Research Note

MGI Research

Commentary: AOL Acquires Huffington Post

February 10th 2011

For a relatively modestly sized deal, the AOL acquisition of Huffington Post generated a disproportionately audible media and investor response. It seems the attention often bestowed on the highly visible and sometimes controversial Huffington Post co-founder, Arianna Huffington, has obscured the obvious fact that this is not about HuffPo, - it is all about AOL. HuffPo was destined to be sold, - after Newsweek acquired Tina Brown's The Daily Beast, the writing was on the wall, it was just a matter of time. News Blogging, especially politically focused, has become a real business. For AOL, the stakes are much larger - this deal is a bet-your-farm kind of transaction. Under different market conditions, AOL would have probably ended up going for a more meaningful target like The New York Times. On the heels of the deal, many investors were doing a double take on many traditional media companies like Gannett.

Lots of attention has been devoted to the price at which HuffPo is being bought. In reality, any informed banker or active Internet company buyer will tell you that the price is rich but not exactly off the wall. At 6X projected revenues, and 10X projected EBITDA, the purchase price is dear, but not over the top when compared to similar high-growth companies with attractive demographics. Still, the deal will consume a large proportion of AOL cash position of about $800 Million.

The transaction will take an even greater proportion of management attention as Tim Armstrong (AOL's CEO) is likely to be hounded at every interview and investor meeting for the next year or two with questions about HuffPo integration. The key issue this deal highlights is one of strategy - does AOL have a real strategy and a plan for realistic growth. Buying companies is not a strategy; usually it is an excuse for not having one. Armstrong and his team still have some time to articulate their approach - beyond just playing for time with acquisitions and hoping to reverse the revenue decline. At the very least AOL executive crew deserve short-term credit by clearly framing AOL's focus on content for discrete audiences. By paying out roughly 40%+ of the cash reserves of the company, Armstrong is making a large bet that HuffPo's team can lead the merged entity to content, page view, and ad-sales nirvana. One can question the "strategy", but the conviction of direction is clear and in stark contrast to a similar situation of woe - namely Yahoo! Unlike Yahoo!'s tough-talking, but slow-acting CEO Carol Bartz, Armstrong is going to live or die based on this content-driven strategy.

MGI Research does not rate AOL. However, we find the deal to be illustrative from several perspectives. The price of the deal assumes HuffPo can continue to fire on all cylinders. It also assumes a lossless transition of HuffPo traffic, content and human talent to AOL and then some synergistic growth and savings as a result of the combination. Against the backdrop of a $2B+ company whose revenues are dropping annually by over 20%, it is hard to see how HuffPo $50Mill in revenue and potential cost synergies of $10Mil can really make a huge difference even under the best scenario. The shelf-life of HuffPo content, still mainly focused on news and commentary is probably not as durable as some other companies with heavy Web presence. HuffPo began to generate local and non-news oriented content but its effort in this area are still embryonic. For this deal to pay-off for AOL shareholders, one would prefer to see a little more cushion.

We expect the management challenges of this deal to be intense, but not insurmountable. Executive teams that are successful in high-growth mode rarely find success in turn-around mode. With revenues dropping precipitously, AOL is clearly a turnaround case if there ever was one. In this context, the executive to watch is not the eponymous Arianna Huffington, but the HuffPo co-founder Kenny Lerer. He is an experienced operating executive with a long stint in the previous (successful) incarnation of AOL. Beyond PR headlines, it is not yet completely clear how committed is Ken Lerer's participation in the newly merged entity. All too often, acquirers focus too much energy on the lead singer of the band, so to speak, and neglect the real talent that made the business successful. Beyond this, it is completely logical to expect attrition amongst HuffPo leadership and technical/marketing talent, especially those that have been there since the start. Even if the remaining HuffPo team is exceptional (and we have no reason to believe otherwise), their daily schedules can quickly get disrupted by endless meetings characteristic of large companies like AOL.

Finally, for all the rah-rah talk of a vision match and a unique combination, the terms of the deal say everything. When one side opts for cash, vision and commitment usually go by the wayside once the spotlight fades and the nitty-gritty of operating the NewCO takes center stage. Nothing says "Bye-Bye" to a business partner like a cash payout. If the HuffPo owners truly believed in the potential to create long-term value, they would have taken a greater than 25% of their payout in AOL shares.