AOL 3.x: completing an internet legacy's turnaround

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ABSTRACT

AOL hired Tim Armstrong as its CEO in early 2009 to lead its transition from an internet service provider to a publicly traded, digital media company. By 2014, Armstrong's efforts started to show encouraging results. Over the same period, a proxy contest from an institutional shareholder, some poorly executed staff meetings, and frequent senior management turnover created questions about Armstrong's ability to complete the job. Then, in May of 2015, AOL received an acquisition offer from Verizon at $47 per share – an 18.5% premium. The offer forced Armstrong into a decision. Should negotiate Verizon's offer? Should he merge AOL with Yahoo!? Or should he leverage capital markets to scale AOL while maintaining its independence? His choice was complicated by its effects on his executive authority, discretion, and compensation.

Keywords: Governance, Strategy, Turnaround, Mergers & Acquisitions, Digital Media

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INTRODUCTION

Every summer since 1983, The Herb Allen & Company Sun Valley Conference in Idaho attracted some of the biggest names in media and technology. CNBC reporter Kayla Tausche's preview of the 2014 conference indicated more of the same:

> The Sun Valley annual media fest has begun in earnest with private jets streaming into the tiny airport in nearby Hailey, Idaho with some 200 moguls from the tech and media landscapes all descending in Sun Valley to mix and mingle and talk some deals.
>
> This year's attendee list includes Facebook brass like Mark Zuckerberg and Sheryl Sandberg, media titans like CBS's les Moonves and Bob Iger, social media execs Jeff Weiner of LinkedIn, Dick Costolo of Twitter, GoPro's newly minted billionaire Nick Woodman is here – he's a newbie, Apple's Tim Cook and Eddy Cue are on the list as is Yahoo! CEO Marissa Mayer. Now some repeat attendees are notably absent this year [including] Square CEO Jack Dorsey, Uber CEO Travis Kalanick, venture capitalist Marc Andreessen – though he tweeted that Sun Valley is one of the few conferences that do still count as work in the VC world. Also, Alibaba's Jack Ma was invited, but has declined to attend. I think that it would be safe to say that Ma has a few busy weeks ahead as they gear up for that all-important IPO…
>
> But why does any of this matter beyond the high-profile people-watching, beyond this beautiful mountainous vista behind me? Well, it's because what happens in Sun Valley doesn't always stay in Sun Valley. This place sows the seeds for some of the biggest and most influential deals in the media space with consolidation already affecting cable. (Busch & Lieberman, 2014).

Tim Armstrong, CEO of AOL (formerly America Online), attended the 2014 conference hoping to capitalize on AOL's return to profitability. AOL spun-off from Time Warner in 2009, seven years after it peaked as an internet service provider with over 35 million subscribers. Since spin-off, AOL acquired branded websites and developed programmatic advertising capabilities to transition from an internet service provider hemorrhaging subscribers into a promising digital media company.

AOL's adjusted operating income for 2013 and the first half of 2014 provided evidence that the company's new strategy could work. This gave Armstrong standing to engage those at the Sun Valley conference about partnering with AOL. Several conversations offered favorable opportunities including one with Marissa Mayer, CEO of Yahoo!. She and Armstrong spoke for hours about numerous topics and discussed the possibility of merging their two companies (Kovach, 2014; Yarow, 2014). In another conversation, Armstrong talked with Lowell McAdam, CEO of Verizon, about some form of partnership between AOL and Verizon to exploit their complementary assets (AOL Inc., 2015c; Oreskovic, 2017). Finally, Armstrong met with a variety of financiers at the conference to discuss the feasibility of these options as well as the possibility of growing AOL through private equity or corporate bonds.

In the spring of 2015, Armstrong's numerous interactions with McAdam produced an acquisition offer. The two executives and companies had partnered in the past and AOL's advertising capabilities seemed to fit Verizon's needs for monetizing its global telecommunications network and the millions of wireless and wireline subscribers loyal to AOL (AOL Inc., 2015c). Verizon made an offer to AOL on May 8, 2015 for $47 per share ("Appraisal of AOL Inc.," 2018). Between March 25, when Verizon first approached AOL, and May 7, AOL's average daily closing price was $39.66 per share (Compustat Annual Updates - Fundamentals Annual, 2019, September 17). Armstrong believed the offer, while attractive, could be negotiated above $50 per share. Regardless of final amount, AOL needed to make a choice: should it counter and, hopefully, finalize Verizon's offer; should it pursue a merger with Yahoo!; or should it continue as an independent company? The answer depended on which alternative best served AOL's strategic vision.

AOL'S SPIN-OFF FROM TIME WARNER

On May 27, 2009, after AOL's declining subscriber base as shown in Table 1 (Appendix) caused its annual revenues to decrease from $7.8 billion in 2006 to $4.1 billion in 2008, Time Warner announced it would spin-off AOL as an independent company (PC Mag Staff, 2009). Time Warner indicated the AOL spin-off allowed Time Warner "to focus, to an even greater degree, on our core content businesses," (Duncan, 2009) which included cable TV subscriptions, film and TV production and distribution, and cable television networks (AOL Inc., 2009b). During its affiliation with Time Warner, AOL's organizational value declined from $186 billion in 2000 to $2.2 billion in 2009 (Collins & Ingold, 2015).

AOL believed the spin-off was an opportunity for reinvention. As former AOL COO (1996-2002) Robert Pittman explained, AOL's internet services produced substantial free cash flow, which, under alternative circumstances, might have been used to adapt AOL to a rapidly changing internet landscape (Harris & Bock, 2010). Instead, Time Warner reinvested it into its other business segments. Armstrong, called the separation "a great opportunity for AOL. Becoming a standalone public company positions AOL to strengthen its core business, deliver new and innovative products and services, and enhance our strategic options" (Goldsmith, 2009, p. 1).

AOL'S SERVICES AND PRODUCTS

AOL identified itself as "a leading global web services company" that serves consumers, advertisers, and publishers (AOL Inc., 2009a). Chart 1 (Appendix) summarizes AOL's three primary revenue sources: subscribers, advertisers, and members of its third-party network.

Subscribers included individuals and businesses who purchased internet services and received email, instance messaging, virus protection, and news services. AOL's internet service emphasized simple, intuitive, and consistent connectivity (Lunden, 2012; Mossberg, 1999). AOL also leveraged its user data to deliver tailored and exclusive content to subscribers (AOL Inc., 2009a). For many rural subscribers, AOL's phone-based internet service (i.e., "dial-up") was the only provider available (Bond, 2017; Pagliery, 2015). For others, AOL represented the more affordable option at around $18 per month (AOL Inc., 2012b, 2015a). Subscribers also appreciated the brevity of an "@aol.com" email address; in fact, for some, an "@aol.com" email

address symbolized status as an early adopter of the internet (Estes, 2011; Hansell, 2008; Johnson, 2014).

