Peter Cox's plans to "Save Fairfax"

I am standing for a position on the Fairfax Media board at the AGM and the chairman Roger Corbett is opposing my nomination. Fairfax urgently needs media experience and knowledge and a fresh approach to save this once-great company

My goals as a director, if elected, will be to develop policies for Fairfax that offer the greatest value accretion to shareholders at the lowest risk.
It is my belief, explained in more detail in the accompanying report, that the

1. Operating segments are largely in mature, low growth businesses with growing competition and diminishing returns
2. The metro and regional newspapers, broadcasting stations, New Zealand media businesses and Trade Me (New Zealand) have little in common and require different skill sets, marketing and resources
3. They are geographically spread, have diverse products with low synergistic benefits and can be operated independently of each other or sold individually
4. The board strategy of moving from print to digital has unrealistic commercial objectives for online services that are already a mature product with high penetration and low yields
5. The SMH and The Age need to be repositioned editorially to meet target socio-economic markets to maximise readership, circulation and advertising revenue
6. The Financial Review, and other products, need to maximise the monopoly profits of specialisation in niche markets with international syndication and lower costs
7. Consideration needs to be given to the sale or merger of regional newspapers within Australia and also in New Zealand that can provide deep tissue connectivity into local communities
8. The poorly performing disparate broadcasting stations are losing share and should be sold individually to best attract buyers and gain the greatest total realized value
9. The existing digital transactions segment is mature, small and has low growth EBIT despite being subsidized by related party marketing. With limited upside potential sale could be considered
10. The Metro digital online business is low growth with no profitability and expectations are based on false assumptions. In contrast to the Chairman's claims the business is not fast growing and the optimism that Mr Corbett holds for digital seem to be unfounded
11. The realization of non-core assets such as Regional media, New Zealand Media, Trade Me, Digital transactions and radio stations will reduce debt, improve profitability and increase shareholder value

The board has made a number of disastrous decisions over the last decade (my Ten Deadly Sins of Fairfax) that have destroyed shareholder value. In the last three years the rate of decline in circulations, ratings and advertising revenue has accelerated threatening the future survival of the company.
I have attached some of my workings to demonstrate the veracity of my proposals. However, one really needs access to the detailed management figures to be more definitive.
Your support of my election would send a clear message to the board, shareholders and the market that the major shareholders are prepared to take action to change the policies of the board to maximise shareholder value.

My ultimate goal is to save Fairfax as a leading Australian media company.
It's time for urgent action.

About me

I have been a leading media economist and analyst in Australia for more than 30 years and have provided advice to Australian and overseas operators, technology suppliers, bankers, stockbrokers, the Senate and the Government. I bring to the Fairfax Media board a unique set of qualifications and skills as a media economist to evaluate the cyclical threats and opportunities facing the media industry. Further, I provide extensive experience and expertise in preparing and evaluating media business models.

I have consulted on new disruptive technologies and new media in Australia from the introduction of commercial FM in the late 70's to satellite transmission, Pay TV, broadband and digital. I bring to the board experience in disintermediation and meeting the challenges of technological and structural changes in media.

Independent expert advice on the Australian media industry has also been provided to private equity funds and investment banks in the US, the UK and Asia. I bring to the board expertise in evaluating the financial requirements of lenders and investors in media companies.

I have been invited to be chairman or speaker at more than 70 media industry conferences and have written numerous papers and articles.

At the newspaper industry PANPA conference in 2008 I warned that the newspaper model was broken – a position later confirmed by Rupert Murdoch but denied by Fairfax.

My concern about the number of poor strategic decisions made by Fairfax Media led me to attend the 2009 AGM and to write the chairman warning of the threats facing Fairfax and offering my media experience to the board. I was rebuffed without any consultation and the board was to subsequently appoint a number of new directors with no media expertise.

The Fairfax Media share price has fallen by 90% from its peak in 2007 causing a reduction in market capitalization of up to $5 billion which has been borne by the 35,000 shareholders of the company and by millions of Australians with superannuation funds invested in Fairfax.

I believe I can offer media experience, digital understanding, independence and credibility to the board. I am completely independent, will agree to meet all corporate governance requirements and have no other board or committee commitments which would prevent me from devoting whatever time and effort is needed to the Company.

There are no quick fixes and I would take a collegiate approach to add to the collective knowledge of the board.

