Activist investor pushes Yahoo to buy rival AOL

26 September 2014, by Michael Liedtke

In this Jan. 7, 2014 file photo, Yahoo President and CEO Marissa Mayer speaks during the International Consumer Electronics Show in Las Vegas. In a letter on Friday, Sept. 26, 2014, activist investor Jeffrey Smith urged Yahoo Inc. to buy another fallen Internet star, AOL Inc. and take steps to reduce the future taxes on the company's lucrative stake in China's Alibaba Group. (AP Photo/Julie Jacobson, File)

(AP)—Yahoo CEO Marissa Mayer is getting some unsolicited advice on how to turn around the long-struggling Internet company, just like some of her predecessors who tangled with investors dissatisfied with management's performance.

In a letter Friday, activist investor Jeffrey Smith urged Yahoo Inc. to buy another fallen Internet star, AOL Inc. and take steps to reduce the future taxes on the company's lucrative stake in China's Alibaba Group. He also chastised Mayer for spending $1.3 billion to acquire an Internet blogging service and more than two dozen other startups during the past two years with little to show in return so far.

To bolster his arguments, Smith says he has built a "significant" stake in Yahoo through Starboard Value LP. The size of the stake wasn't quantified in the letter and hasn't yet been divulged in regulatory filings.

The idea of Yahoo and AOL getting together isn't a new one. Various analysts and other Internet observers have argued a marriage between the two companies would allow them to cut costs, attract more Web surfers and, most importantly, strengthen their online advertising arsenal to improve their chances of competing against Internet stalwarts Google Inc. and Facebook Inc.

"It makes a lot of sense," said BGC Financial Partners Colin Gillis.

In a statement, Mayer said she looked forward to discussing Smith's ideas. "Going forward, we have great confidence in the strength of our business," Mayer said.

AOL didn't respond to requests for comment Friday.

The prospect of a change in Yahoo's recent direction seemed to excite investors. Yahoo's stock rose $1.71, or 4.4 percent, to close at $40.66. AOL's stock added $1.58, or 3.7 percent, to finish at $44.55 as investors reacted to a potential buyout bid.

Smith agitated for change at AOL in 2012 after he acquired a 5.3 percent stake in that company and mounted an unsuccessful campaign to win three board seats. He didn't express any interest in trying to replace anyone on Yahoo's nine-member board, which includes Mayer.

This is the third time in the past six years that an activist investor has targeted Yahoo for a shake-up. Billionaire Carl Icahn seized three spots on Yahoo's board in 2008 after attacking the company for spurning a $47.5 billion takeover offer from Microsoft Corp. Hedge-fund manager Daniel Loeb also wound up with three board seats in 2012 after orchestrating the ouster of one of Yahoo's previous

CEOs, Scott Thompson.

Since becoming Yahoo's CEO in July 2012, Mayer has been buying startups and trendy services such as Tumblr in an effort to appeal to a younger demographic and expand Yahoo's audience on smartphones and tablets as more people rely on those mobile devices to connect with digital services.

Given that AOL is still closely associated to the days when people relied on dial-up modems to surf the Web, Mayer might view a buyout to be "too backward-looking for Yahoo," Gillis said.

Yahoo could easily afford to take over AOL, whose market value is currently hovering around $3.5 billion. After paying taxes, Yahoo is expected to pocket about $6 billion from selling 140 million of its shares in Alibaba, a rapidly growing e-commerce company that went public last week.

Yahoo still holds a 15 percent stake in Alibaba worth about $34 billion, an asset that Smith contends has been mismanaged. He believes that Yahoo could boost its stock price by about $16 per share by coming up with a strategy that would minimize the company's taxes when it sells the rest of its holdings in Alibaba Group and another investment in Yahoo Japan.

One way this might be done would be to engineer a tax-free spin-off of Yahoo's Asian investments, though Smith didn't explicitly float that idea in his letter. He said Starboard has discussed several "alternative structures" for Yahoo's Asian investments with tax specialists.

As it is, Yahoo's stakes in Alibaba and Yahoo Japan are valued at a combined $42 billion. Before the letter was released, Yahoo's total market value stood at $39 billion—an assessment indicating that investors put little or no value on the company's ongoing U.S. business while discounting for the taxes that currently would have to be paid in eventual sales of the Alibaba and Yahoo Japan stakes.

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