Advertisers purchased display and search advertisements from AOL. Display ad revenue was generated when ads appeared on webpages viewed by users. Each appearance counted as an impression and ads were generally priced at a "cost-per-thousand impressions." Search ads, also called "contextual ads," generated revenue each time an advertisement appeared within users' search results. Search ads produced additional revenue when users clicked on them to learn more, register for a product, register as a customer, participate in a survey, or purchase a product (AOL Inc., 2010a). AOL asserted that it offered advertisers more comprehensive, tailored, flexible, seamless, and informative advertising solutions. AOL had the "largest display advertising network in terms of online consumer reach in the United States as of June 2009" (AOL Inc., 2009c, p. 1) and its U.S. sites collected an average of 108 million monthly visitors in 2009; an amount that compared favorably with Facebook's 57 million and Google's 151 million visitors (AOL Inc., 2010a; Facebook Inc., 2013; Lipsman, 2010; Radwanich, 2009). AOL also believed that the size and breadth of its advertising opportunities allowed advertisers to reach a diverse range of demographic and geographic audiences through one interface (AOL Inc., 2013). AOL's third-party network included independent content publishers who contracted with AOL to license its ad-serving technology. AOL's ad-serving technology placed and distributed ads on websites through programmatic advertising. AOL's advertising platform in 2009 connected more publishers, advertisers, and users than any other alternative (AOL Inc., 2015a; Lipsman, 2010). In addition, publishers received the most robust real-time analytics with which to make better informed editorial decisions (Carlson, 2009).

AOL's strategic logic depended on presenting unique and original content to consumers through appealing and fun-to-navigate websites to attract traffic (Belvedere & Tausche, 2014). Consumer traffic would attract advertisers, which would attract content publishers and producers, which would increase AOL's content library and attract even more consumers. Hence, the number of consumers, advertisers, and publishers determined AOL's success at delivering value.

After his hire, Armstrong led efforts to attract more consumers by strengthening AOL's content offerings through the acquisitions listed in Table 2 (Appendix). One of the more controversial acquisitions was Patch.com. The website described itself as "an innovative way to find out about, and participate in, what's going on near you" ("About Patch," 2019, p. 1). Armstrong co-founded Patch.com in 2007 after he noticed community events in Greenwich, Connecticut relied on yard signs for publicity. Patch.com aggregated such events by location through a collection of online bulletin boards and news pages (Carlson, 2009). AOL's acquisition of Patch.com was part of its strategy to provide unique content to consumers. The idea also fit with consumers' increasing preference for online local news (Baker, 2013). Since Armstrong had equity at stake, he recused himself from negotiations between AOL and Patch.com. He did, however, request compensation for his personal investment in Patch.com, $4.5M, in the form of AOL stock (Schonfeld, 2009). In 2014, AOL would sell 60% of its stake in Patch.com to Hale Global, a private equity firm specializing in technology (Yu, 2014).

The acquisition of The Huffington Post in 2011 also made headlines for AOL (Steel, 2011b). The Huffington Post was founded in 2005 by Arianna Huffington, Andrew Breitbart, Kenneth Lerer, and Jonah Peretti. The online news, analysis, and opinion website averaged 25 million unique visitors per month. The acquisition intended to cement AOL's position as a provider of premier content with local, national, and international reach (Steel, 2011a). However,

online media executives and Wall Street analysts thought AOL paid too much for The Huffington Post and questioned AOL's ability to accommodate Arianna Huffington's need for editorial independence. Financial markets seemed to support these perspectives as AOL's stock declined by 3.42% ($0.75) one day after the acquisition announcement (Kopytoff, 2011).

In 2012, AOL stopped considering itself a one-segment business and began reporting revenue along the segments displayed in Table 3 (Appendix): brand, membership, AOL Platforms, and Corporate. Brand included "advertising offerings on a number of owned and operated sites, such as AOL.com, The Huffington Post, Patch, TechCrunch and MapQuest" (AOL Inc., 2013, p. 30). Membership represented internet service subscription fees and advertising revenues from offerings pushed through AOL mail and instance messaging. AOL Platforms, previously known as Advertising.com and AOL Networks, included advertising revenues generated by selling advertising inventory from AOL's third-party network (AOL Inc., 2013).

THE INTERNET SERVICE INDUSTRY

Internet service providers (ISPs) offered customers internet connectivity and information services. ISPs needed telecommunications and network equipment, data storage facilities, a relatively skilled IT workforce, efficient marketing activities, and telecommunications licenses to provide service. ISPs' capital-intensive IT equipment and facilities required regular and substantial upgrades. To stay price-competitive, ISPs mitigated substantial capitalization costs by serving a large volume of customers. The need for a large customer base placed a burden on ISPs' marketing and sales departments to acquire and retain customers efficiently (Hanafizadeh, Hatami, & Bohlin, 2019).

Growth of the U.S. internet services industry was stable. Estimated industry sales for U.S. internet service providers totaled $22.6 billion in 2011 reflecting a compound annual growth rate (CAGR) of about 6.5% from 2007 to 2013 (*2010 U.S. Internet Service Providers Industry Report*, 2010). From 2009 to late 2013, the percentage of U.S. Households with internet service increased from 68.7% to 74.2% (OECD, 2019). Over the same period, the percentage of homes with broadband service increased from 59% to 70% (Pew Research Center, 2019). Worldwide, households with internet service increased from 30.2% in 2010 to 42.8% in 2014 (ICT Data and Statistics Division, 2011, 2016). Global revenues for internet service providers totaled $931 billion in 2014 and were forecasted to grow at a CAGR of 9.7% through 2019 (*Internet Access: Global Industry Almanac 2014 for the $931 Billion Market*, 2015).

More video content, interactive programs, and internet-connected devices (e.g., TVs, security cameras, and refrigerators) encouraged users to adopt broadband access for faster data transfers. For the most part, consumers selected their internet service provider based on price and data speeds. At the same time, most consumers did not know the actual data speed received and considered changing service providers to be a hassle (Gurin, 2010). Typically, buyers were bundling broadband access with their TV subscriptions, phone service, and/or wireless phone service providers (Berty, Baschnonga, Guatam, Orr, & Wolf, 2016). The average monthly cost of broadband service in the U.S. increased from $39 in 2009 (Pew Research Center, 2009) to $51 in 2014 (Russo, Kehl, Morgus, & Morris, 2014).

