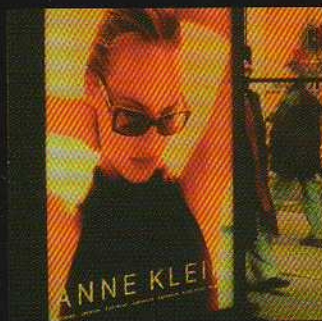


Make Space For Advertising

**CONSOLIDATION AND DIVERSIFICATION ARE THE NAME
OF THE GAME, AND THE COMPETITION IS FIERCE**

New markets and new products are proliferating faster than ever.



In an industry where “new” is the operative word, it’s ironic that the dominant trend in advertising actually started 40 years ago. That’s when Marion Harper, an idiosyncratic visionary, created Interpublic Group of Cos., the first ad

agency holding company, which offered a solution to client conflict. Each of the agency networks is totally separate and independent.

The holding company concept didn’t solid-

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ify until years later. Now, consolidation is the big theme. One of the forces driving this trend is Wall Street's strong expectations for the industry:

Greg Smith, managing director of investment banking at AdMedia Partners, says EPS growth targets range from 15% to 20% per year. Since 8% to 10% is generally the internal growth rate of large agencies, the rest must come from acquisitions.

Anthia Christian of William Blair & Co. has three words for the ad industry: "hot, hot, hot." She finds advertising prospects to be just as exciting as the most talked-about industries on the Street.

Clients in healthcare and high technology have moved into mass-market branding — expensive television commercials. The FDA's decision to relax the rules on television drug commercials is expected to unleash a flood of new advertising by pharmaceutical companies. Drug advertising soared to over \$1 billion in 1997, up from \$595 million in 1996.

The typical holding company includes tradi-

The outdoor advertising medium generates high cash flow margins and enjoys favorable consolidation economics.



tional advertising, direct marketing, public relations, new media, marketing services, as well as specialty agencies.

"Global advertising agencies are not cyclical because they are geographically diversified and able to gain market share," says Bill Bird of Salomon Smith Barney. He likens a regional agency to a single mortgage and a global agency to a pool of mortgages, where geographic and client diversification reduces risk.

New markets and new products are proliferating quickly. Deregulation in various industries creates new competitors that become new advertisers, alongside those that must defend their positions. Change in industries also leads to more marketing since companies must redefine themselves.

Bird says new media outlets and market fragmentation are a force of growth. Advertisers must now spend more and spend

in different places to reach their target audiences. The very complexity of this environment is a benefit to advertising agencies.

In short, the ad business is booming, and Robert Coen, forecasting director at McCann-Erickson U.S.A. and a leading ad agency prognosticator, estimates that ad spending in 1998 will total a record \$198.4 billion, an increase of 6.2% over 1997. And Standard & Poor's reports that gross income of publicly held ad agencies should show double-digit improvement in 1998.

Competition in the ad industry is fierce. Experts predict that in the near future there will be a handful of players left among global agency holding companies. The big three are Omnicom Group, Interpublic Group and WPP Group.

After an 85% gain in 1997, Omnicom is priced at the top of the publicly traded advertising company universe. Jim Dougherty of Prudential Securities likes the company, which runs three independent agency networks: BBDO Worldwide; DDB Needham Worldwide; and TBWA.

BBDO, in 1996, was recognized by *AD AGE Magazine* as the most creative agency network in the world. BBDO accounted for 29% of Omnicom's total revenues last year.

DDB Needham is a combination of DDB, known for its groundbreaking Volkswagen ads, and Needham, which helped propel the meteoric rise of McDonald's Corp. Led by Keith Reinhard, it accounts for 30% of Omnicom's total revenues.

When TBWA bought Chiat/Day, it acquired the creative powerhouse of the 1980s. Chiat/Day created the famous Macintosh commercial in 1984. It was recently named agency of the year by *ADWEEK*, an industry trade journal.

Omnicom, through its Diversified Marketing Services unit, is a leader in "below-the-line services." Its other unit, Diversified Agency Services, is bringing in an increasing share of revenues, which rose 36% in both 1996 and 1997. Dougherty says by 1998 Diversified Agency Services will account for 35% of Omnicom's revenues, which are expected to increase 15% in 1998. He believes that return on equity should remain in the 20% to 25% range from 1997 to 1999.

David Leibowitz of Burnham Securities likes Interpublic Group, citing its diversification into new areas, such as sports and event marketing, celebrity management and TV syndications. Its main "traditional" agency network, McCann-Erickson, is the largest in the world, operating in 117 countries.

