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Media Business: Adapt or Face Nightmare of Change

Few industries have been harder hit by technological change than media and publishing, yet companies in that field with successful reinvestment strategies have shareholders singing their praises.

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No one could have dreamed up all the wonderful technological innovations and communications we are enjoying today from companies like Apple, Amazon, Twitter, and Google. But for some, the dream has turned into a nightmare. Media and publishing companies face the daily threat of newspapers, books, and television and losing attention at an alarming rate to blogs, message boards, e-readers, tweets, and YouTube videos.

This spectacular transformation leaves many media executives feeling like horse-and-buggy whip manufacturers, with some choosing to hunker down to wring out what cash they can. But a careful examination of 28 of the largest U.S. media and publishing companies shows that the best shareholder returns have come from those that have reinvested in the future of their businesses.

ANALYSIS

In comparing the capital deployment practices for these firms with total shareholder return (TSR), the media and publishing industry overall has been ineffective at creating value for shareholders. The data incorporated dividends and share-price appreciation to determine the strategies of the best companies in the sector from 2002 to 2011.

In the first period (from 2002 to 2006), the median industry TSR was 12% less than the S&P 500, and in the the second period (from 2007 to 2011), it was 20% less. That’s dismal.

However, those with higher rates of reinvesting cash into such things as capital expenditures and acquisitions managed to outperform those that simply milked their business and distributed their cash.

We separated the companies into a high and low group based on their reinvestment rate. From 2002 through 2006, the low group invested a median of 34% of their cash earnings, while the high group reinvested nearly 90%. The median TSR for the low group was only 14%, compared with 45% for the high group. Put differently, the high group invested at nearly three times the reinvestment rate and generated more than three times the TSR.

Despite the great recession, we found similar results for 2007 through 2011. Although the median reinvestment rate for the industry was 17% lower during that time period, those embracing higher investment strategies delivered higher TSR. The high group invested 66% of their cash earnings at that time and delivered a median TSR of -12%, compared with a 16% reinvestment rate and -38% TSR for the low group.

In both periods, the “reinvestment gap” included both organic investments, such as capital expenditures and working capital, and acquisitions. In fact, if we sort the companies based solely on cash acquisition investments divided by cash earnings, the highly acquisitive companies outperformed in both periods.

Surprisingly, successful high-reinvestment strategies are not limited to flashy new technology companies. Consider publisher John Wiley, which managed to outpace peers in terms of reinvestment and TSR in both periods.

By 2002 Wiley completed several acquisitions, including the $185 million deal for Hungry Minds, publisher of the “For Dummies” series of how-to books, which at the time was the largest acquisition in the company’s history. Wiley’s management stepped it up in 2007 when it invested $1.1 billion in Blackwell Publishing to expand the company’s reach into higher education, research, academic, and corporate libraries.

In both periods in the study, Wiley reinvested more than 100% of its cash earnings and delivered substantial TSR of 75% and 24%, respectively, which far outpaced the industry median and the S&P 500.

So what was the low group doing with all their cash if not reinvesting it into the business?

From 2002 to 2006, it was predominantly buying back shares, repaying debt, and accumulating cash. The low group deployed a median of 42% of cash earnings to such "financial" uses versus only a net of 4% for the high group. In the later time period, from 2007 to 2011, it was much of the same, though the gap narrowed as the low group deployed a median of 28% of cash earnings toward financial uses, compared with 11% for the high group.

So while one group was investing in the future of its businesses, the other was simply rearranging its capital structure and executing a financial strategy. Investors clearly preferred the companies that were investing in their businesses.

Another example of this investment strategy can be seen with Meredith Corp., which has interests in publishing, TV broadcasting, and interactive media. From 2002 through 2006, the company reinvested nearly 75% of its cash earnings, grew revenue at 9% per year, and delivered TSR of 66%, far outpacing the industry. The company deployed only 20% of cash earnings toward buybacks and dividends, net of new borrowings.

But management substantially changed its strategy during the 2007 to 2011 period. Its reinvestment rate plummeted by more than half, to 33%, revenue declined at 3% per year, and TSR underperformed the industry by 11%.

Rather than continue successfully investing in the business, management chose to deploy 65% of cash earnings toward buybacks, dividends, and debt repayment. It appears the strategy of investment and growth was overtaken by fear and conservatism, and what may have seemed like prudent balance-sheet management turned out poorly for investors.

Interestingly, another look at the data shows that unlike many other industries, the larger media companies tended to be in the high reinvestment group in both of the time periods studied. Does that mean the larger and more diversified companies in media and communications have an edge relative to their smaller specialized or niche competitors? Or simply better strategies?

Many business-news pundits have depicted the business models of the old traditional media industry as archaic and heading toward extinction, yet the worst share-price trends seem to have resulted from poor strategic choices and underinvestment rather than an industry death spiral.

Media and publishing executives face a stark choice: underinvest in their future and invite a nightmare of technological changes or wake up to new ways they can shape the industry. Shareholders have demonstrated they would prefer them to wake up.

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