At the start of 2014, over 3,300 companies provided internet service to the U.S. (*2010 U.S. Internet Service Providers Industry Report*, 2010). However, just six ISPs held a combined market share greater than 70%: Comcast held 21.6% , AT&T held 17.2%, Time Warner Cable

held 12.1%, Verizon held 9.4%, Century Link held 6.3%, and Charter Communications held 4.9% (French, 2014). In most metropolitan areas, consumers had a choice of providers. In some rural and suburban areas, consumers had fewer provider options and commonly settled for less reliable connections with slower data transfer speeds. The capital intensity of internet service limited the ability of ISPs to generate surpluses from small and geographically dispersed populations (Russo et al., 2014).

THE DIGITAL ADVERTISING INDUSTRY

Digital advertising included online ads that appeared on desktops, laptops, tablets, and smart phones. Online media companies developed advertising inventory and used online tools to sell it in real time to advertising agencies, brokers, other advertising companies, and large commercial entities. Most members of the industry categorized advertising revenue as "display" or "search." Display ads appeared on webpages that attracted regular internet traffic. Advertisers targeted users through display ads by considering the interests and demographic traits of those inclined to visit the webpage. In addition, display ads allowed advertisers to choose where on the webpage the ad appeared and if it included images and videos. Alternatively, search ads appeared on pages that provided results from users' searches. Search ads did not integrate images or video, but they were more targeted than display ads. Advertisers supplied keywords that dictated when a search ad appeared in users' queries. The difference in targeting produced greater click-through rates for search ads relative to display ads. As a result, search ads were more expensive than display ads (3Bug Media, 2017; Frost, 2019). For advertisers, these differences between display and search ads were critical to the design of successful advertising campaigns. Digital media companies differentiated their display and search ad services based on audience reach and programmatic capabilities (Evans, 2009).

In 2014, trends in ad spending as shown in Table 4 (Appendix) favored digital over the traditional formats of print, catalog, newspaper, TV, and radio. By 2020, digital ad spending would surpass non-digital ad spending in the U.S. (Balderston, 2019). Furthermore, digital ad spending was trending towards mobile devices (i.e., phones and tablets) and video as technology improved and as social media platforms became more pervasive (Kaushal, 2013).

A relatively small number of companies dominated digital advertising. Table 4 (Appendix) includes advertising revenue for the largest members of the industry. As indicated, competitive positions within the industry were rapidly changing between 2009 and 2014. Google's leadership position was a function of its dominant market share in search; from 2009 through 2014, Google's quarterly share of market search averaged 90.7% ("Search Engine Market Share Worldwide," 2018). Microsoft's advertising revenue matched industry growth in online advertising and reflected the company's success in distributing its operating systems and software. These products integrated Bing, Microsoft's search engine, which delivered reliable advertising revenue. Facebook and Twitter saw rapid expansion of advertising revenues as social media platforms became dominant in terms of consumer engagement (i.e., frequent and lengthy interactions). Lastly, Amazon experienced rapid growth in advertising revenue as the default location for consumers' online shopping. In comparison to Google, searches conducted on Amazon's platform were more likely to lead to purchases. This difference translated to click-throughs and purchasing behaviors that increased the attractiveness of Amazon advertisements (Turak, 2018).

AOL'S PERFORMANCE

The consumer and financial information presented in tables 1, 3, 5, 6, and 7 (Appendix) display the initial shock of AOL's strategic transition and gradual return of advertising revenues. Although AOL continued to lose internet service subscribers, the rate of attrition as shown in Table 1 (Appendix) was declining. With each passing year, the subscribers who remained were more resilient because they had fewer alternatives and an unwillingness to learn new internet service tools (AOL Inc., 2010a). Despite fewer customers, AOL's internet service remained quite profitable. Table 3 (Appendix) indicates that from 2010 through 2014, AOL's membership group generated gross margins of 69%-75% and overcame the combined losses in adjusted operating income for all other AOL segments.

The post-spin-off performance of AOL's advertising revenue was mixed. AOL attributed declining advertising revenues from 2009 to 2010 to asset divestments, product changes, and fewer internet service subscribers. About 75% of the $464 million decline in advertising revenues was caused by sunsetting "certain products" and operations in Germany and France as shown in Table 7 (Appendix) and the sale of Bebo, Inc. and ICQ, LLC (AOL Inc., 2011). Another 13% was caused by redesigning AOL sites "to enhance the consumer experience" (AOL Inc., 2011, p. 8) with more unique, branded content and fewer ads. Obviously, fewer ads reduced advertising revenues. However, over the long-term, AOL expected the redesign to increase the frequency and duration of consumers' visits, thereby increasing the attractiveness of AOL sites to advertisers (AOL Inc., 2010b). The final 12% decline in advertising revenues stemmed from fewer internet service subscribers. AOL's ever-shrinking population of subscribers reduced the number of users with AOL-designed tools proven to monetize ad revenue at a greater rate.

By 2014, AOL's efforts produced turnarounds in display and third-party network revenues. Display revenue increases were earned, in part, through the acquisition of branded properties, such as The Huffington Post and TechCrunch, that attracted regular traffic (AOL Inc., 2015a). AOL's plans for future growth included an improved programmatic advertising platform called, "ONE." ONE was announced in the first quarter of 2014 as a cross-screen – i.e., computer, tablet, phone, TV – advertising platform that integrated all the tools and features acquired or developed by AOL (Leochner, 2014).

A substantial contributor to AOL's financial performance and, in turn, its stock performance was a 2012 agreement to sell more than 800 patents to Microsoft for over $1 billion (Jannarone & Ramachandran, 2012). According to AOL, the decision emerged from a critical review of strategic assets and how to unlock their value (Aguilar, 2012). As shown in Chart 2 (Appendix), the initial announcement impacted AOL's stock price as did several later announcements that AOL would return cash from patent sales to shareholders via stock buybacks (AOL Inc., 2012a). The buybacks reduced the number of outstanding AOL shares by 26.3% while its stock price increased from a low of $11.25 on September 22, 2011 to $46.17 on December 31, 2014 (Compustat Annual Updates - Fundamentals Annual, 2019, September 17). Table 8 (Appendix) indicates this stock price growth compared favorably against the S&P Midcap 400 and the Morgan Stanley High-Technology Index, which were the benchmarks used by AOL's board of directors (AOL Inc., 2015b).

SHAREHOLDER ACTIVISM AND SELF-INFLICTED WOUNDS

Although AOL's financial results showed promise, Armstrong's performance as an executive attracted several public challenges. The first instance came on January 21, 2011, Armstrong's 41st birthday, with a letter from Starboard Value LP (Starboard), a private investment fund that owned about 4.5% of AOL's outstanding shares. In the letter, Starboard asserted that Armstrong exploited his position as CEO and chair to assemble a board of directors unwilling and uninterested in critically reviewing the acquisitions he championed. According to Starboard, AOL overpaid for branded content sites that were inefficiently managed and incapable of attracting sufficient traffic. Starboard and AOL engaged in several rounds of negotiations, but no compromise or consensus was formed. Both sides became increasingly frustrated with the other and traded public barbs. Eventually, Starboard mounted a proxy contest at the 2012 Annual Shareholders meeting to elect three new board members. Starboard advocated that the superior qualifications and independence of its nominees would improve AOL's decision-making, strategy, and performance. While Starboard's proxy content was unsuccessful, AOL did adopt some Starboard-advocated changes to financial statements, executive compensation, and stock buybacks (AOL Inc., 2012a, 2012c).

