What a Yahoo! Inc.-Verizon Communications Inc. Merger Cancellation Means for Investors

Description

The recent announcement of yet another massive data breach in 2013 affecting approximately one billion users was not taken lightly by financial markets Thursday. **Yahoo! Inc.'s** (NASDAQ:YHOO) stock price slid more than 6% on the news with investors questioning whether the proposed merger between Yahoo and **Verizon Communications Inc.** (NYSE:VZ) will go through.

The merger, which had been finalized, was expected to close in March 2017. Any re-negotiations of the Verizon offer would involve a lawsuit and would likely slow or halt the merger altogether should Verizon seek a haircut from Yahoo.

On Thursday, stock prices moved in sync with investors pricing in the likelihood of the potential merger cancellation. Typically, when a merger is announced, the target company's share price goes up, and the acquiring company's share price goes down. The exact opposite scenario happened Thursday; the potential merger cancellation resulted in Yahoo's stock price decreasing and Verizon's stock price increasing on the news.

Poor timing for Yahoo shareholders

This new data-breach announcement could not have come at a worse time for Yahoo shareholders. The company's core assets (its websites, media platforms, Flickr, Tumblr, etc.) have been losing money for years, and Yahoo shareholders were banking on a core asset spinoff to get at the meat of the value of Yahoo–its 15% stake in China's e-commerce mega giant **Alibaba** (NYSE:BABA) and its stake in Yahoo Japan.

In 2005, Yahoo decided to invest $1 billion in then-startup Alibaba. This investment, as well as the company's interest in Yahoo Japan, have grown substantially and have been assessed at or near the entire market capitalization of the company.

At points in time, the company's stake in Alibaba and Yahoo Japan actually exceeded the market capitalization of the publicly traded company. In other words, the market has, at times, assigned a negative value to Yahoo's core assets, essentially meaning that Yahoo's core business is destroying value from its Alibaba and Yahoo Japan holdings.

In deciding what to do with the company's core assets, CEO Marissa Mayer had to decide if selling Alibaba stock to finance core operations made sense, given the rapidly increasing value of the company's Alibaba holdings. Shareholders petitioned for a spinoff of the Alibaba and Yahoo Japan holdings into a separate company, and Mayer pursued this route until a determination from the IRS that a massive tax liability would be a possibility killed the potential spin off.

The only other way for Mayer and shareholders to unlock the value of the company's Alibaba and Yahoo Japan holdings was to sell the company's core assets, leaving the shell with only the remaining shares. The subsequent acquisition offer from Verizon gave Yahoo shareholders something to cheer about. That is, until this most recent announcement.

What the future may hold

It has been determined that Yahoo has access to capital that may keep the company liquid for a few more years, but it appears that the company’s core assets can’t support the losses generated by the company’s core assets much longer. I remain skeptical as to whether this merger will indeed go through and will continue to watch eagerly from the sidelines.

Stay Foolish, my friends.

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1. NYSE:BABA (Alibaba Group Holding Limited)
2. NYSE:VZ (Verizon Communications Inc.)

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