Please do not hesitate to call me with any questions and I would welcome the opportunity to meet with you to discuss my proposal and your views on Fairfax Media.

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Introduction to Cox's Plan for Fairfax

I have looked at all the Fairfax reporting segments in detail and drawn a number of conclusions that are outlined in my accompanying letter and highlighted here.

1. Operating segments are largely in mature, low growth businesses with growing competition and diminishing returns
2. The metro and regional newspapers, broadcasting stations, New Zealand media businesses and Trade Me (New Zealand) have little in common and require different skill sets, marketing and resources
3. They are geographically spread, have diverse products with low synergistic benefits and can be operated independently of each other or sold individually
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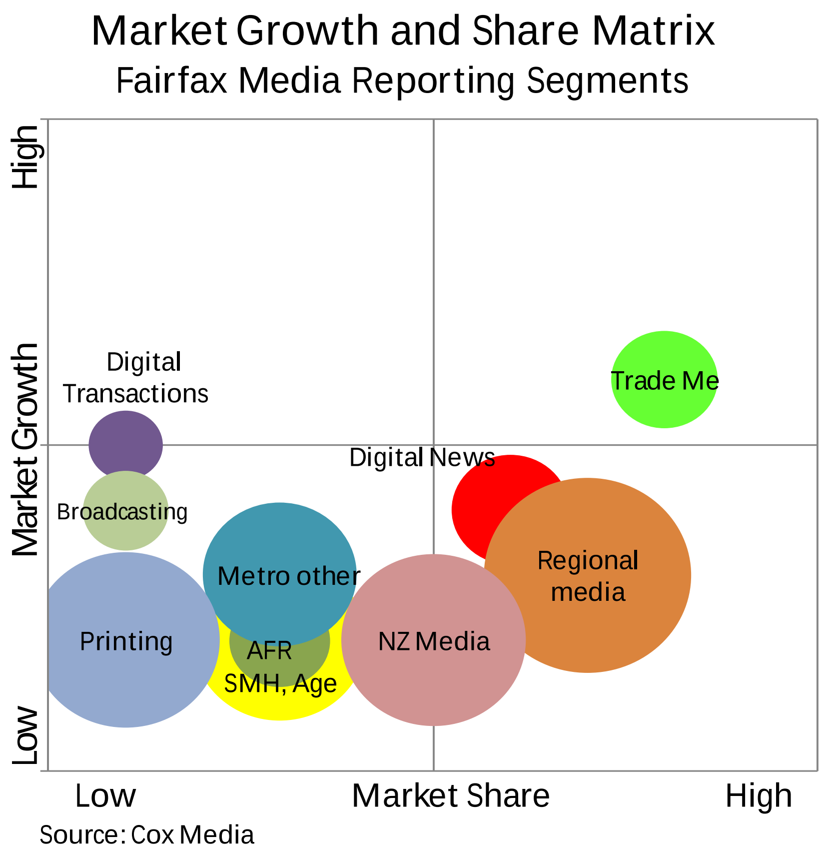
10. The Metro digital online business is low growth with no profitability and expectations are based on false assumptions. In contrast to the Chairman's claims the business is not fast growing and the optimism that Mr Corbett holds for digital seem to be unfounded.
11. The realization of non-core assets will reduce debt, improve profitability, increase shareholder value and allow consideration of diversification into higher growth businesses

I have chosen to provide more detail on several of these segments because the Chairman has emphasized their importance to the company but on which I have a number of reservations.

Also it enables me to demonstrate different types of analysis of which the methodologies can be applied to all the businesses.

Firstly, I think it is of value to see where the Fairfax business segments sit in a typical BCG Matrix analysis.

The size of the bubbles reflects the revenues of the businesses and I have made assumptions about the Market share and the Market growth of each of the businesses. Undoubtedly these assumptions are arbitrary and a range of numbers could be argued but these estimates are made from figures available on growth in recent years and from my long experience in building media business models.



The predominant factor is that most are low growth and as I write later even Digital Transaction and Online News have limited growth potential to me.

Regional Media and New Zealand Media are declining cash cows with high market shares with some protection from structural challenges but this is mostly temporary. Trade Me has been a star but already has a high market share in a flat New Zealand market.

Printing is basically an in house function that Fairfax intend to rationalize by closing Tullamarine at substantial cost. Printing for outside parties is a highly competitive low margin business.