The second challenge came on August 8, 2013. Armstrong held a conference call with Wall Street analysts to review AOL's second quarter earnings. During the call, he disclosed that AOL would be shuttering roughly 300 of the 900 local sites under the Patch.com domain (Crugnale, 2013). Obviously, employees working at Patch.com were shaken by the news. So, the next day, Friday, August 9, Armstrong held a conference call with roughly 1,000 of them to explain the decision and rally enthusiasm for AOL's revised vision. Unfortunately, the call took a turn for the worse. During the call, Armstrong fired Abel Lenz, the creative director at Patch.com. A recording of the conference call leaked online through the Jim Romenesko blog on August 10, 2013 (Carlson, 2013a). The following is a transcript of Armstrong's statements from the call:

> There are a couple things I want you guys to realize and really think about and sink in. And if it doesn't sink in, and if you don't believe what I'm about to say, I'm going to ask you to leave Patch. I don't mean that in a harsh way, I mean that in the way of, we have to get Patch to a place where it's going to be successful, and it's going to be successful, for a long time. There's a whole bunch of [Patch town sites] that are going to be successful, but we need the whole enterprise to be successful.
>
> The first one is I will take full credit and full responsibility for anything that's not right at Patch. The coffee machine doesn't work, or a [Patch town site] doesn't work, or anything that's going wrong at Patch, you can blame me for it. I founded Patch, we brought it into AOL, we've been very busy turning around AOL overall. I don't care what the press says, I don't care if people leak information, I have already lived through that at AOL when I took over AOL, so if you need somebody to blame for why we're making changes at Patch, you can blame me. I'll take full responsibility. Uh… if you need… you talk to your friends, family,

> the press, anybody… 'Tim Armstrong's fault.' Ok? So, everybody is off the hook at Patch for any of the changes we make overall and I want to clear it up.
>
> I also want to clear up the fact that leaking information or anything around Patch isn't going to bother me. Doesn't bother me. I'm not changing direction. When you hear about what we're doing today at Patch, it's very serious, and it's very forward-thinking, and anything that happens around Patch is not going to change that direction.
>
> Third thing is, if you don't use Patch as a product, and you're not invested in Patch, you owe it to everybody else at Patch to leave. If you think what's going on right now is a joke, and you want to joke around about it, you should pick your stuff up and leave Patch today. And the reason is, and I'm going to be very specific about this, is… uh… Patch from an experience…
>
> Abel, put that camera down right now! Abel, you're fired! Out!
>
> Uh… if uh…if you guys think that AOL has not been committed to Patch, and won't stay committed to Patch, you're wrong. The company has spent hundreds of millions of dollars, the board of directors is committed, I'm committed, Bud is committed. Bud has been working on the Patch thing with me this weekend…

By Monday, August 12, the recording had over 600,000 playbacks and television news outlets such as CNBC and Fox News were featuring it. Apparently, Lenz regularly posted pics of conference calls on Patch.com's internal websites for employees in remote locations. Armstrong thought the practice was inappropriate for a call dealing with layoffs. While AOL claimed that Lenz had been warned previously about recording confidential meetings, others speculated the firing was already in the making. Lenz oversaw the redesign of the Patch.com website in 2012, which Armstrong blamed for Patch.com's inability to meet growth and profitability projections (Carlson, 2013b). On August 13, Armstrong issued a memo to all employees apologizing for publicly firing Lenz. The memo also indicated that Armstrong personally apologized to Lenz (Kaufman, 2013).

The third challenge concerned controversial comments Armstrong made on Thursday, February 6, 2014, at a company town hall about quarterly earnings and changes to AOL's employee benefits (Saba & Richwine, 2014). Armstrong explained that AOL would contribute to employees' stock plans on an annual, rather than monthly basis. The cost-savings from delayed contributions would mitigate increases to AOL's employee health insurance costs. The controversy emerged when Armstrong identified "two distressed babies" as the cause for AOL's rising health insurance costs. Armstrong's objectification of two employee's children as million-dollar expenses resonated as callous and disingenuous. AOL employees challenged Armstrong in online public forums to demonstrate increases in AOL's health insurance costs that resulted from $2 million of insured claims. In addition, employees wanted him to reconcile AOL's savings from delayed stock plan contributions against the earnings employees sacrificed by waiting for their stock plan contributions. Lastly, employees wanted to know why cost savings were needed given that AOL's most recent quarterly earnings were the best they had been in ten years. Within

a week, Armstrong personally apologized to the parents of the children referenced at the meeting and AOL abandoned the stock plan changes it proposed (Miller, 2014).

The business press asserted that the Abel Lenz and "distressed babies" controversies were facilitated by AOL's substantial turnover in human resources executives under Armstrong's tenure. Dave Harmon, AOL's EVP of Human Resources since 2007, was terminated by Armstong in March of 2011. Seven months later, Kathy Andreason became AOL's EVP, Chief People Officer. However, before the end of September 2011, Andreason resigned. John Reid-Dodick then replaced Andreason until his resignation in August 2013. From Reid-Dodick's resignation through 2014, AOL did not have a named executive officer with human resource responsibilities. Notably, AOL's turnover of human resource executives occurred as it was shedding employees to reduce costs (Carlson, 2010; Harmon, 2020; "Is This CEO HR's Worst Nightmare?," 2014; Letzing, 2009).

AOL'S CHOICE

AOL's strategic plan for 2015 emphasized content, video, and programmatic advertising. For content, AOL wanted to acquire and develop premium sites suited for global audiences. AOL's management believed sites with professionally produced, unique content encouraged consumers to visit more frequently and for longer periods. Such a "relationship" would facilitate the collection of consumer data that AOL could leverage across its other branded websites to better serve advertisers (AOL Inc., 2015a).

AOL prioritized video in its 2015 strategic plan to exploit forecasted growth. In 2014, the growth in the number of video advertisements watched by consumers outpaced the amounts advertisers spent on video ads (Auletta, 2011). AOL needed an industry-leading video advertising competency to compete for the imminent and substantial growth in video ad revenues. A competitive advantage in video would mean that AOL had the ability to sell advertising attached to video content and the ability to adjust content in a video advertisement based on consumer data. Furthermore, it would mean that AOL's video advertising interface would outperform rivals' interfaces in terms of its compatibility with an increasing range of video formats and social media platforms (AOL Inc., 2015a).

