The Nine and Fairfax merger is about survival, not costs

The proposed $4.2 billion merger of Nine Entertainment and Fairfax Media would produce something quite unique within the Australian media landscape. Whether that's positive for shareholders, consumers and the people within the companies will depend critically on how it is executed.

It IS obvious from the estimated cost synergies of about $50 million over two years that the deal is not driven by the opportunity to materially reduce costs. Between them, the companies have combined earnings before interest, tax, depreciation and amortisation of more than $500 million.

That signals the rationale for the combination is underwritten by a belief that there is significant revenue and value to be added via the merger; revenue and value that wouldn't be available to either without the deal.

There are several layers to those potential gains. One is provided by the success of Fairfax in developing its Domain real estate business into what is now a separately-listed entity with a $1.8 billion market capitalisation by leveraging the audiences within its newspaper and digital mastheads – using the mastheads to funnel readers and subscribers to Domain. A similar example is its contribution to the success of the Stan video-streaming joint venture with Nine.

Another is the sheer scale and reach of the combined audiences, the value of the data the merged business could extract from those audiences and the number of distribution platforms for Nine and Fairfax content that the enlarged Nine would have.

The audiences and the data should enable Nine to offer far broader and more targeted – and more valuable – opportunities and distribution channels to advertisers.

Then there is the obvious cross-promotion, cross-platforms opportunity to not only help build the individual brands within the business, but support the range of verticals and mastheads and build the digital businesses and digital subscriptions within both entities.

Both companies have faced – and have faced up to – wrenching changes in their sectors over the past decade or so as the rise and rise of digital behemoths like Google, Facebook and Netflix and the emergence of online competitors have ravaged their traditional advertising bases and fragmented their audiences.

Massive and near-continuous cost-reduction in their traditional businesses and significant investment in digital assets have enabled them to survive and, more recently, to stabilise their financials.

Obvious combination

But the question marks about their long-term viability haven't disappeared. While the proposed merger could be characterised as one which puts two challenged and vulnerable business models together, Nine's Hugh Marks – who will lead the enlarged entity – will have an opportunity to make a whole that's not just bigger but better than the sum of the parts.

It should be noted that the proposed merger, which followed an approach from Nine to Fairfax early this month, is not a done deal now that Fairfax is demonstrably in play with a price-tag its directors have endorsed.

Before and after the Turnbull government scrapped the key limits on media ownership last year, the most significant of which was the "two-out-of-three rule" that prevented a company from owning a newspaper, television station and radio station in the same city, the big media companies have all held talks about combining.

Nine and Fairfax, as co-owners of Stan, is one obvious combination to create a true multimedia business. Perhaps the more obvious, however, would have been a combination of Fairfax and Kerry Stokes' Seven West Media, with its newspaper and magazine assets perhaps offering greater cost synergies.

Potential gatecrashers

Stokes, and for that matter private equity, can't be ruled out as potential gatecrashers for the Nine/Fairfax deal, which will be effected via a scheme of arrangement. Fairfax's Greg Hywood referred indirectly to that possibility when he said there was no certainty it would be finalised.

With a modest break fee of $20 million if the deal does not go ahead, the barrier to entry is not high, although private equity would perhaps find it difficult to compete against a Nine or Seven without the cost synergies or revenue opportunities they can achieve in the merger.

The announcement of the deal was short on financial details but it is clear that, while it was presented as a merger and since the payment is almost entirely share-based will be effected as one, it is in reality a takeover by Nine of Fairfax.

Nine is paying a premium of about 22 per cent to acquire Fairfax. Its shareholders will hold 51.1 per cent of the combined entity. Its chief executive will be CEO of that entity and its chairman, Peter Costello will retain that role. Three current Fairfax directors will join the ''new'' Nine board.

Within Fairfax and its audiences there will be some angst about the relegation, perhaps disappearance, of the Fairfax brand, which dates back to 1831.

Marks will have to deal carefully with that issue, given the intensity of the engagement audiences have with media properties and the risk that much of what he's paying for could evaporate if the execution of the merger and the treatment of the Fairfax mastheads and brands aren't sufficiently sensitive to that threat.

*This article was first published in *The Sydney Morning Herald* and *The Age*, and was republished with the permission of Fairfax Media. Stephen Bartholomeusz is one of Australia's most respected business journalists. He was most recently co-founder and associate editor of *Business Spectator* website and an associate editor and senior columnist at *The Australian.*