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MEDIA CENTRIC

Old Media's New Math

Why bloated deals could sink under their own weight

If you wanted, you could create the laboratory conditions for a spate of risky media deals. You'd want a market flooded with money from private equity, hedge funds, and bankers eager to lend at ever-increasing multiples of cash flow. You'd want a bunch of operating guys (and they remain almost exclusively guys) grumpy about life in previously conceived media conglomerates and starry-eyed at the prospect of equity stakes that could turn into eight-figure fortunes. And you'd want a media world in flux, in which profits from once-steady sectors and properties cannot be presumed to be stable.

Actually, you don't have to construct it. You're soaking in it.

"IT'S BEEN PRETTY AMAZING that investment bankers haven't made more stupid deals," says one active player in this market. The math for media deals—we're talking about traditional media deals, since those for Web properties like MySpace and YouTube defy any standard metrics—is based on the cash-flow indicator EBITDA; that is, earnings before interest, taxes, depreciation, and amortization. Earlier this decade, say executives involved in the deal markets, those seeking to buy a media property could borrow about five times an acquisition's EBITDA. Today, they can borrow seven times. It's no surprise that lenders like this can jack up the price of a potential deal.

Meanwhile, more money keeps targeting this market. On Feb. 21 media-focused Providence Equity Partners announced it had raised $12 billion for another buyout fund—its sixth. None of this automatically spells doom for media transactions, and no deal vehicles are being driven off the cliff just yet. But it is safe to say that the potential for dumbness is mushrooming. "We've seen this, and it doesn't work out well," offers one deal-side executive. At current maximum debt-to-EBITDA ratios, operating a company "doesn't leave a lot of room for error..... If you start running into problems—and you will, and there will be a recession—you won't be able to service the debt."

What sparked Wall Street's romance with media decades ago was the realization of just how much cash the companies of yore threw off. Some investors feel "media, as a consumer product, has some stability to it. And most media companies don't have a lot of capital spending needs," explains CreditSights senior analyst Jake Newman. "They can generate pretty good cash flows as long as their business model is sound." This, coupled with the ease of borrowing, has given rise to highly leveraged deal proposals for Clear Channel and Univision. *BusinessWeek*'s corporate sibling Standard & Poor's notes in a report downgrading Univision's credit outlook that the potential deal would leave the company's total debt at 12 times its 2006 EBITDA.

Neither deal is necessarily heading for a crack-up. But ponder this portion of Newman's comment: "as long as their business model is sound." This is an era in which long-held media revenue calculations have to be refigured practically weekly. It's not that the Web will destroy all traditional media businesses. It's that you can't pinpoint which sector will next face dismemberment by a fast-blossoming newcomer.

In retrospect, the spectacular implosion of tech player Ziff Davis—bought by Willis Stein &

Partners in 2000 for $780 million, and, after much tumult, widely believed to be worth a fraction of that—seems preordained. But I would never have guessed that magazines aimed at new parents would be hit hard by message board-y sites like Johnson & Johnson's BabyCenter.com, even though that's exactly what has happened. (Two executives familiar with Time Inc.'s Parenting Group properties, which were just sold to Sweden's Bonnier Magazine Group, says their EBITDA was roughly halved from 2005 to 2006. A Time Inc. spokeswoman declined to comment.) The risks keep mounting. But the money keeps flowing.

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By Jon Fine