Lastly, AOL's prioritization of programmatic advertising leveraged its content and video initiatives. AOL expected to compete by offering more effective and efficient digital advertising services. Such advantages would be built on a state-of-the-art programmatic advertising interface that incorporated comprehensive and unique consumer data and offered unmatched video capabilities. AOL planned to develop the interface through a combination of internal resources and acquisitions of entrepreneurial firms possessing novel technology (AOL Inc., 2015a).

Verizon's May 2015 acquisition offer forced AOL to decide if the above strategic initiatives would be better served under a Verizon corporate umbrella, or as an independent company. Complicating this choice was the possibility of merging with Yahoo!; a possibility that was regularly covered by the business press and appeared likely given AOL and Yahoo!'s history of partnering and regular interactions between their CEOs (Jannarone, 2014; Tsukayama, 2014; Vauhini, 2014).

Accepting Verizon's Acquisition Offer

Using $274 billion in assets and more than 176,800 employees, Verizon provided telecommunications services across more than 150 countries in 2013. It's 2013 total revenues totaled $120.5 billion from two primary sources: wireless and wireline. The wireless segment sold tablets and mobile phones and, more importantly, connectivity services to those devices. Verizon's wireless segment accounted for $81 billion of its total revenues in 2013. Verizon's wireline segment sold landline connectivity services for voice, data, and television; data and cloud storage services; and network security and management services. The wireline segment accounted for $39 billion of Verizon's 2013 total revenues (Sundaramurthy & Lewis, 2003; Verizon Communications Inc., 2014a).

Verizon's strategic initiatives focused on improving its capacity and technology to meet customers' demands for video, commerce (i.e., buying goods and services with a phone), data storage, data transfer, data security, and vehicle communications (e.g., mobile device integration, commercial fleet management, and usage-based insurance programs) (Verizon Communications Inc., 2014a). Many industry analysts labelled Verizon as a "dumb pipe" company based on its product offerings and strategic initiatives (Reed, 2014). The label refers to an organization that transmits data at greater speeds than users expect. The practice eliminates the need for the organization to prioritize or control transmissions based on the source, recipient, or size of the data transferred (Peck, 2017). The implication is that dumb pipe companies miss opportunities to maximize revenues from services provided. As expected, Verizon disputed the assessment and regularly described in the press and through SEC filings how its initiatives advanced its position as a technological leader in the telecommunications industry (Verizon Communications Inc., 2014a).

Verizon's acquisition offer included employment terms for Armstrong to remain "CEO of AOL." Verizon would honor Armstrong's four-year employment contract signed with AOL on March 29, 2012. This contract supplemented $1 million in base pay with an annual discretionary bonus targeted at 200% of base pay (i.e., $2M) and $5 million in equity awards (AOL Inc., 2012a). In 2016, after the AOL contract ended, Armstrong would receive $3 million in Verizon-based equity awards and RSUs totaling 1.5% of Verizon's market value. Armstrong's position at Verizon would report to Ms. Marni Walden, President of Global Media and New Business, who reported to Lowell McAdam. Armstrong would not have a seat on Verizon's Board of Directors (Verizon Communications Inc., 2015).

Acquisition by Verizon would instantly eliminate AOL's size disadvantage as summarized in Table 9 (Appendix). Since its spin-off, AOL had used profits from its membership segment to fund technology and brand acquisitions vital to its digital media operations. While AOL achieved profits in 2013 and 2014, growth was modest. At the same time, subscriber attrition was reducing profits available for re-investment. Conversely, Verizon's net income averaged 10% of total revenues between 2005 and 2014 and never dipped below 6% (Mergent Inc., 2020). In addition, Verizon's working capital as of December 31, 2014 totaled $1.6 billion, or $1 billion greater than that available to AOL (AOL Inc., 2015a; Verizon Communications Inc., 2014b). In addition to its greater financial scale, Verizon had online data for millions of users. Such data included users' location, browsing history, purchasing history, streaming volume, mobile devices, apps, and service packages. Adding data of this scale and

depth to AOL's programmatic advertising capabilities would greatly increase the value AOL delivered to advertisers and consumers.

Merging with Yahoo!

Yahoo! transformed from $17 billion to $62 billion in assets over 2014. Most of the growth was based on the IPO of Alibaba, a Chinese company Yahoo! funded in 2005 with $1 billion (Pimentel, 2014). Yahoo! sold a substantial portion of its stake in Alibaba before Alibaba's debut on the NYSE in September 2014. The 16.3% equity Yahoo! retained in Alibaba, in addition to the $8.3 billion in cash it received from selling 122 million shares, caused Yahoo! to realize a balance sheet increase of more than $40 billion (Lorenzetti, 2014).

In 2014, Yahoo! generated $4.6 billion in total revenue from more than one billion monthly users. Just like AOL, Yahoo! sold search and display advertising by emphasizing branded content. More than half of users visited Yahoo! properties in 2014 through mobile devices. Unlike AOL, Yahoo! organized its segments by geography: Americas produced 76%, Europe/Middle East/Africa produced 8%, and Asia Pacific produced 16% of total revenues. Since 2012, the concentration of revenues from Americas increased. Yahoo! employed 12,500 employees as of December 31, 2014 (Yahoo! Inc., 2015).

Yahoo!'s strategic initiatives emphasized growth. Yahoo! stated growth, "starts with hiring the best people who will build beautiful, engaging products. Those products drive increased traffic. The increased traffic generates greater advertiser interest, which ultimately results in revenue growth" (Yahoo! Inc., 2014, p. 4). Through 2014, Yahoo! focused investment into products that exploited user growth in mobile devices, video formats, and social media platforms (Yahoo! Inc., 2014).

Similar business models and strategies made an AOL-Yahoo! merger attractive. Both companies sold display and search advertising using programmatic technology and both emphasized premium content as a point of differentiation for advertisers and consumers. According to Starboard Value, a Yahoo! shareholder, eliminating redundant activities and costs from a new Yahoo!-AOL organization would save about $1.2 billion annually. For Yahoo!, a merger with AOL offered access to AOL's advanced programmatic advertising technology, which was compatible with a wide variety of devices, formats, and platforms. In addition, AOL's brands, such as TMZ and MapQuest, would substantially contribute to Yahoo!'s portfolio of sites and increase its market share of U.S. search queries, traffic, and, in turn, advertising revenues. For AOL, a merger with Yahoo! offered size and superior user products (Lazaroff, 2014; Levy, 2014). Yahoo!'s market capitalization exceeded AOL's by a factor of thirteen and Yahoo!'s revenues almost doubled AOL's. Furthermore, Yahoo!'s net income averaged 39% of revenues from 2005 through 2014 and its working capital at the end of 2014 totaled $5.2 billion (Mergent Inc., 2020). As for user products, Yahoo!'s instant messaging and email were considered superior to AOL's offerings (Blodget, 2008).

