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Edgy Holders Constrain Comcast

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Abstract (Article Summary)

The unhappiness among major Comcast investors about the bid for the Magic Kingdom is an issue for Mr. [Brian Roberts], because he's hoping to pay for Disney primarily with Comcast stock. The more the stock of his Philadelphia-based company falls -- and it's down close to 11% since he announced the bid -- the more stock he has to offer and the greater the displeasure of Comcast shareholders. That could lead to even more pressure on Comcast's stock.

Making matters even more worrisome for Comcast investors is the strong likelihood that Mr. Roberts eventually will make a higher bid -- especially since at Disney's current stock price, the Comcast bid includes no premium. Many think Mr. Roberts's plan is to wait until after Disney's annual meeting on March 3, when shareholders are scheduled to vote on a measure withholding support for Disney Chief Executive Michael Eisner and three other directors. If that measure gets a lot of support, it will strengthen Comcast's argument that a management change is needed.

How high would Comcast bid? The company's initial bid on Feb. 11 was valued at $26.47 a share, a slight premium to the $24.08 price that Disney shares closed at the previous day. In 4 p.m. composite trading on the New York Stock Exchange yesterday, Disney's stock was at $27, up 29 cents, so obviously Comcast would have to increase its bid with Disney and Comcast shares at current levels. But Comcast put the word out earlier this week that it would not go as high as $30.50.

Full Text (1251 words)

THE BALL IS BACK in Brian Roberts's court now that Walt Disney Co. has rejected his initial unsolicited offer of about $49 billion.

But Comcast Corp.'s chief executive is in a bind because he has to force Disney's board to the negotiating table without stoking percolating opposition among Comcast investors irked by his strategy. For Mr. Roberts, a championship squash player, it's the equivalent of hitting an ace with a broken racket.

The unhappiness among major Comcast investors about the bid for the Magic Kingdom is an issue for Mr. Roberts, because he's hoping to pay for Disney primarily with Comcast stock. The more the stock of his Philadelphia-based company falls -- and it's down close to 11% since he announced the bid -- the more stock he has to offer and the greater the displeasure of Comcast shareholders. That could lead to even more pressure on Comcast's stock.

"There's a real risk that Comcast [stock] turns out to be dead money for a long period of time," said Craig Moffett, an analyst with Sanford Bernstein & Co.

Many Comcast investors are disgruntled because of what might be called the curse of the cable investor. For more than 15 years, investors in cable stocks have been frustrated by the elusiveness of real profits. Every time cable companies have gotten close to being profitable, they have launched another round of capital spending or investments that has returned them to the red.

Now, in the mind of some Comcast investors and analysts, the company is doing it again with its bid for Disney, a company they feel has much less growth potential than Comcast. "They were four inches from the cup and they picked up the ball and threw it in the woods," says Glenn Greenberg, managing director of Chieftan Capital Management, a Comcast investor, using a golf metaphor. "Now it's going to take a great chip shot to put it on the green again."

Before Comcast announced its bid last week, stockholders had been encouraged because the company was on track to begin enjoying a steady increase in "free cash flow," earnings before depreciation and amortization. With Comcast mostly done with a significant upgrade of its cable systems, many analysts are expecting at least $2 billion in free cash flow this year and $4 billion in 2005. Comcast also is sitting on a nice cushion of cash and assets that could be easily converted into cash, such as stakes in Time Warner Inc.'s cable operation and Liberty Media Corp. Total value: $10 billion to $12 billion.

Critics of the merger note that under Comcast's all-stock bid for Disney, Disney shareholders would wind up owning 42% of the combined company -- free cash flow, assets and all. In exchange for giving that up, Comcast shareholders would get 58% of a company with much less clear growth prospects, they say. Disney's free cash flow is expected to be $1.8 billion this year, but it's far from clear that that will grow much in 2005. Disney also has less in the way of cash and assets, about $1.5 billion.

"It's dilutive to our interest," says Mr. Greenberg, whose firm owned more than 20 million Comcast shares before the announcement. He said that he presented an analysis of the deal, identifying its shortcomings, to Comcast management, and that they have yet to convince him of the merits of the merger.

Particularly unsettling Comcast investors and analysts also is the negative signal about Comcast that Mr. Roberts seems to be sending by making such a high-profile, high-risk grab at a content company. "Although he [Mr. Roberts] is the first to say that's not his view, an awful lot of the market sees it as a vote of no confidence in his cable assets," says Mr. Moffett of Sanford Bernstein.

Investor worries drove Comcast shares down more than 11% in the two days after the company announced its bid, but they recovered some as Mr. Roberts crisscrossed the country assuring investors he will be "disciplined" in his pursuit of Disney. However, in 4 p.m. trading on the Nasdaq Stock Market yesterday, Comcast Class A shares fell 55 cents, or 1.8%, to 30.25. The day before the bid, they closed at $33.93.

As for why the merger makes sense, Mr. Roberts and his management team have projected that they would be able to boost Disney cash flow within three years by $800 million to $1.2 billion by doing such things as cutting jobs and improving the lagging performance of Disney's ABC network. Mr. Roberts has also predicted a wide range of benefits by combining Comcast's vast network of cable and broadband systems with Disney's rich sources of content, such as its ESPN Network and library of movie and animation classics.

To be sure, some Comcast investors support Mr. Roberts's bid, citing his history of successful acquisitions, even those made in the face of strong skepticism. The company invested an estimated $400 million in a 57% stake in QVC, the home-shopping network, which it sold last year for $7.9 billion. After acquiring AT&T Corp.'s cable operation in 2002, Comcast has successfully merged the two operations faster than expected.

"They have delivered what they said they're going to do," says Duncan Richardson, chief equity investment officer of Eaton Vance Corp., a Boston money-management firm.

But the team's past performance hasn't been enough to convince some investors that it will do equally well in improving Disney's performance. Critics note that it takes different skills to produce a hit animation movie than it does to run a cable system. "There's quite a bit of 'trust me' involved in this, and that makes everybody nervous," says one analyst who works for a Comcast investor.

Making matters even more worrisome for Comcast investors is the strong likelihood that Mr. Roberts eventually will make a higher bid -- especially since at Disney's current stock price, the Comcast bid includes no premium. Many think Mr. Roberts's plan is to wait until after Disney's annual meeting on March 3, when shareholders are scheduled to vote on a measure withholding support for Disney Chief Executive Michael Eisner and three other directors. If that measure gets a lot of support, it will strengthen Comcast's argument that a management change is needed.

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Many feel that Comcast could end up going as high as $30 a share, either by putting in more stock or adding a cash component to the bid. There's also speculation that Comcast might bring a partner into the deal such as cash-rich Microsoft Corp., which already owns a 7.3% stake in Comcast.

"From my numbers, you can make the economic case that [a $30-a-share price] is appropriate," says Andrew Rittenberry, an analyst with Gabelli & Co., the research arm of the Gabelli Asset Management Inc., which holds both Disney and Comcast stock. "But some shareholders would get upset. They think it would be buying Disney at full price, and there's not going to be much value left to create."