

Now for some Micro'hard' talk



What had started as a good ol' peaceful offer for merger, is now turning into a rather unpleasant war of words between Steve Ballmer and the Yahoo! board of directors.

Despite an elongated period of negotiations (since Microsoft put forward their proposal to buy Yahoo! at a 62% premium to the closing price on January 31, 2008, the day preceding the announcement), the stalemate continues. Steven A. Ballmer, CEO, Microsoft Corp. said in a letter on

April 7, "The goal in making such a generous offer was to create the basis for a speedy and ultimately friendly transaction." But since speed is a pipedream still, Ballmer has threatened to take the battle to the shareholders and also that the valuation will be reduced significantly.

"Yahoo! is pulling out all the stops to try to prevent such an acquisition, primarily because I believe management really does feel that Microsoft's \$44 billion offer is too low," feels Richard Dorfman, MD, Richard Alan Incorpo-

rated (a New York-based investment firm) and Chairman, TransMedia Institute. If first quarter numbers are good, it would signify Yahoo!'s best shot at gaining some power in negotiations with Microsoft ahead of its Saturday deadline to accept the software company's nearly \$44-billion takeover offer. A good Q1 would mean that Ballmer eats crow.

Even if a combined Microsoft-Yahoo! is unable to dethrone Google as the online advertising leader, the combined company would still be a very substantial player in this extremely profitable business. The present Yahoo! sentiment is tough to agree with but the situation shows it all. Others are equally getting vehement at the situation. "At the moment, Microsoft is mired in a three-dog fight to acquire Yahoo!", reveals Marc Edelman, a New York law professor with an expertise in antitrust law. At present it's competing against Google, which has tons of free cash flow and AOL, which presents lower antitrust risk. At least publicly, Microsoft is the only company that has submitted a formal acquisition bid. Plus, of these three companies, Microsoft may stand to benefit most based on synergies between Microsoft's core business units and Yahoo!'s web-based capabilities. "Yahoo! will eventually sign a sale agreement with Microsoft but is using Google and AOL to try to convince Microsoft to both increase its bid price and incur the antitrust risk of regulators rejecting the deal on antitrust grounds," adds Marc.

The advantages for Microsoft are greater scale in ad sales, media, and email markets, the ability to compete in instant messaging more directly against AOL and the ability to compete more directly in innovation markets against Google. Experts speculate that a successful deal could lead to AOL being lapped up by none other than Google; creating a virtual duopoly in the online advertising space. But with Yahoo! being

a struggling conglomerate, dabbling in media, sports, internet technologies and just about everything else, it's a bit of a mess. "There certainly will be high integration costs", opines Marc. Of course, for Microsoft, that hardly seems to be a constraint. As per Richard, "Microsoft would become a powerhouse player in online advertising and a much stronger competitor to Google."

Yahoo! relies on a robust first quarter to improve its bargaining position, as the Board of Directors responded back to Balmer, "we recently reaffirmed our Q1 and full year guidance, which is a testament to our ability to perform in line with our expectations despite the current economic environment." But will the results be good for the company?

Though Google just reported a 30% jump in quarterly earnings, it is not clear whether that signals a turn in the industry or just taking more share from Yahoo!," says Marc. Yahoo! has been trying since early February to get other bidders to exceed Microsoft's bid,

but nobody has done so yet. One more bad quarter from Yahoo! and Microsoft might lower its bid price, and even perhaps pull out – that's quite evident!

The fact that stands tall is that Microsoft is not buying Yahoo! to be Yahoo!. This would lead to gross re-organisation of Yahoo!, probably all under the Microsoft brand name. Plus, if ultimately antitrust regulators block the deal, it would be very hard for Yahoo! to regain the needed brand equity to again be able to compete independently. Given the lackluster performance of Yahoo!'s business & stock price, there actually exists no reason for shareholders to be against a sale to Microsoft, feel other analysts.

The M&A folks of any business are

always supposed to solicit the highest bid possible. Plus, with companies like Google, as well as aggressive PE groups, there is always that theoretical chance that something more desirable for Yahoo! would emerge. It may be more an issue of Yahoo!'s management really believing that there is great upside potential if the company remains independent and not wanting to transfer that potential to Microsoft regardless of price. "If it were ever put to a shareholder vote, however, I imagine shareholders would look at the situation much differently and line up in overwhelming numbers in support of a sale to Microsoft", feels Richard.

At the end of it all, Microsoft is in too strong a position and Yahoo! in too weak a position for the latter to

fend off Microsoft's overtures indefinitely. "Microsoft may have to increase its bid by a dollar or two per share to get the deal done, but I suspect that it will ultimately prevail in this takeover battle," concludes Richard. A Google-Yahoo! merger has way too much antitrust risk to even consider absent ma-

jor divestitures, and an independent Yahoo! has been losing a several year battle to both Google and Microsoft. "Ultimately, I believe a lot of this will come down to antitrust issues - would regulators approve Microsoft-Yahoo! merger, and how should those two parties allocate the risk in case regulators either do not approve the deal or require significant divestiture," says Marc.

To sum up, if Yahoo! posts better Q1 results, it may be able to put up a better case in front of its shareholders for now; but the key consideration is whether the company is ready for plan B, that is standing on its own if need be, since that could very much be a possibility now. **4PS**

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Sunanda Roy