Merging with Yahoo! offered familiarity to Armstrong. Marissa Mayer, CEO of Yahoo!, started her career at Google in 1999 as the twentieth employee. Hired as a software engineer, she was part of the three-person team that created AdWords, Googles' platform for selling search and display advertising. Mayer worked with Armstrong at Google from 2000 through 2009. In 2012, she accepted the CEO role at Yahoo! (Doorey, 2019). A merger between AOL and Yahoo! would allow Armstrong to report directly to a CEO who he had worked with and who understood his vision for the future of digital media.

Remaining Independent

Publicly, Armstrong denied rumors of merging with Yahoo! or any other company. As he stated at the October 2014 TechCrunch Disrupt Conference in London, AOL's strategic initiatives for 2015 focused on global content, video, and programmatic advertising and none of these actions necessarily required a merger (TechCrunch, 2014).

The argument for remaining independent required several presumptions. First, AOL's recent performance improvements in brand and platform segments would outpace profit declines for AOL's membership segment. Second, AOL could fund acquisitions and resource investments through working capital, debt capacity, and/or equity markets. Table 10 (Appendix) suggests that relative to the communication services industry, AOL's current and debt ratios at the end of 2014 were favorable. Issuing more equity, however, would threaten the recent stock price appreciation enjoyed by shareholders. Third, after absorbing $335 million in restructuring costs since 2009, and after reorganizing activities by business segment, AOL's corporate and organizational structures were flexible and strong enough to handle the stresses of additional acquisitions and new resource allocations. The proxy contest with Starboard and Armstrong's propensity for public missteps hinted otherwise.

Time Pressure

Armstrong was under pressure to make a choice. Increasing AOL's stock price through repurchases was not sustainable. Additional buybacks would raise red flags about the organization's belief in its digital advertising strategy. Investors, analysts, and strategic partners would wonder why AOL was using its cash or leverage to repurchase stock rather than reinvesting in AOL and increasing its scale. Time pressure also increased as Armstrong began discussing Verizon's acquisition offer with AOL's legal counsel and select board members. The more individuals that knew about the situation, the greater the likelihood that news of it would leak. Such a leak might spawn additional bidders and repel Verizon's interest, or it might discourage others, such as Yahoo!, from exploring partnership opportunities with AOL ("Appraisal of AOL Inc.," 2018).

APPENDIX

Table 1. AOL Consumers by Year

	2007	2008	2009	2010	2011	2012	2013	2014
Subscribers (thousands)	9,337	6,879	4,999	3,852	3,272	2,794	2,501	2,217
Subscriber Churn*	4.6%	3.6%	3.4%	2.6%	2.3%	1.8%	1.5%	1.5%
Average Paid Tenure of Subscribers (years)	6.0	7.0	8.2	9.1	10.6	11.8	12.9	14.0
Average Revenue per Subscription	$18.66	$18.38	$18.46	$18.16	$17.71	$18.39	$19.85	$20.70
Average Monthly Unique Visits (millions)	156	171	179	184	184	186	152	179

* Does not include promotional subscriptions that expire.

(AOL Inc., 2008, 2009b, 2010a, 2011, 2012b, 2013, 2015a)

Table 2. Notable AOL Acquisitions (In millions of U.S. dollars)

Year	Company	Price
2009	Patch.com	7.0
2010	StudioNow, Inc.	32.1
	5 Minutes Ltd	64.7
	Thing Labs Inc & TechCrunch	32.4
	Pictela Inc. & About.me Inc.	31.4
2011	GoViral	69.1
	Huffington Post	295.5
2012	AJM Productions, StyleMePretty LLC, Everlater Inc, & Buysight Inc	27.8
2013	Adap.tv	413.8
2014	Project River, Inc.	83.2
	Converto Inc	98.6
	Vidible	55.9

(AOL Inc., 2008, 2009b, 2010a, 2011, 2012b, 2013, 2015a)

Table 3. AOL Business Segment Information (In millions of U.S. dollars)

	2010	2011	2012	2013	2014
Revenue					
Brand Group	727	733	730	794	771
Membership Group	1,278	1,036	915	839	792
AOL Platforms	427	491	644	785	1,080
Corporate and other	43	7	2	1	-
Intersegment eliminations	(59)	(64)	(99)	(99)	(116)
Adjusted OIBDA					
Brand Group	54	(48)	(33)	40	68
Membership Group	956	712	633	594	562
AOL Platforms	(27)	(40)	7	(15)	4
Corporate and other	(235)	(215)	(195)	(138)	(128)

(AOL Inc., 2012b, 2013, 2015a)

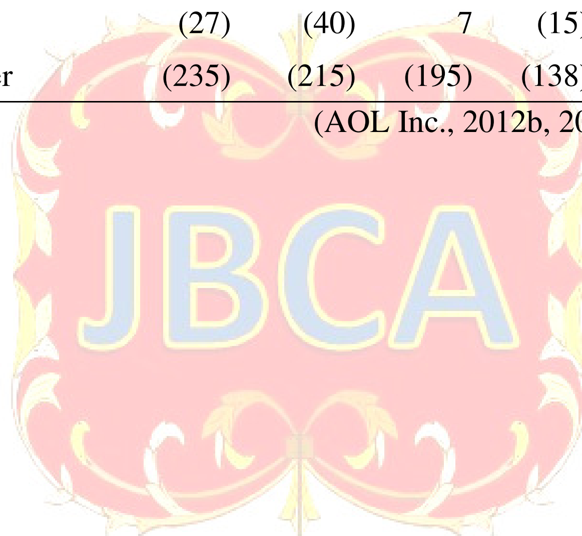

Table 4. Media Spending and Digital Advertising Market Share (In billions of U.S. dollars)

	2012	**2013**	**2014**
Worldwide Total Media Ad Spending	503.15	516.20	545.40
Worldwide Net Digital Ad Revenue (after TAC*)	104.57	120.05	140.15
Worldwide Mobile Ad Spending	8.76	17.96	31.45
U.S. Total Media Ad Spending	165.00	171.00	177.80
U.S. Digital Ad Spending	36.80	42.30	47.60
U.S. Mobile Ad Spending	4.40	8.50	13.10
Market Share of Worldwide Net Digital Ad Revenue (after TAC*)			
Google	31.3%	31.9%	31.5%
Facebook	4.1%	5.8%	7.8%
Microsoft	2.4%	2.5%	2.5%
Yahoo!	3.4%	2.9%	2.5%
IAC	1.3%	1.3%	1.0%
AOL	1.0%	0.9%	0.9%

*Traffic Acquisition Costs. Amounts paid to have users interact with ads or visit online properties. Includes purchases of third-party advertising inventory and distribution arrangements that direct users to websites (e.g., OEMs including branded toolbars within the pre-installed browsers).