Interpublic's current acquisition strategy has been to focus

on marketing services, where it has lagged behind others. William Blair's Christian says of the 20 companies Interpublic acquired in 1997, all but two are in marketing services.

Dougherty praises Interpublic's cost disciplines and margins, which are "at, or near, the top of the advertising industry." He sees operating margins of 15.9% in 1998, and he foresees EPS of \$2.20 this year, up from \$1.90 in 1997. Cash flow is expected to increase over the next several years, with share buybacks being the biggest use for cash. Interpublic is committed to purchasing about 3 million shares per year, he says.

For those looking for a value investment, Rick Plummer of Value Line suggests WPP Group. It is a turnaround story, with operating margins that have been improving 100 basis points a year for the last two years. Plummer says there is still more fat to trim, and he expects further improvement in margins.

Salomon Smith Barney's Bird says WPP Group, like Omnicom and Interpublic, is now a consistent grower. Dougherty agrees that it is "fast approaching the quality of Interpublic and Omnicom." Most experts consider the price gap between WPP and the other big three players to be too wide.

True North Communications has recently increased its global presence, but not without a battle. In 1997, the company was engaged in a legal battle with its former partner, Publicis S.A. True North won the right to acquire Bozell, Jacobs, Kenyon & Eckhardt, becoming the world's sixth largest agency holding company and boosting its international presence.

Plummer favors the deal but adds that it might take a while for the synergies to happen. In addition to strong marketing services companies, such as FCB Direct, True North is also in the new media arena. Its TN Technologies group was bolstered by the recent acquisition. Billings for the new True North are estimated at \$12 billion for 1998.

Over the past decade, direct marketing has been one of the

fastest-growing segments in the ad industry. Expenditures in this category in 1997 exceeded \$150 billion, and the growth rate for the next five years is expected to average close to 7%.

While most major direct marketing agencies have been acquired by advertising holding companies, it is possible to participate more directly in their growth through the companies that serve and supply direct marketing agencies and clients.

Asa Graves of Wheat First Union recommends ADVO, calling it "a cash flow machine." It specializes in shared mailings in which a group of companies sends promotional materials in one package, which can then be targeted by zip code. In fiscal 1997, it achieved a quick cash cycle of six days. As the country's largest full-service direct mail marketing services company, ADVO is the only one that can offer more than 95% penetration into households across the nation. Graves believes that earnings will grow 25% a year.

MORE CONSOLIDATION AHEAD OUTDOORS

The name of the game for outdoor advertising companies has also been consolidation. Companies and investors participating in consolidation have profited, but James Marsh of UBS Securities believes that this is far from over. "The top three outdoor advertisers take a smaller share of revenues than other industries typically thought of as consolidated," he says. The industry is still fragmented, allowing room for more consolidation. In 1998, revenue growth for this segment is estimated at 7% to 8%.

High cash flow margins of 50%, the ability to generate strong free cash flow, favorable consolidation economics and strong management are good reasons to like outdoor stocks, says Marsh.

Susan Decker at Donaldson, Lufkin & Jenrette Securities Corp. is also bullish. She says very high levels of profitability and regulations have created high barriers to entry. Addressing the issue of the loss of tobacco advertising revenue, Decker says

the "industry has been preparing for it for quite a while, and the effect will not be that great. In some respects, it's a positive because the tobacco companies were under long-term contracts at relatively low prices for the full billboard."

Throughout the consolidation period, Outdoor Systems, Lamar Advertising Co. and Universal Outdoor Holdings (acquired by Clear Channel Communications) have shown strong gains.

UBS Securities' Marsh favors Outdoor Systems, praising its "ability to hunt the big deals and integrate

ADVERTISING SALES GROWTH

Company	Sales Growth (past four quarters)	Return On Equity	5-Yr. Projected Earnings Growth
Clear Channel Communications (CCL)	70.2%	6.4%	30.8%
CKS Group (CKSG)	66.8	9.7	34.2
Lamar Advertising Co. (LAMR)	39.8	4.0	22.0
True North Communications (TNO)	30.6	-22.7	14.8
Outdoor Systems (OSI)	22.7	4.5	30.0
Interpublic Group of Cos. (IPG)	19.5	27.1	15.1
Omnicom Group (OMC)	16.6	27.3	15.9
ADVO (AD)	3.5	N/A	21.7
DoubleClick (DCLK)	N/A	-245.5	N/A
WPP Group (WPPGY)	N/A	N/A	16.7

them effectively." Harry DeMott of Credit Suisse First Boston Corp. adds that "It's an excellent business, with steady growth, high sustainable EBITDA margins, little capital expenditures and a high degree of free cash flow." He calls Arte Moreno one of the best CEOs in the country. Capital expenditures are minimal, and Outdoor Systems could grow its after-tax free cash flow at roughly 20% for the next five years, he says.