The decision that needs to be made is which businesses if any should be kept as core assets, what realized value could be achieved from selling the non-core businesses and could the proceeds be better used to reduce debt and increase the market capitalisation of the business to shareholders.

Fairfax Metro Media

What I have demonstrated is that Fairfax did not protect themselves against structural changes in the industry by diversifying into new higher growth industries as Murdoch did with movies, Pay TV and cable networks. Fairfax actually operated in denial of these changes over a long period doubling up their investment in mature low growth and increasingly competitive markets.

Fairfax have not identified their political and socio-economic markets and pursued a suitable editorial strategy to exploit the market. As a result Fairfax has lost market share and News Ltd have increased their share and dominance. The financial aspects I have not written here in detail but I am willing to discuss. Let me just say that without a highly questionable, and in my opinion inappropriate, reallocation of $100 million in costs from the newspapers to the online digital segment the metro newspapers would barely have made a break even EBITDA.

Metro Digital Transactions

I have highlighted the fact that the major Fairfax digital transactions business of RSVP and Stayz were bought in 2005 and have had seven years to flourish but are in low growth highly competitive markets which are unlikely to experience high growth in the future

Metro Digital Online

In this case I look at the financial figures presented by Fairfax and question the assumptions on digital measurement. It has been operating since 1997, has high penetration but according to Fairfax still loses money and has no viable business model for the future. Unfortunately the hype and expectations of the Chairman in the 2012 Annual Report seem unrealistic and unfounded again.

Fairfax Broadcasting

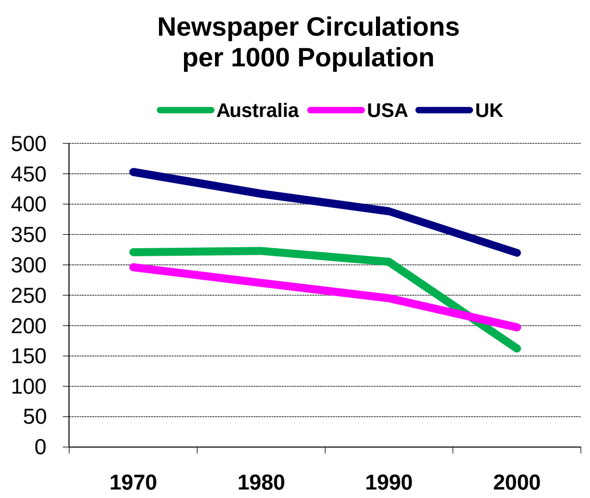
Here I have examined in some detail the difficulties of the industry, the particularly inappropriate formats and demographics of the stations, their poor ratings and financial performance and their valuation scenarios for the future.

Trade Me, New Zealand Media and Regional Media

It is not my intention to go into further details here at this time on the Trade Me, New Zealand Media and Regional businesses except to note that I do not believe that any of these businesses are essential integrated core assets of Fairfax. As a result the board should consider the alternatives of selling these assets or perhaps merging with competitors to achieve synergistic benefits.

Fairfax Metro Media

The problem of falling circulations and readership has been occurring for a long period. In my presentations to conferences and clients beginning in 1993 one of my first charts listed all the evening newspapers that had closed down due to the impact of the television evening news.



A second slide I used was from the US, and updated with my data for Australia, demonstrating the decline in newspaper circulation per capita and the same trend was occurring in Australia.

Therefore it was a surprise when Fairfax announced in 1998 that they were going to spend over $200 million on expanding the printing plant at Chullora and building a state of the art new plant at Tullamarine in Melbourne. At the same time Fairfax under Fred Hilmer was promoting its new free websites in competition to its own paid for printed newspapers.

