Debt-laden Yellow Pages searches for growth

If CEO Marc Tellier wants the company to survive, he will have to convince consumers to click their way online

Susan Krashinsky, Globe and Mail Friday, Oct. 16, 2009

Ask Marc Tellier for evidence that the Yellow Pages is moving into the future, and he'll mention two words you'll rarely hear in this order any more: carbon paper.

Several years ago, not long after Mr. Tellier took up the post as CEO at the directories publisher, the company launched a project to streamline the categories in the print book. Not surprisingly, advertising under “carbon paper” had evaporated. So, nearly half a century after Xerox started selling its first photocopiers, Yellow Pages finally deleted the heading for carbon paper from the computer system that organizes some 400,000 different advertisers selling thousands of different products and services. New categories were added – sushi restaurants, for example, and tattoo parlours.

For the 41-year-old executive, this is proof that the fat books of business ads his company drops on millions of Canadian doorsteps are still relevant to younger consumers in a digital era. “Which demographic is getting tattoos? It's typically not your mother and mine,” he says. “The print book is generating tons of leads ... Tattoo parlours are seeing a growth in usage.”

The trouble is that while those advertising groupings are relatively new, the story is not. Mr. Tellier has been using the same line about tattoo and sushi to audiences in the financial community for years, part of his campaign to persuade Bay Street that Yellow Pages Income Fund is not at all on the same downward trajectory of many newspapers, magazines and other print media.

For a time, investors bought that idea. Mr. Tellier, the son of Paul Tellier, legendary former chief executive officer of Canadian National Railway Co. and Bombardier Inc., was a corporate star. He made the list of Canada's top 40 under 40, led the largest initial public offering ever for a Canadian income trust, and saw his own net worth rise significantly.

But that halo has now gone the way of carbon paper. Print advertising everywhere is down, of course: The Canadian Newspaper Association reports that ad volume has fallen almost 17 per cent since the start of this year, and many magazines are also suffering from double-digit declines. In July, a U.S. company that tracks ad revenue forecast that by the end of 2009, revenue for all U.S. media would see the worst advertising declines since the Great Depression.

Yellow Pages' 2.3-per-cent drop in the first half of this year seems minor by comparison – except for the fact that the company is carrying $2.5-billion in long-term debt, much of it added during the glory years to make acquisitions. While some paper boats are sinking, Mr. Tellier is trying to keep a heavy vessel afloat, managing a century-old company whose main product is a clunky paper directory that stakes its entire existence on the number of ads it can sell.

“The credit crunch drove home that what the market used to consider a reasonable level of debt maybe isn't so reasonable,” says Leslie Lundquist, an investment manager with Franklin Templeton Investments and an expert on income trusts. The $400-million Bissett Income Fund that she manages has held Yellow Pages since its IPO in 2003.

As credit markets tightened, management tried to comfort investors by insisting it would not cut its distribution to unitholders until at least 2011, the deadline to shift to corporate status or face a new tax on income trusts imposed by the federal government on Halloween night in 2006.

Christinne Muschi for The Globe and Mail

A worker looks through a directory in a reference room of Yellow Pages Montreal offices.

“The implication was they may not even have to cut the distribution in 2011,” Ms. Lundquist says. So it came as a surprise when a 30-per-cent cut was announced last May, taking the payment down to 80 cents per unit annually. “There were a lot of people who felt management said one thing and did something else. Investors hate that.”

Ms. Lundquist says her fund is a long-term holder of Yellow Pages because they believe the company's business outlook is still good. But she admits the unexpected nature of the distribution cut has left her somewhat uncertain if it could happen again.

Now, as Yellow Pages approaches the third anniversary of Finance Minister Jim Flaherty's surprise crackdown on income trusts, its stock price has tanked. Mr. Tellier is forced to change his previous strategy of buying growth through acquisitions – most notably the 2005 purchase of SuperPages for $2.55-billion, a deal that gave Yellow Pages an effective monopoly on the directory business in Canada with a market share of more than 90 per cent in most places.

Some analysts suggest it is now nearing zero-growth territory, which will make that debt harder to handle.

“They've tried to manage the transition by consolidating the industry across Canada ... all that's gone now,” says ***Neeraj Monga***, an analyst with ***Veritas Investment Research*** who has been forecasting Yellow Pages' demise for years.

The consensus seems clear: The future is online. If Yellow Pages wants to stay on its feet, the walking fingers brand will have to convince consumers' digits to click their way to its Internet directories. With the rising popularity of smart phone applications, to be truly competitive they'll have to get people's thumbs involved too. It won't be easy.

“The Googles of the world, the Yahoos of the world, local search engines, bigger brands branching out, I don't believe Yellow Pages can sustain itself,” ***Mr. Monga*** says.

David and Googliath

No less a voice than Bill Gates was already ringing the Yellow Pages death knell in May of 2007, at a Seattle conference. “The Yellow Pages are going to be used less and less,” Mr. Gates said. “Yellow Pages usage among people, say, below 50, will drop to zero – near zero – over the next five years.”

It's a long way from that now. But Yellow Pages must make its presence felt online. So far, it has done well. It launched the popular Canada411.ca in the late '90s, and has geocoded all its listings, a process that records the latitude and longitude of addresses so they're easily placed on online maps and GPS.

Staying on top of that technology smoothed the way for Yellow Pages to mark a number of X's on ubiquitous Google maps. The vast majority of Canadian local listings on Google – the dotted map that comes up when you search “bar Calgary,” for example, or “grocery Charlottetown” – are powered by Yellow Pages, Mr. Tellier says. “We're the ones who have the content.”