(eMarketer Inc., 2018)

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Table 5. AOL Income Statement (In millions of U.S. dollars)

	2009	2010	2011	2012	2013	2014
Revenue						
Display Ads	604	512	573	575	610	593
Search Ads	610	428	357	372	389	403
Third-party Network Ads	534	344	384	472	615	856
Total Advertising Revenues	1,748	1,284	1,314	1,419	1,613	1,921
Subscription Revenues	1,389	1,024	803	705	650	607
Other Revenues	120	109	85	68	56	
Total Revenues	3,257	2,417	2,202	2,192	2,320	2,527
Expenses						
Personnel Costs	598	495	646	649	644	611
Facilities Costs	53	42	57	54	56	54
TAC*	567	298	306	357	479	703
Network-Related Costs	283	207	187	161	149	166
Non-Network Depr. & Amort.	108	84	71	63	58	62
Content Costs				78	86	80
Other Cost of Revenues	284	297	318	227	235	244
Total Cost of Revenues	1,899	1,421	1,584	1,587	1,706	1,921
SG&A	538	491	440	413	322	318
Amortization of Intangible Assets	145	145	92	38	45	66
Securities Litigation	28					
Restructuring Costs	190	34	38	10	41	22
Goodwill Impairment Charge		1,414			18	
Operating Expenses	2,799	3,505	2,155	2,049	2,132	2,327
Other Income Sources - Net						
Net Income from Licensing				96		
Net Income from Asset Disposal		106	(2)	963	3	5
Net Income	249	(783)	13	1,048	91	123

(AOL Inc., 2008, 2009b, 2010a, 2011, 2012b, 2013, 2015a)

Table 6. AOL Balance Sheet Information (In millions of U.S. dollars)

	2009	2010	2011	2012	2013	2014
Assets						
Cash & Equivalents	147	911	408	467	207	489
Good Will	2,184	811	1,064	1,084	1,362	1,524
Intangible Assets – Net	225	100	135	133	208	224
Total Assets	3,963	2,962	2,825	2,797	2,983	3,457
Expenses						
Current Liabilities	751	559	515	510	548	563
Total Liabilities	900	675	652	646	706	1,059
Total Equity	3,063	2,287	2,173	2,151	2,277	2,398

(AOL Inc., 2008, 2009b, 2010a, 2011, 2012b, 2013, 2015a)

Table 7. AOL Revenues by Country (Except total employees, in millions of U.S. dollars)

	2006	2007	2008	2009	2010	2011	2012	2013	2014
United States	5,712	4,535	3,624	2,864	2,193	2,001	1,959	2,059	2,241
United Kingdom	1,014	283	258	158	102	99	98	97	89
Germany	652	187	82	59	43	40	33	39	57
France	302	57	82	70	17	9			
Canada	56	52	48	36	37	38	40	49	54
Japan							35	33	30
Other international	51	67	72	59	24	15	27	43	56
Total Revenues	7,787	5,181	4,166	3,246	2,417	2,202	2,192	2,320	2,527
Total Employees	14,230	8,000	7,000	6,700	5,860	5,660	5,600	5,100	4,500

(AOL Inc., 2008, 2009b, 2010a, 2011, 2012b, 2013, 2015a)

Table 8. Cumulative Total Return of $100 Investment (As of December 31)

	2009	2010	2011	2012	2013	2014
AOL Inc.	100.00	101.85	64.86	147.72	232.59	230.34
S&P Midcap 400	100.00	126.64	124.45	146.69	195.84	214.97
Morgan Stanley High-Tech Index	100.00	110.89	115.75	137.66	177.31	205.65

(AOL Inc., 2008, 2009b, 2010a, 2011, 2012b, 2013, 2015a)

Table 9. AOL Relative to Most Prominent Rivals (In millions of U.S. dollars)

Company	Total Assets 12/31/2014	Market Capitalization 12/31/2014	Digital Ad Revenues 2009	Digital Ad Revenues 2014	Total Revenues 2014
AOL	3,457	3,597	1,748	1,921	2,527
Amazon	54,505	144,313	102	1,050	88,988
AT&T	292,829	174,228	713	*	132,447
Century Link	50,147	22,502	**	**	18,031
Charter	24,550	18,661	249	341	9,108
Comcast	159,339	147,229	221	609	68,775
Facebook	40,184	218,222	764	11,492	12,466
Google	131,133	359,263	22,889	59,056	66,001
IAC	4,275	5,115	565	1,400	3,110
Microsoft	172,384	343,566	1,900	4,047	86,451
Time Warner	63,259	71,069	619	651	27,359
Twitter	5,583	23,042	4	808	1,403
Verizon	232,708	194,369	**	**	127,079
Yahoo!	61,960	47,320	5,263	3,225	4,618

*AT&T sold Advertising Solutions segment in 2012.
**No digital advertising revenue reported.

(Compustat Annual Updates - Fundamentals Annual, 2019, September 17; Mergent Inc., 2020)

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Table 10. Financial Ratios for AOL and the Communications Services Industry

	2009	2010	2011	2012	2013	2014
AOL Financial Ratios						
Gross Margin %	42%	41%	28%	28%	26%	24%
Net Income %	8%	-32%	1%	48%	4%	5%
Asset Turnover	0.82	0.82	0.78	0.78	0.78	0.73
ROA%	6%	-26%	0%	37%	3%	4%
ROE%	8%	-34%	1%	49%	4%	5%
Current Ratio	1.96	1.39	1.74	1.57	2.22	0.91
Debt:Equity	0.19	0.05	0.05	0.05	0.04	0.02
Communications Service Industry Financial Ratios						
Gross Margin %	58%	58%	58%	57%	56%	56%
Net Income %	1%	1%	3%	3%	2%	2%
Asset Turnover	0.58	0.54	0.54	0.54	0.55	0.51
ROA%	14%	15%	15%	14%	12%	12%
ROE%	0%	3%	4%	4%	3%	3%
Current Ratio	1.55	1.58	1.41	1.45	1.40	1.47
Debt:Equity	1.52	1.48	1.51	1.70	1.86	1.62

(AOL Inc., 2010a, 2011, 2012b, 2013, 2015a; Mergent Inc., 2020)