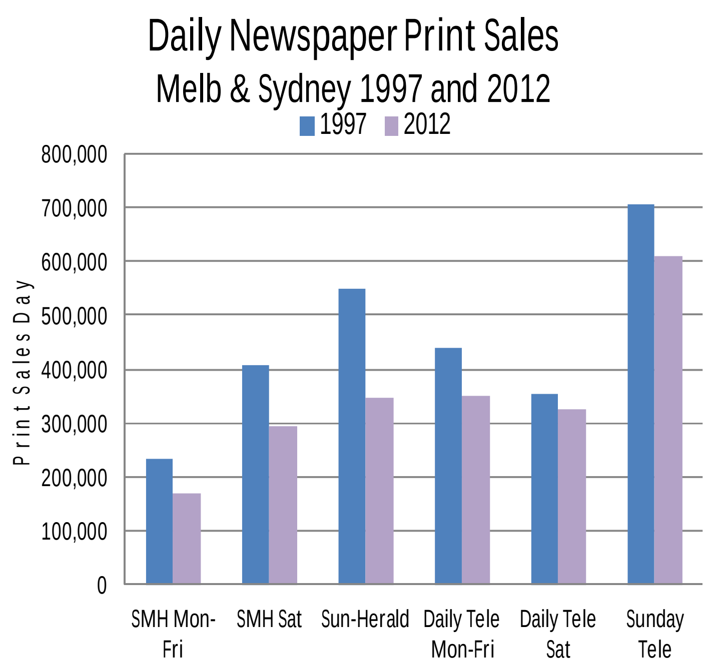
I started recording circulations in 1997 and below is a comparison of the major metro circulations between 1997 and 2012.

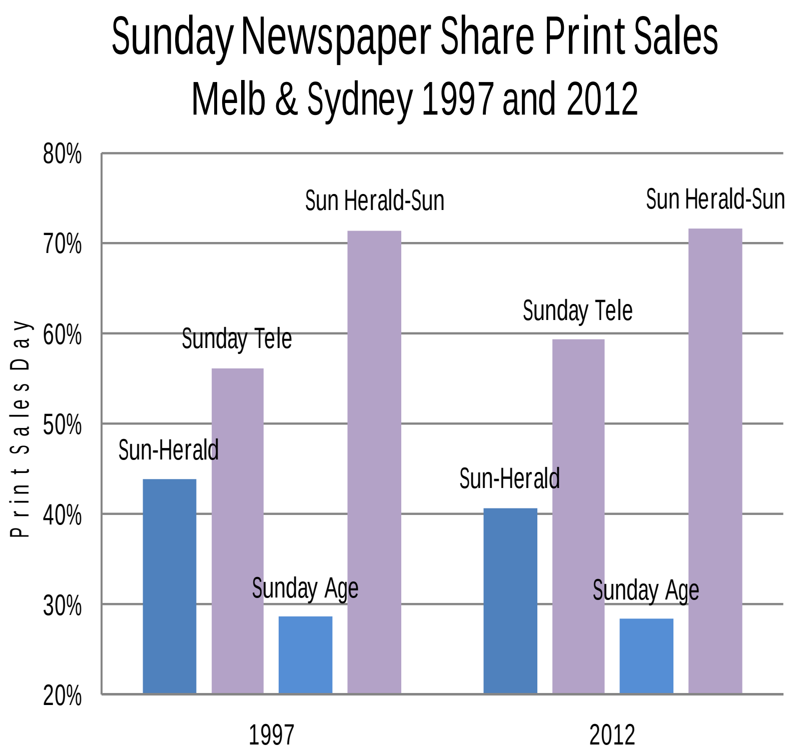
The circulation of the Mon-Friday editions of the SMH have fallen 27% since 1997 and the “Rivers Of Gold” Saturday edition has fallen 28%.

During this period the population has grown by 22% resulting in circulation per head falling by about 50%.

The Saturday edition of The Age has fallen by 33% since 1997 whilst its competitor the Herald –Sun only fell by 12%.

The Daily Telegraph in Sydney fell by 20% on week days and by 8% on Saturdays.





A major problem lays in the Sunday papers with their highly valuable advertisement filled colour inserts which are of increased importance since the demise of the Fairfax Saturday classifieds. The Sun-Herald has fallen by 37% and The Sunday Age by 5%.

As we can see all newspapers have lost circulation but the Fairfax papers substantially more than the News Corp papers.

As a result the News Corp Sunday Telegraph has increased its share to 59% well ahead of the Fairfax Sun-Herald share of 41%.

The Sunday Age has a 28% share in Melbourne compared to the Sun-Herald with a share of 72%.

In conclusion News Corp has limited the reduction in circulations far better than Fairfax and as a result has increased its market share dominance over Fairfax.

The question is whether the editors and journalists have relatively underperformed over a long period at Fairfax or have the board and senior management not pursued the right socio-economic target market or political agendas. Or is it the fault of both groups.

