Cobalt

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Seeking an audience

Publishing companies and advertising agencies have had to adapt to the new digital realities. Acquirers are refining their plans too, writes Christopher Spink

Since the start of this year Google has seen its shares fall by more than 40%. While it is still more than 300% above the search engine's 2004 flotation price, this is the first serious setback for the world's favourite internet site since it joined Nasdaq.

Microsoft's proposal to take over Yahoo is in part responsible. Such a group would be a substantial competitor to Google for advertising revenues, the latter's main source of income.

Advertising has become a more sensitive subject since a ComScore report showed that the amount of people clicking on the adverts on Google's site fell year-on-year during January.

Google's latest quarterly figures confirmed that its spectacular revenue growth, while still strong, was slowing. This might reflect the fragile US economy, but it could also indicate that the internet is becoming a more mature part of the media landscape.

Occupying a unique position at the heart of this complex modern picture, Google relies in equal measure on the published content on the web that it points its users towards and the advertisers who fund its business, as well as that of many others on the net.

Google's US$3.1bn acquisition of DoubleClick, which has just been completed 11 months after it was first unveiled, stands to reinforce the company's dominant position at the centre of the web.

The combined entity stands to usurp the traditional role of both advertising agencies and publishers, advising the former how best to spend their clients' money and the latter on more effective ways to attract their audience online.

Google chief executive Eric Schmidt said it would “dramatically improve the effectiveness, measurability and performance of digital media for publishers, advertisers and agencies, while improving the relevance of advertising for users”.

No wonder the deal attracted scrutiny from competition regulators. Now it has been completed, some advisers believe the transaction will also affect the strategies of acquirers in both areas.

Interactive agencies

“There is an enormous amount of M&A activity in the digital advertising space,” says Chris Williams, a partner at Cobalt Corporate Finance. “Advertising is essential for content producers to be paid. News Corp’s purchase of MySpace was driven by advertising.”

The large global agencies, such as UK listed WPP and Aegis, appear to be well-positioned to take advantage.

WPP estimates online media accounts for less than 10% of total advertising spending around the world. But digital-related income now makes up 23% of WPP’s revenues. This is in part because of the company’s long-term acquisition plans.

Chairman Sir Martin Sorrell aims to buy businesses in the “the faster-growing functional areas of marketing services, particularly direct, internet, interactive and market research”. Last year, the company spent £579m on roughly 30 small acquisitions.

The largest saw US$649m spent on Nasdaq-quoted 24/7 Real Media, a digital marketing specialist that advises clients on how to make best use of search engines such as Google as well as other technologies.

Rival Publicis, which owns Saatchi & Saatchi, completed its purchase of Nasdaq listed Digitas, another interactive agency, for US$1.3bn early last year as well.

“This concentration on digital marketing is not just a one-off change for 2007,” says Mike Reid, a director at private equity firm 3i. “It is one that will run for five or six years.”

Jonathan Goodwin, global head of media investment banking at Jefferies International, agrees. “US consumers spend 25% of their ‘media time’ online but only 8% of advertising spend is currently on the net. So there is massive growth to come,” he says. “Digital is stimulating activity across mid-market media companies.”

However, the global agencies are not expected to initiate many more major deals in the interactive space.

“There are not that many big independents left in Europe,” says Reid. “There is less chance of mega deals but large agencies will continue to have the objective of adding capacity and consolidating in particular areas. There is a plethora of small to mid-sized players.”

Others foresee the major agencies implementing their tried and tested acquisition strategies here. “The large agencies are like sausage machines in the way they execute numerous deals,” says one adviser.

Roger Alexander, chairman of law firm Lewis Silkin, which has a thriving media practice, notes that Omnicom, for example “prefers to build from the inside out, rather than the other way round”.

Commentators suggest that smaller agencies are more likely to do transformational deals.

“WPP and the larger agencies are so big that they face significant cultural issues when they integrate acquisitions,” says Reid. “There is an opportunity for mid sized players to consolidate.”

He cites i-level and TradeDoubler as examples of digital media agencies that could be involved in these moves. In France, Publicis bought Interactif for €137m last year.

In early March, market research group Taylor Nelson Sofres bought US digital intelligence group Compete Inc for US$75m in cash. Compete, which made a US$4.5m loss last year, tracks the activities of users on the web, rather like DoubleClick.

