Time spin-off highlights risks facing magazines

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From Sports Illustrated to People to its namesake magazine, Time Inc. was always an innovator. But now when the troubled magazine industry is facing its greatest challenge, the company Henry Luce founded is struggling to find its way in a digital world.

Time Warner Inc.'s decision to shed its Time Inc. magazine unit last week underscores the challenges facing an industry that remains wedded to glossy paper even as the use of tablet computers, e-readers and smartphones explodes.

Although the new devices might seem to present an array of opportunity for Time Inc.'s 95 magazine titles, many publishers have found the digital transition troublesome. Digital editions of magazines represented just 2.4 percent of all U.S. circulation in the last half of 2012, or about 7.9 million copies, according to the Alliance for Audited Media.

Although that number more than doubled from a year earlier, it's hardly spectacular growth, considering that the number of tablets in the U.S. also more than doubled last year to 64.8 million, according to research firm IHS.

The fact that so few tablet owners are buying magazines on their devices is a concern because both ad and circulation revenue from print editions have fallen more than 20 percent since their peak near the middle of the last decade. And, according to forecasts, there's no recovery in sight.

"We have to get much better at capturing those (digital) readers," said Mary Berner, president of The Association of Magazine Media.

Before publishers can accomplish that, they need to address a number of problems, experts say. First, the range of free content on the Web has given some readers the impression that it's not necessary to pay for the digital versions of magazine stories. Also, there's no industry standard for pricing. Publishers aren't in agreement over whether to include free access to digital copies as part of a print subscription.

There are technical challenges, too. It's been difficult for magazine makers to create compelling digital editions that fit every screen size and resolution.

Berner acknowledges that customer confusion is part of what's preventing the magazine industry from selling more digital copies. She is working with industry players like Time Inc., Hearst Corp., Conde Nast and Meredith Corp. to standardize both the format of magazines and the way they are sold.

"There used to be a couple ways you used to be able to get a magazine: you could subscribe or buy it at the newsstand. Now there's 25 ways. Joe Average consumer just isn't that clear on it yet," she said. "The confusing part is hurting."

Advertisers are making matters worse. The ad industry has been slow to warm to the notion that they still need to pay top dollar to advertise in the tablet editions of magazines, even though much cheaper website ads are just a finger-swipe away.

But many magazines still command significant premiums. A full-page ad in Elle magazine, for instance, costs $155,680 to reach the readers of 1.1 million copies, or about $141 for every 1,000, according to a rate card that the magazine posted online.

Compare that to a 30-second ad during this year's Super Bowl, which —at most— cost $37 per 1,000 TV households, or $4 million to reach 108 million TV sets, according to CBS. A typical website ad costs in the single-digit dollars per 1,000 viewers, although pricing varies by ad size and other features.

Magazine insiders say the price of their ad space is worth it because ads reach a targeted, engaged audience that actually wants to see the commercial come-ons. Even so, advertisers bristle at the idea that tablet editions command the same price premium as print pages.

"The costs per thousand are out of whack," said George Janson, director of print for GroupM, a subsidiary of advertising agency giant WPP, whose clients include Ikea, Mars Inc., Marriott and Xerox. "The advertising challenge is there haven't been a lot of metrics. There's very little accountability. That's starting to change now at the advertisers' insistence."

The magazine industry's slim but growing digital subscriber base could help convince advertisers of the value of magazines. Research firm eMarketer predicts that while print magazine ad revenue will remain flat at about $15.1 billion from 2011 to 2016, digital magazine ad revenue will grow from $2.7 billion to $4.1 billion over the same period.

"Tablets have reinvigorated magazine ad revenues," said eMarketer spokesman Clark Fredricksen.

But even as overall magazine advertising revenue grows, it's not expanding nearly as fast as U.S. ad spending as a whole. The predicted turnaround won't return the industry to pre-recession levels —and it may come too late for Time Warner Inc.

Revenue at its Time Inc. unit slipped to $3.4 billion in 2012, about 38 percent below its peak in 2004. Operating profit declined to $420 million, down by more than half of the $934 million posted eight years earlier.

Analysts say spinning off the magazines into a separate, publicly traded company reduces Time Warner's risk. On Friday, two days after Time Warner announced the spin-off, its shares hit a 52-week high of $57.85.

Tony Wible, an analyst with Janney Capital Markets, said the spin-off frees Time Warner from the uncertainty of the magazine industry's digital transition.

"It has the potential to save money, increase revenue per ad, improve measurement, and increase distribution," he wrote in a research note, "but it also competes with a growing number of free online publications and there may be few ad slots in the new medium."

In other words, it's better for parent Time Warner to separate itself now.

Reed Phillips, the CEO of media company advisory firm DeSilva + Phillips, said that for the parent company, there is too much risk involved if the magazines stay.

"Will you come out on the other end as large and as profitable as the current company? There's a lot of concern," he said. "Because of the volatility, that's why Time Warner wants to spin off Time Inc."

Meanwhile, magazine publishers are carefully parsing consumer behavior data to learn how they might make digital magazines more attractive to readers and advertisers. They want to know which ads attract consumers and how long readers engage with an ad. They are trying to learn how people read magazines (So far, it's still front to back).

It's still not clear whether such data is valuable to advertisers and worth paying more.

"This is a fairly early stage business," said Liz Schimel, the chief digital officer at Meredith Corp., which was in talks to combine with Time Inc. before talks were called off. "We're still in lots of conversations about models and features and metrics."

Magazines don't have a lot of time to figure the digital transition out. TV and digital ad spending is growing quickly, and there are more ways than ever to track down consumers and get a company's message in front of them.

"It's not just print and TV and radio," said Brenda White, a senior vice president in charge of publishing industry ad spending at Starcom USA, a subsidiary of ad agency giant Publicis Groupe, whose clients include Facebook Inc. and Google Inc. "There are all these different digital channels: mobile, tablets, social. Publishing companies have had to evolve their business models to keep up."