Editorial position

Under editor Adrian Deamer in the late 60s, The Australian was the darling of the Left, strongly opposing Vietnam, and it became the favourite of academics. However, over time it moved to the right where today it is very right wing opposing climate change, the NBN and Prime Minister Gillard. Murdoch has always taken a pragmatic approach to political favouritism around the world favouring both Thatcher and Blair when about to win power.

On the other hand The Age was liberal from the Syme family takeover in 1856 until Graham Perkin’s editorship supported Gough Whitlam. After Perkin’s death The Age supported the Fraser liberal government until the signing of editorial independence in 1966 and the purchase by Fairfax in 1972 it swung back to the left. Fred Hilmer in his memoirs wrote that he struggled to cope with the left leaning editorial culture at the SMH and The Age where journalists saw themselves as advocates and Fairfax's position was to turn left and be agenda driven." Again in Sydney the SMH had been a conservative newspaper but supported Labor at the 2007 and 2010 Federal Elections.

The problem is that in Australia both major parties have moved to the right particularly under the Keating government and then the Howard government where the aging population have become increasingly concerned about financial security, health, housing, environment, crime and immigration.

The chart of distribution of Sydney metro seats in the 2010 Federal election shows that the coalition won the City and Inner West, the Eastern suburbs, North Shore and the South. The share of real estate advertisements in the SMH is dominated by the City, East and Inner West with 60% and Northern beaches 35% all liberal electorates. Yet the SMH is left leaning in contradiction to the conservative nature of its markets.

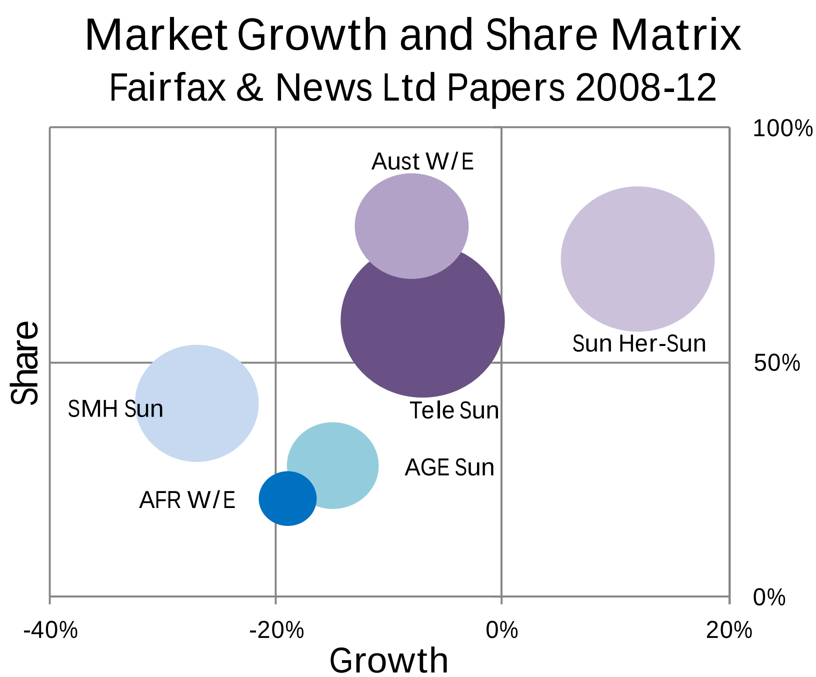
There are hardly any listings in the upwardly mobile Hills districts, the Shire or the West to the Blue Mountains. The SMH does not seem to be attracting property ads from the aspirational blue collar markets as labor moves towards the conservative side of politics.

The average post war margins average only about 4% as the Labor party finds that its traditional left wing union support evaporates and struggles to find a core identity in an increasingly conservative population.

News Ltd has put Fairfax in a pincer movement with the Herald-Sun having a 72% share in Melbourne compared to The Age with 15-17%. The Telegraph in Sydney with 60% share dominates the SMH with 40% taking the lower demographics.

On the other hand The Australian also owned by News Ltd has a 65-79% share of the national market to only 21-36% share for the AFR and dominating the higher socio-economic market.

Fairfax has ended up losing out in both markets in the two cities.



News Ltd has far better exploited this shift in social and political trends gaining market share at the expense of Fairfax with left leanings in a conservative world. Hilmer at least understood the editorial mismatch but lost the ideological fight, Corbett has fought for the editorial independence approach and Fairfax has paid the price.