Donald McLagan, Compete’s chairman, said: “Companies need to understand how the internet affects consumer preferences, attitudes, knowledge, understanding and motivation. They also need help in maximising the new online sales and marketing opportunities to target their prospective customers more effectively.”

Developing markets

Aegis, which has long been besieged by French entrepreneur Vincent Bollore, who owns rival Havas, is also concentrating its acquisition energies on emerging markets, another area of expected strong growth for advertising agencies with a global spread.

This coincides with Sir Martin Sorrell’s plan for WPP to invest “in the faster-growing geographical areas of Asia-Pacific, Latin America, Africa and the Middle East, and Central and Eastern Europe”.

Olivier Woolf, media sector leader in the corporate finance team at PricewaterhouseCoopers, says: “The advertising industry is still quite small in some areas of the world. Multinational agencies have a strong interest in these developing markets.”

In late December, Aegis said it would spend up to £31m on Heartland Media, a leading Chinese agency with clients including Nokia and Coca-Cola. That sum equates to more than 20 times Heartland’s pre-tax profits of £1.5m for 2006.

Heartland was Aegis’s largest acquisition last year, followed by the £15.9m purchase of AgenciaClick, Brazil’s largest digital agency.

WPP, meanwhile, has just bought a group of 30 agencies under the Team Y&R banner in 10 Middle Eastern countries. No transaction figure was disclosed but these agencies produced combined turnover of US$100m last year.

Back in Europe, there is also ambitious acquisition activity among smaller companies, such as Cello, Mission Marketing Group, Creston and Adventis, all of which are listed on the London Stock Exchange.

Charles Philpott, chief executive of Adventis, says “Vendors want to give their businesses critical mass. We are looking for a unique selling point – though we find we have to kiss a lot of frogs.”

Although he expects deal volumes to be slightly lower after the first quarter of the year, the digital dimension is driving much of the activity.

3i’s Reid says: “Last year saw agencies specialise in particular parts of the digital space. The next two years will see the integration of multi-channel advertising, such as TV, search, banner and radio, across both digital and traditional forms.”

For Adventis, it is only part of the company’s offering. “Digital is simply another medium for us,” says Philpott. He wants to expand the group beyond its current sectors of real estate, financial services and healthcare, chosen for their higher margins.

Don Elgie, chief executive of Creston, is slightly more circumspect at present. “We need to be realistic in the current economic climate,” he says. “Like most marketing services companies, our share price has come off lately.

“We want to lock in people with shares, but we wouldn’t want to issue paper at the moment,” Elgie says. He wants to expand the business overseas, when things stabilise.

Lewis Silkin’s Alexander believes there are likely to be fewer deals around after the flurry of activity in the first quarter, prompted by vendors trying to sell before the capital gains tax regime changes. He also thinks several of the AIM-listed agencies might merge.

“I’d be surprised if we didn’t see some AIM companies acquiring each other,” he says. “Private equity buyers might be attracted by the lower valuations of companies on the stock market and try and take them private.”

Publishers on offer

Although mega deals involving advertising agencies may not be expected, changes in the way advertising money is spent has provoked a number of significant publishing companies to change hands in the past year. This process has not yet finished either, with Reed Elsevier recently signalling that it wanted to sell Reed Business Information.

The break-up of EMAP was perhaps the longest running saga last year. This eventually saw the group split. Its consumer publishing arm was bought by German group Heinrich Bauer Verlag for £1.14bn and the business titles were sold to a special purpose vehicle owned by Apax Partners and Guardian Media Group (GMG) for £1.01bn.

Apax has been a prolific deal-doer in the business-to-business area. At the end of 2006 the private equity firm succeeded in taking Incisive Media private. Since then, this business has formed the centrepiece of further related acquisitions, such as the US$630m purchase of American Lawyer Media. This culminated in the purchase of EMAP’s B2B interests.

Further deals could also be seen as Apax and GMG have recently appointed David Gilbertson, chief executive of listed company Informa, to the same role at the EMAP titles. Gilbertson mastered a string of acquisitions at Informa, most recently picking up Datamonitor last summer for £502m.

Roger Alexander at Lewis Silkin says “Private equity firms can gain by acquiring top talent and then making informed acquisitions of underdeveloped assets that are around.”