Clear Channel Communications, which acquired Universal Outdoor Holdings, "is a fantastic company," DeMott adds. It has national coverage in outdoor advertising, and the combined company has radio and TV properties, offering advertisers cross-selling opportunities. After-tax cash flow growth is expected to exceed 20% in the next few years, says DeMott, who adds that Clear Channel has been one of the best-performing stocks on the New York Stock Exchange.

Lamar Advertising, which targets smaller markets, has demonstrated an ability to find and integrate acquisitions. Because of this, Marsh maintains a buy rating. Its shares were on a roll in 1997, appreciating about 100%.

HERE COMES THE INTERNET!

The Internet will play an increasingly important role in the near- and long-term prospects of the advertising industry. Right now, it is a small fraction of national advertising expenditures. But Mary Meeker of Morgan Stanley Dean Witter believes that certain characteristics of the Internet will enable it to erode the tremendous dominance of traditional media — but this will occur over a long period. She cites "low barriers to entry, the reduced cost of publishing or broadcasting (no print or paper), and many targeted special interest and segmented sites."

Spending on the Web was about \$750 million in 1997, compared with \$262 million in 1996, according to Jupiter Communications, a market research firm that predicts total Internet advertising spending could reach \$6 billion by 2001.

When Internet advertising really takes off, CKS Group, with a focus on high technology and new media, will make its presence known. Because of its superior technological capabilities, CKS can be viewed as an Internet company as much as it is an advertising agency. Prudential Securities' Dougherty believes CKS is the right play on new media advertising, with EPS growth estimated at more than 40% per year over the 1998 to 2000 period. William Blair's Christian likes its prospects now that it has made some necessary changes, but she maintains a wait-and-see attitude.

DoubleClick, which places banner ads on the Internet, had a stunning debut on Wall Street, with the shares soaring 57% above their offering price of \$17 on their first day of trading. Despite the company's loss of \$8.4 million last year on revenues of \$30.6 million, its successful IPO underscores investors' anticipation of growth in Internet advertising.

New advertising-related Internet companies are born every day. By most accounts, this will add up to significant investment opportunities. Stay tuned.

The forces for growth in advertising seem to be creating an economic phenomenon that still has a way to go. The regenerative nature of the ad industry plays an interesting role in the continuing consolidation trend. In an arena ripe with entrepreneurial pluck and creative ego, new agencies spring up all the time. With a few new business wins, these agencies can grow fairly quickly. But the infrastructure and capital to grow past a certain point will be lacking. That's where the public markets step in.

The mother of all advertising IPOs is imminent. In a business where the brand is king, Young & Rubicam, one of the most notable brands in the agency business for more than 75 years, is about to go public. Its acquisition strategy actually started years ago in the late 1970s, with its "whole egg concept," when it bought direct marketing and other specialty agencies. But Young & Rubicam is just one major ad network and may be at a disadvantage to other holding companies that have multiple networks. Still, it carries a great deal of clout and has a reputation for smart management and strategic skill. Its IPO is expected to raise \$350 million.

So look for the consolidation process to continue with no lack of new acquisition targets. In short, bet on the empire builders. But keep an eye on the buccaneers. ■

TOP ADVERTISING ISSUES IN 1997

Lead Manager (Market Share) Issuer	U.S. Amount Offered (MM)
BTAlex. Brown (43%)	
Outdoor Systems (OSI)	\$393.3
Universal Outdoor Holdings (UOUT)	192.5
Lamar Advertising Co. (LAMR) (two times)	63.7
Merrill Lynch & Co. (19%)	
Snyder Communications (SNC)	157.6
Snyder STRYPES Trust (STX)	116.2
Robert W. Baird & Co. (12%)	
Select Appointments (Holdings) (SELAY)	190.0
Bear, Stearns & Co. (7%)	
Boron LePore & Assoc. (BLPG)	63.0
Morgan Stanley & Co. (6%)	
TMP Worldwide (TMPW)	92.0

SOURCE: COMMSCAN