On a more practical level the CEO in his 2012 Report says “removing ineffective circulation channels from the SMH and The Age that offer no value to advertisers whilst maintaining readership market share” means we have been overstating the circulation. Our calculations find the difference between the claimed circulation and the posted revenue is very substantial which could raise concerns by advertisers on the price they have been paying based on circulation and hence readership. This could have commercial and legal implications.

Future Considerations

Paywalls

Unfortunately, the history of Fairfax, and others, of providing free online news has conditioned the readers expectations to not pay for news. There are numerous pay wall experiments going on around the world including in Australia and it is far from conclusive that this will provide sufficient revenue to replace lost circulation revenue even after the reduction in printing and distribution costs. I am not going to list these tests in length here but though I am an advocate of pay walls I think they may provide a limited revenue opportunity.

Fairfax needs to examine the different styles of pay walls including the freemium models from offering certain no of pages free before paying for access to more in depth coverage, payment for individual stories to paying for the whole service. The Australian have some stories open but most are behind a pay wall and so far they have been slow to disclose the number of subscriptions indicating a slow take up. The Herald- Sun in Melbourne offers full digital access for $2.95 a week, weekend papers + digital for $5 a week ever day newspapers + digital for $8.95 a week. The Australian offers a similar deal. Despite the pay wall the circulation for the Herald-Sun fell by less than the Fairfax publications in 2012.

The basic subscription to Crikey.com is actually more expensive at $3.80 per week but has a subscription base of fewer than 20,000 compared to the circulation of The Australian of 130,000.

However, the success of Crikey and the recent sale of Business Spectator/Eureka Report for up to $30 million with their low cost base demonstrates that there is a market for specialist papers.

Business Spectator with 400,000 unique browsers a month poses a threat to the AFR in the future, particularly now that it is backed by Murdoch. The Business Spectator group employs 43 people in comparison to the Financial Review with about 275. There are stockbrokers in Sydney who produce over 100 pages a day of research with only a few staff.

In the media industry I receive for free online everyday media specialist papers including Mumbrella, B&T, AdNews plus aggregated news services from Google and a leading media agency and there are others. I am sure you get newsletters in your industry.

The Financial Review online is $13.60 per week or $680 a year. The Wall Street Journal in comparison costs only $4.87 per week or $253 per year in Australia. The price of the Financial Times is highly confusing but seems to be between $5-6 per week. The FT sales online freemium service now outnumber those in print and with 300,000 subscribers sales are half of the FTs revenue. The basic free service with a limited amount of content has 4.3 million registered users which demonstrates the low conversion rate to a paid service. The WSJ and FT have increased sales in the first half of this year.

There are several conclusions we can draw from this including:

1. The SMH and The Age need to better identify their core market and deliver a product that meets the social and political aspirations of that market
2. This realignment of product and market will increase the level of support from existing or past readers, widen the readership into areas of Sydney that have been underserviced in the past and increase circulation, digital or print, and grow the advertising base
3. Editorial needs to win back market share from News Ltd in Sydney on week days and Sundays and in Melbourne at The Age on all days
4. Consideration needs to be given to pricing combinations including free and whether to print on week days
5. What were the recommendations of both the Bain and McKinsey reviews and how do their recommendations relate to the sudden decision for restructuring of June 18 to fire 1900 staff and establish pay walls?
6. Need to determine the true circulation numbers and prices as the calculation of claimed circulation and revenues differs by up to 50% from the reported circulation revenues for the SMH and The Age. Could there be recourse for advertisers to claim make good contracts or legal liability and how does this affect claimed yields for print versus digital?
7. The financial records need to be examined to determine the fair allocation of costs between print and digital as it is important to the allocation of resources and the value of the businesses
8. A senior editorial executive has claimed that the worst of the job losses is over at Fairfax and yet the accounts only show a low proportion of the costs and savings have been incurred so far.
9. His desire to return to “old fashion story telling” seems to indicate an unrealistic editorial approach to that needed for a modern 24/7 news world
10. There is a big difference between the “pull” strategy of marketing as well exploited by Google and the “push” strategy necessary to provide advertisers the means of reaching mass audiences
11. If the metro mastheads are to be financially viable and retained the printed weekend editions are essential to retain the 60 plus pages on Sundays for example

Australian Financial Review

12. There is a market for specialist niche publications for which some people will pay as demonstrated in both Australia and overseas and Fairfax needs to target these markets
13. The AFR needs to substantially reduce its staff and costs to be competitive with low cost online competitors
14. The pay wall is overpriced and more aggressive pricing is needed to increase subscribers
15. Financial news is now a global online product and the AFR needs international syndications as The Australian has done with the WSJ for both domestic protection and international content

Finally, in the Fairfax Media 2012 Annual Report the CEO Greg Hywood says ”we remain committed to print for as long as it remains profitable.” As we show later Print would not have been profitable without a special reallocation of $100 million in costs to digital.