Apax also teamed up with GMG to acquire a minority stake in Trader Media last March, valuing the business at £1.35bn. The firm benefited from obtaining a covenant-lite financing package from JPMorgan to pay for the deal.

Olivier Woolf at PwC says Apax might be “a natural buyer” for Reed Business Information, which has numerous advertising-driven titles.

“The business has been positioned as a private equity play rather than trade,” he says. “Most of these products are mature, so a private equity investor, with interests in the area already, could come in and take out costs; integrate an online offering; or do both.”

Jefferies’ Goodwin expects keen interest in the group, saying: “All the major private equity players should be interested.” However, in the current environment, many admit that it will depend on whether the financial buyers manage to raise sufficient finance. "Constraints on the availabiliyt of sterling debt may make the financing tough if it is sold as a whole. It is more likely it will be broken up."

“It will be a key test of whether private equity can take on debt,” says PwC’s Wolf. Analysts have estimated that the business could fetch more than £1bn. That greatly depends on how much leverage can be obtained.

Wolf notes that Clarion Events’ buyout in February by Veronis Suhler Stevenson obtained debt worth six times earnings before interest, tax, depreciation and amortisation (Ebitda). Although the deal was only for £120m, this shows that sizeable borrowings can be arranged against attractive assets.

Reed Elsevier’s chief executive Sir Crispin Davis has accepted that he might have to wait to get the best price. “We are going to divest this business in a way that maximises shareholder value,” he says. “We are not going to be rushed into a sale. It is possible that we may have to wait till the trading environment improves.”

Private equity firms themselves are not exactly enthusiastic about picking up this business.

“It is not that attractive as it relies on advertising for the majority of its income,” says Jeff Montgomery, managing partner of GMT Communications. “There would be more interest in business-to-business (B2B) publishers with value-added data that can be replicated on the internet.”

GMT is currently building up Asiakastieto, a leading Finnish provider of credit information bought in 2006, through a series of acquisitions. “These businesses can be pretty stable, despite the credit crisis,” Montgomery says.

Data-driven deals

“B2B publishers, particularly those with data, can be wonderful businesses for private equity but we are not seeing a lot of publishing deals that we would do,” says Louis Elson, founding partner of Palamon Capital Partners, a keen media investor. “That’s not to say we are not seeing a lot of companies in this area.”

Lewis Silkin’s Alexander explains the dilemma. “It is such a changing scene in publishing at the moment, so it is hard to discern where next year’s profits might come from. Investors have to take a longer-term view, pay what might seem a toppy price and wait to see if it can pay off.”

Elson adds: “Bold venture capital investors can prosper by taking a stake in a business where no one else sees value and then finding out which buyer wants to acquire it.” He singles out Balderton Capital, which recently sold Bebo, in which it had a 15% stake, to AOL for US$850m.

Jefferies’ Goodwin believes there are “some quality rough diamonds worth between £100m and £200m out there” waiting to be unearthed. He says trade buyers will still be keen acquirers, rather than just venture capital investors. “There is no let up in the amount traditional media players will pay for digital,” he adds.

Established media companies, such as News Corp, need to find fresh sources of revenue growth.

“Publishing is either benefiting or not from the increase in internet advertising spend, depending on where they are positioned,” says GMT’s Montgomery. “Broadly speaking, all newspapers, whether local or national, are negatively impacted as advertising is cheaper to do online and is more measurable.”

3i’s Reid says that, given the current scenario, he is “not bitten on big publishing plays”, adding: “Transitioning a leading offline magazine title in one vertical market into a leading offline and online player is a big challenge. Doing it for over 200 or 300 titles is immense. That might be why so many publishers are up for sale at the moment.”

This could mean many acquirers, both trade and financial, might be interested in picking up parts of Reed or EMAP’s portfolio.

Boutique van Tulleken specialises in these niche transactions. “Reed Business Information has some wonderful assets within it and not all of them are online,” says chief executive Kit van Tulleken. The boutique has just advised on the sale of Heren Energy to RBI.

She maintains that despite the uncertainty in the credit environment and the fundamental changes that the media landscape is undergoing, the outlook for vendors of desirable businesses with attractive data and a strong position remains good. “Quality companies will attract quality prices,” she says.