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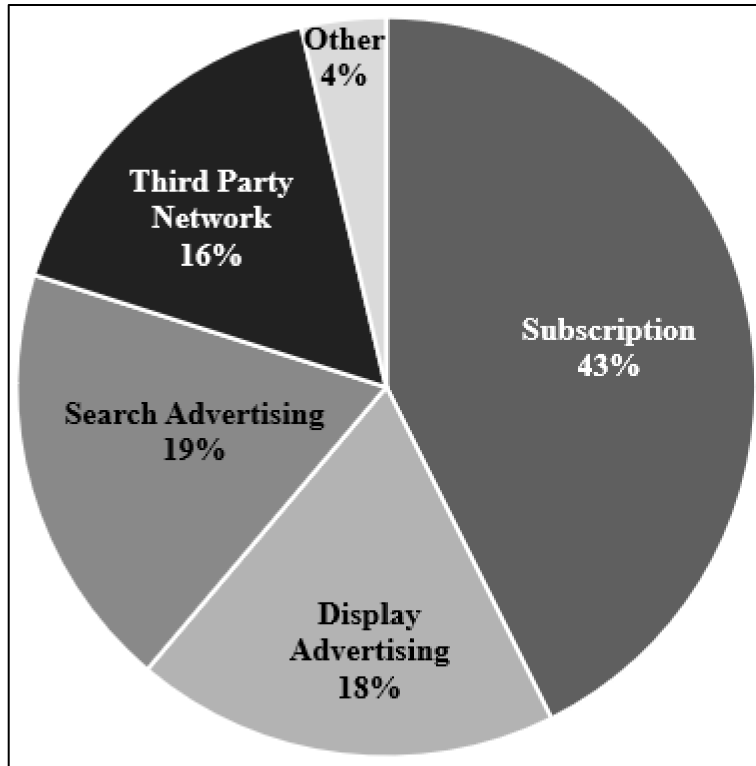
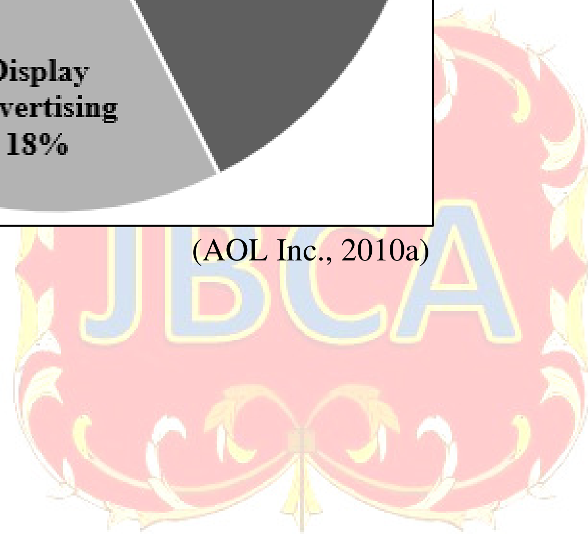
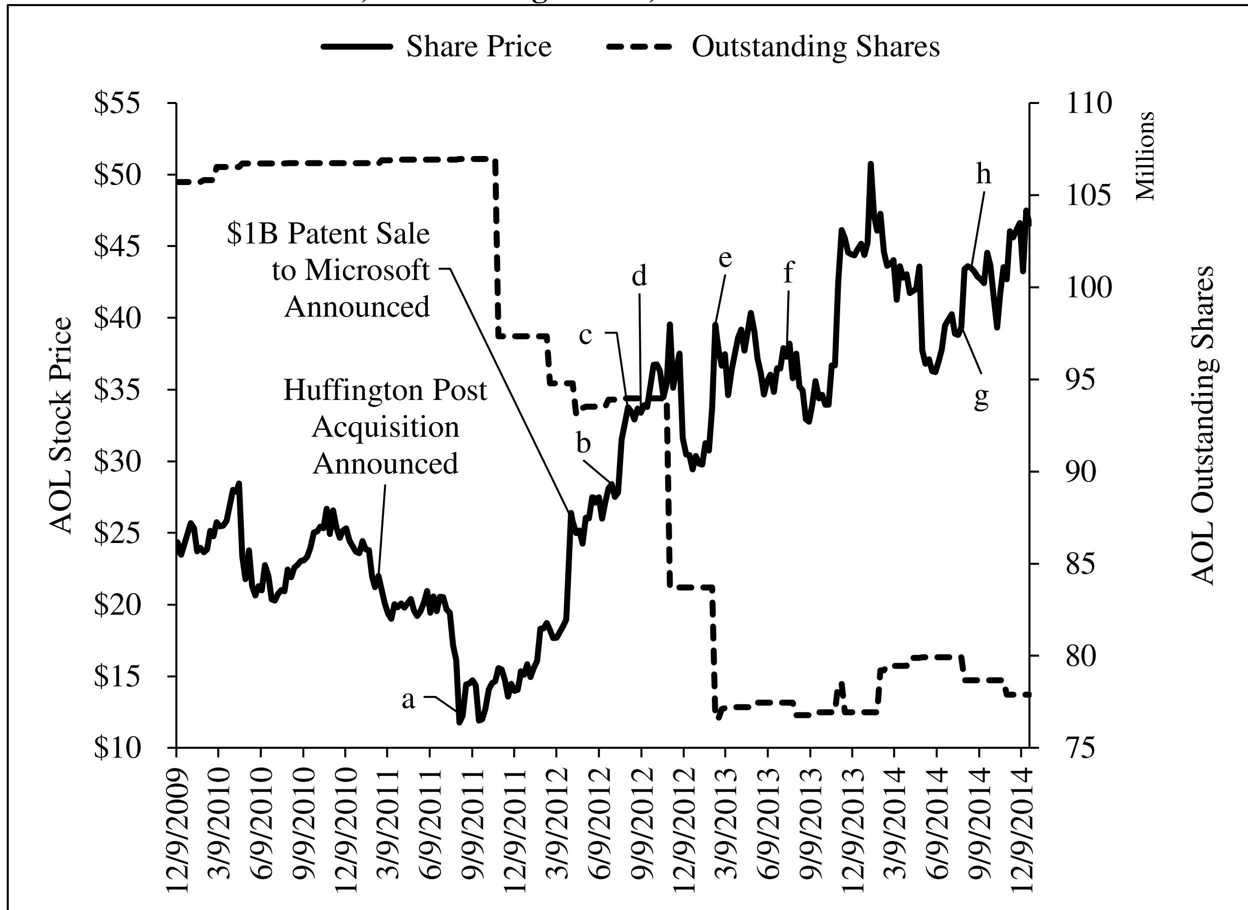
Chart 1: AOL 2009 Total Revenues





(AOL Inc., 2010a)

Chart 2. AOL Stock Price, Outstanding Shares, and Notable Announcements



a - $250M Buyback Announced
b - $400M "Dutch" Auction Buyback Announced
c - $550M Buyback Announced
d - $5.15 Dividend Announced
e - $100M Buyback Announced
f - $150M Buyback Announced
g - $150M Buyback Announced
h - $300M Convertible Note Announced

(Compustat Annual Updates - Fundamentals Annual, 2019, September 17)

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