Metro Digital Transactions

Fairfax have considerable expectations for the Digital transaction business in the future but we have some reservations.

Fairfax Metro Digital Transactions

	2011	2012
Metro Digital transactions		
Advertising	7.1	8.3
Transactions	52.8	66.0
Total Gross Revenue	59.9	74.3
Costs	33.0	42.9
EBITDA	26.9	31.3
EBIT	24.7	25.2
Funds Employed 2011	144.0	
ROCE %	18%	
ROCE $M	25.9	

Metro Digital Transactional business revenue grew by 24% in 2012 to $74.3 million but off a fairly low base. Costs allocated to the business increased by 30% and EBITDA by 16.4% to $ 31.3 million. Depreciation and Amortisation were doubled to $6 million, which seems a lot, and EBIT only rose marginally to $25.2 million.

The financial presentation in 2011 highlighted that a ROCE of 18% was earned on Capital Employed of $144 million. ROCE is normally calculated on net operating profit after tax which means the results may be slightly exaggerated.

However, the concern lies with the fact that the major businesses are fairly mature and highly competitive. The estimates on the right are purely subjective guesses and though may be out individually are correct in total.

Estimate Metro Digital Transactions by Business

2012 Estimates $M	Revenue	EBITDA	Margin
RSVP (2005)	30	13	43%
Stayz (2005)	22	10	45%
Weatherzone (2008)	7	3	43%
Others (2006-2011)	15	6	40%
Total Transactions	74	32	43%

RSVP was acquired in 2005, has a very large penetration and No 1 share of the market with little potential growth. Stayz also was bought in 2005 and had strong growth in 2012 with a new online payment system. It operates in a highly competitive market which itself is under pressure. Presumably both businesses have benefited over the last seven years from the cross promotional opportunities from the newspapers and online sites.

As a result it would appear that market awareness and penetration should have been largely achieved by now and exponential growth is unlikely in the future. Tenderlink, which was acquired in 2010, had growth in revenue of 11% in 2012 off a low base and may be affected by any cutbacks in related outside and online Government print advertising. Other digital businesses include APM (2006), Commerce Aust (2006), InvestSmart (2007), OMG (2008) and Occupancy (2011). Most of these are quite old, must each be fairly small for a total revenue of about $15 million and not showing strong signs of future growth.

In conclusion, Digital transactions are a non-core relatively small business with substantial related party marketing support with few signs of dynamic growth in the future. Using an EBITDA multiple if 10x then the enterprise value could be valued at $300 million to a buyer who also had a cross promotional base.

Metro Digital Online

In 2012 Fairfax have laid out the business segments slightly differently to the past and have adjusted the reported figures for online in 2011. There was a small reallocation of $14 million revenue presumably to some other business segment.

Reconstruction of Fairfax Online Financial results
In 2012 Fairfax adjusted the previous figures for 2011

Online					
$M	2009	2010	2011	2011 Adj	2012
Revenue	186.7	212.4	234.2	220.5	251.8
Costs	95.9	101.4	115.9	216.0	233.4
EBITDA	90.8	111	118.3	4.5	18.4
Margin	49%	52%	51%	2%	7%

In the previous years costs were approximately half of revenue resulting in a 50% margin, fairly typical for an online business. However, Fairfax have decided to double the costs allocated to online by $100 million. It is believed that Fairfax thought this was a more appropriate allocation of costs from the print business to the online business in particular for journalists and news content onto the online sites. This is the equivalent of allocating an additional one thousand journalists at $100,000 a year to online.

This seems an inexplicable and ridiculous charge against online. The effect was to reduce online EBITDA from $118 million to only $4.5 million. The real advantage of course was to make the metro newspapers appear profitable rather than break even or perhaps a loss at the EBITDA level before allocating interest, depreciation, amortization or tax.

