal, AT&T committed to expanding its rural reach using fixed wireless and fiber to the premises technologies. It is likely that IP Broadband will play a role in this expansion as well.
- Service provider competition. With the Comcast/TWC merger, there will be two pay TV giants in the U.S., each serving over 25 million subscribers. Combined, this represents more

than half of the U.S. pay TV subscriber base. While DISH Network has more than 14 million subscribers, DISH will remain essentially a standalone video provider (albeit one sitting on wireless spectrum). Speculation regarding a DISH/DirecTV merger will of course go away and more attention will be paid to possible DISH M&A activity in the wireless space. Verizon, a distant competitor in terms of video subscribers, will nonetheless have similar nationwide reach through its wireless network and has amassed a collection of in-house OTT video distribution assets across Verizon Digital Media Services (which recently acquired EdgeCast and upLynk) and the purchased assets of Intel's OnCue platform. Smaller cable provider may find themselves increasingly looking to hitch a ride with Comcast which has focused on in-house technology development and a corresponding technology licensing strategy.

- Emerging competitive threats. The video market in the United States, and around the globe, is undergoing significant change as the competitive threat from over-the-top (OTT) continues to grow. As one looks to the future, IDC believes that opportunities exist for companies to offer "virtual cable" services in which traditional multichannel and on-demand TV services are offered via broadband. While Intel bowed out of this opportunity with the sale of its OnCue assets to Verizon, the possibility remains that large companies (perhaps Google, Apple, Microsoft, or Amazon) may enter the pay TV market with an OTT service. In terms of customer reach and market capitalization, these companies represent significant competitive threats and the scale associated with enlarged service providers such as AT&T/ DirecTV and Comcast/TWC must be considered in a context far broader than just today's pay TV market.
- Multiscreen video. On the heels of the launch of joint venture with the Chernin Group to focus on platforms and services for multiscreen and OTT video distribution, AT&T now adds an important piece in a broad video distribution strategy. DirecTV has long been known as a leader in the U.S. pay TV market in terms of subscriber quality, ARPU, and service innovation. DirecTV was an early mover with DVR boxes and HDTV and is poised to repeat this role as Ultra HD emerges in the years ahead. This deal creates opportunities for the migration of DirecTV 20 million video subscribers to advanced multiscreen services associated with AT&T's mobile and broadband services. At the same time, DirecTV's subscriber base enlarges AT&T's TV customer base beyond the AT&T wireline footprint so that AT&T can now offer services on a nationwide scale. This forms an attractive addressable market for future OTT video services, in-car entertainment, and mobile video.
- Content costs. An ongoing rationale for service provider consolidation is the belief that larger pay TV providers will gain new leverage in content licensing negotiations with major media companies. Increased content costs, which squeeze pay TV service margins and drive subscription fee hikes, are a sore spot with service providers and consumers alike. Given that DirecTV and U-verse content licensing deals are distinct, it may take time for new deals to emerge that consolidate licensing across the satellite and telco TV offerings, in addition to OTT and mobile video services.
- NFL Sunday Ticket. DirecTV currently has exclusive rights to offer the NFL Sunday Ticket package to pay TV subscribers in the United States. As speculation continues with respect to the upcoming expiration of the current deal, a DirecTV/AT&T combination will be a formidable force with respect to outbidding other service providers and offer expanded reach for the NFL Sunday Ticket service across a combined satellite, wireline and mobile addressable market.
- Business services. The acquisition of DirecTV expands AT&T's reach into the business services market with access to DirecTV's reach into key business TV market opportunities including hotels, hospitals, college campuses, and bars and restaurants. AT&T's business TV services are not as robust in terms of market segments served and the addition of DirecTV's customer base with AT&T's existing small business focus that leads with voice, broadband and mobile, will enable AT&T to have greater reach and new bundling opportunities.
- International. While this deal fortifies AT&T's position in the U.S. market, the acquisition of DirecTV provides AT&T access to the growing Latin American pay TV market. The U.S. pay TV market is largely saturated and while DirecTV continues to grow subscribers in most quarter, subscriber growth in Latin America has been a key part of DirecTV's overall growth in recent years.

- Regulatory approval. While one may be tempted to draw parallels with Comcast/TWC, a key difference exists with the AT&T acquisition of DirecTV: service territory overlap. An important rebuttal to those that argue that Comcast's acquisition of TWC is bad for consumers is that cable systems rarely overlap and that within the combined Comcast/TWC service footprint, consumer choice will not change. The same cannot be said for this deal in which some geographic overlap exists across AT&T U-verse TV and DirecTV. The companies note, however, that DirecTV will continue to be offered as a stand-alone service and that DirecTV's strength in rural areas will dovetail with AT&T efforts to enhance broadband coverage and speeds in these areas.
- AT&T's commitment to the net neutrality rules laid out in the 2010 FCC Open Internet ruling is noteworthy. AT&T has agreed to adhere to these rules regardless of the outcome of the notice of proposed rulemaking issued by the FCC on May 15. Essentially, this concession eliminates the need for the FCC to have Title 2 regulatory powers in order to enforce net neutrality guidelines – AT&T has volunteered to abide by the rules in order to get this deal done. This is the second large provider the FCC has used M&A activity to gain net neutrality compliance – Comcast agreed to these rules when merging with NBC and agreed to extend this commitment as part of the TWC acquisition. If these mergers take place, the debate around FCC authority related to net neutrality will become moot for over 50% of the U.S. broadband population. While this concession does not seem to be a big one on the surface, a lot can change in three or four years, and if new transactional business models emerge both AT&T and Comcast could be left behind.

Closing thoughts:

- Due to content costs, broadband margins are simply higher than pay television margins – making the retention and acquisition of broadband subscribers of paramount importance. Broadband speed, value and bundling are the keys to winning at broadband. And greater scale on the pay TV side may offer more leverage in content negotiations as a means to address video service margins.
- OTT video will continue to grow in importance and will require faster networks that are capable of delivering greater volumes of traffic. Even after its Project VIP investment, in a large part of AT&T's footprint there is no clear path to accommodate the demand for increased broadband speeds with the existing fixed network strategy and also be able to deliver IPTV-based video services over ADSL2+-based IP Broadband. This acquisition allows AT&T to squeeze as much value out of its IP Broadband investment as possible within its 22 State serving area, while simultaneously creating the opportunity for a new type of all-wireless triple play on a national basis.
- TV service evolution is critical for service providers in a period of heightened competition both from within and outside the traditional pay TV market. For AT&T, which already has a nationwide focus through its wireless network, the acquisition of DirecTV offers a means to tap into a nationwide TV service subscriber base for bundling and advanced services opportunities. The nationwide scale and wireless network is a key differentiator relative to a post-TWC acquisition Comcast.

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