McGraw-Hill Companies MHP

Analyst Report | 08-02-2001
by George E. Nichols

Thesis

McGraw-Hill's maturing business inspires a collective yawn from growth investors, but we think the century-old textbook publisher will prove that slow and steady wins the race.

Shareholders should be prepared to endure some short-term bumps, however. In particular, revenue from the information and media services segment fell nearly 14% in the latest quarter. McGraw's Business Week has been hard-hit by market weakness--ad pages fell 38% last quarter. This unit is unlikely recover before mid-2002, so investors will have to ride out the storm.

But a beauty of McGraw's business is its diversification; advertising accounts for only 13% of total revenue. McGraw continues to show strength in its core educational publishing market. The company has been able to head off competitors and remain the market leader, bolstered by the acquisition of Tribune Education. McGraw's financials are stellar relative to those of rivals like Houghton Mifflin HTN , which has been mired in a string of quarterly losses. Houghton was recently swallowed up by Vivendi V , but its publishing operations, which will rank second in market share, will still fall in McGraw's shadow.

McGraw's financial information unit is another source of strength. In particular, its Standard & Poor's business continues to generate robust growth, boosted by an active bond market.

At 23 times First Call estimated 2001 earnings, McGraw-Hill is trading in line with its peers. Considering its strong returns on equity and dominant market share, we think the stock is attractive at these prices.

Valuation

Strategy

McGraw-Hill has become synonymous with school textbook publishing. The company, which commenced operations way back in 1888, hopes to reinvigorate growth by moving into new markets. In particular, McGraw is increasing its focus on the financial information market with its Standard & Poor's

As of 08-02-2001

Morningstar Rating

★★★★

Business Risk

Below Avg

Stock Price

$60.50

Fair Value Estimate

$79.00

Bulls Say

- McGraw-Hill is top dog in the educational publishing market. As for its rivals, McGraw has been takin' em' to school, expanding its market with the acquisition of Tribune Education.
- The company's diverse revenue stream beyond advertising--financial services, textbooks, and subscriptions--provides it with greater stability than most publishers during this market downturn.
- The company owns Business Week and Aviation Week, which are industry-leading publications.
- Politicians are placing greater priority on education, leading to increased school budgets. McGraw stands to benefit, and is now entering the seasonally strong back-to-school quarter.

Bears Say

- Although the company's revenue stream is diverse, it isn't immune to the ad industry meltdown. Roughly 13% of sales come from advertising, and Business Week is taking it on the chin.
- McGraw's core education publishing business is maturing, which puts a ceiling on the company's growth opportunities.
- McGraw-Hill recently made five acquisitions in its educational publishing segment, which could pose

unit.

integration challenges.

Management

Harold W. (Terry) McGraw III leads the company that bears his family's name. Since joining the company in 1980, he has gradually moved up the ranks, becoming president in 1993, CEO in 1998, and chairman in 1999.

Profile

Growth

Investors can't expect a maturing business to have blazing growth. In the second quarter, revenue grew a respectable 13% while earnings increased 7%.

Profitability

Returns on equity and assets have steadily improved since 1997, and are now among the industry's best.

Financial Health

With more than $1 billion in debt, the company is fairly leveraged. However, it should be able to generate more than $300 million in free cash flow this year to help pay off debt.