Google has had access to that content since 2004. Two years ago, Yellow Pages began reselling AdWords ads, which allow clients to pay to have their ads pop up when certain keywords are punched into Google.

Mr. Tellier has a cliché name for this relationship: “co-opetition.” Google gains access to content and sells more ads; Yellow Pages gives its advertisers a bigger Net presence. It's hardly a deal that rakes in cash, Mr. Tellier admits, but he says it has value in the exposure it provides his clients.

“Yes, in a sense, we're fuelling the competitor by allowing their users to get a satisfactory experience. But the flip side is, we also benefit in the relationship we strike with the merchant.”

Yellow Pages has been fighting to keep up with the digital transition, and it's way ahead of other directories of its kind. Its smart phone applications are very popular, among the top-rated for the BlackBerry and iPhone. Other well-used local search apps, like Poynt and Layar, power their results with Yellow Pages listings.

“Whether he's got the best search engine out there is irrelevant. He's going to get all the eyeballs at the end of the day, and ... continue to get pricing power,” says David Lambert, an analyst with Canaccord Adams who is recommending Yellow Pages units to investors. “People will develop apps ... As a merchant I'm going to continue to advertise on Yellow Pages because I know I'll show up on these apps.”

The online side of Yellow Pages still accounts for less than one-fifth of the business. It could reach 20 per cent by year's end if management's guidance is correct. But the question isn't whether Yellow Pages' Internet presence is growing; it's whether it's growing fast enough to make real money. On the Web, no one holds a monopoly. As is the case with newspapers and magazines, it's far from certain whether the Web will be enough to compensate for Yellow Pages' print losses.

John Morstad for the Globe and Mail

Marc Tellier, CEO of Yellow Pages Canada.

The writing on the Facebook wall

And Yellow Pages faces a threat from another dot-com behemoth: Facebook. Social media is chipping away at the directory's credibility, click by click.

Getting noticed in the Yellow Pages has never been as easy as ABC. While businesses are listed alphabetically in each category, priority has always gone to those with the most generous budgets. Simply put, it's a book of ads with no quality measure aside from who can pay for the biggest, most colourful slice of the page. That's a problem for some.

“There's a trust issue,” says Niraj Dawar, a professor of marketing communications at the University of Western Ontario's Ivey School of Business. “Consumers much prefer to get information from other consumers who are like them. Other sources of information, advertising in particular, are considered partisan.”

That wasn't bad for Yellow Pages as long as people were just talking to their neighbours over the backyard fence. But now, social media has made it easy for consumers to swap stories and recommendations on public forums. Word of mouth spreads faster than ever before. Traffic to consumer review pages, like those on Chowhound.com, a forum for foodies, is driven by that sense of trust.

“Word of mouth is how we market ourselves,” says Janis Cousyn, the owner of Calories, a popular restaurant in Saskatoon with mentions on the Chowhound site. “More and more, people are not using paper, but are using the Internet. That's where it's going.” But Marc Tellier argues that's not enough. “You can't run a business on word-of-mouth alone,” he says.

“In some categories [the shift to online] is going to happen in two or three years. In others it's going to take 30 years ... I would have lost all my hair at the ripe old age of 41 if I believed a lot of what we'd been reading in terms of the pundits – you know, print is dead and so forth. It's not true.”

Many observers disagree. Much as he would like to, Mr. Tellier can't separate himself from declines in the rest of the print industry.

Newspaper classifieds are declining, and that bodes ill for Yellow Pages, Benjamin Mogil of Thomas Weisel Partners said in a research note last week. Things look especially grim for the Trader part of Yellow Pages' business, which focuses on classified publications, many of them in print. AutoTrader was hit especially hard with the decline in car sales last year and the proliferation of free online listings.

Monopoly matters

Yellow Pages' grip on the such a huge share of the Canadian directories business puts him in a better position than the similar companies in the U.S., which was fragmented into a number of smaller players battling for market share. In the spring, two major publishers filed for bankruptcy, unable to carry the debt on their books amid plunging ad sales.

Mr. Tellier's acquisitions in the middle of the decade has allowed him avoid this kind of fragmentation. There is some competition from the likes of Vancouver-based Canpages Inc., but so far it's a bit player. Still, Canpages CEO Olivier Vincent says it's only a matter of time. He'll compete through online innovation and by attacking Yellow Pages' quasi-monopoly prices.

“They were generating 60 per cent profit margins,” Mr. Vincent says. Once clients realize they've been paying too much, he argues, they'll look to other options.

Mr. Tellier admits Yellow Pages costs as much as 80 per cent more than some competitors.

“You know what? We are charging more than the other guy,” he says. “But look at the number of calls we're generating...You get what you pay for.”

But will they pay for it? Mr. Tellier may not be losing his hair worrying about a decline in his business, but even he can't deny that with looming competition and huge online growth, Yellow Pages has work to do – and an adjustment to make, to the inevitable loss of its monopoly as the business goes digital.

“You're seeing fragmentation of a medium that was a unique medium. There's nothing Yellow Pages can do about it,” says ***Neeraj Monga***. “It's a secular change.”

Making the sale

The last time Marc Tellier used his directory was three weeks ago.

“Air duct cleaners,” he says, flipping the tissue-thin pages of the book on his boardroom desk. Finding someone to clean your ducts, the cost comparisons, the scent of newsprint – none of this is sexy, he admits. But it works.

“Could I have solved that problem on Facebook? I don't think so,” he says. “This is a growth industry ... The business is remarkably healthy.”

Now he'll just have to convince investors of that fact, make them believe his book isn't a dinosaur on the brink of extinction. That could be the toughest sale of all.