Metro Digital Online Proforma by Fairfax excluding Digital Transactions businesses

$M	2011	2012	Change
Digital			
SMH, AGE			
Advertising	138.0	154.1	12%
Other	22.5	24.5	9%
Total Gross Revenue	160.5	178.6	11%
Costs	183.0	190.5	4%
EBITDA	-22.5	-11.9	-47%
EBIT	24.7	25.2	

Fairfax have provided a proforma schedule in the Investor briefing of 23 August 2012 for Metro Digital that includes online classifieds, Aust news and transaction sites.

Elsewhere in the document they also provide a separate breakout of the Digital transactions business which when subtracted from the proforma leaves a strange outcome.

The outcome is the reallocation of costs leaves the digital transaction business with an EBITDA of $31 million and the online business a loss of $11.9 million.

Even if this is not the exact picture Fairfax was trying to tell it demonstrates inconsistent and illogical financial reporting.

It also raises the question whether there was some attempt to artificially reallocate costs and profits for other objectives.

The big question is whether the news online sites have the potential to replace the lost circulation and advertising revenue from the printed newspapers.

Unfortunately we do not have a historical record of the circulation and advertising revenue for each of the SMH, The Age and the AFR. However we do have the CEASA figures for total metro newspaper advertising for many years. In 2004 metro newspaper advertising was 24% of all advertising and this proportion had fallen to 14% by 2011 and the decrease is accelerating. Over the last five years from 2007 total metro advertising has fallen $440 million from $2.342 billion to $1.9 billion. Classifieds have fallen 37% from $941 million to $592 million in the same period. As the Age, SMH and the AFR alone account for 50% of total metro advertising the majority of the losses have come from Fairfax.

In the last year Fairfax metro print advertising revenue has fallen by $118 million and metro digital advertising has increased by $16 million, a ratio of 7:1. This is typical of international losses where digital advertising gain only replaces 10-15% of print advertising lost.

However, Fairfax is highly enthusiastic that the future lies in digital growth.

Digital Measurement

I have been studying television ratings since 1976 and am on an industry research committee and despite a long history of accepted detailed measurement using established electronic panels I have concerns over their accuracy and reliability. I find that there is still great confusion in understanding this complex area including by senior executives in the industry.

I have also studied newspaper circulation and readership research for many years and have even more concern for their accuracy. Circulations have been boosted by free handouts at hotels, airports, universities and other places though the industry is trying to reduce this practice. A comparison of the claimed circulation of Fairfax metro papers shows a huge disparity with the circulation revenue received.

I also have concerns with the multiple of circulation used to determine readership which appears to be excessive in comparison to market observations over the years.

So when we come to the new area of online measurement where we are struggling to agree on measurement techniques and reporting procedures I believe great caution should be used.

Fairfax is arguing that the number of people reading or viewing its sites are at a record level justifying their belief in the future. The measurement they are using is UBs (unique browsers) however this is a very unreliable measurement. Nielsen measured 115 million UBs for the month of March 2011 for a country with a population of only 22 million people which is obviously impossible.

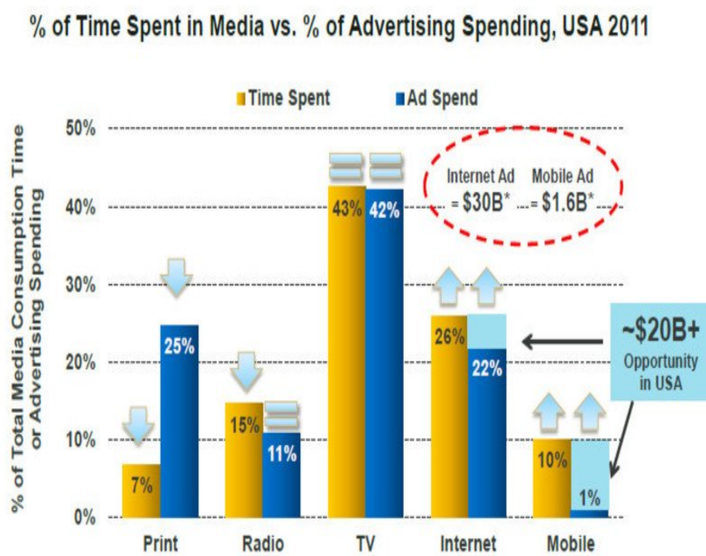
Fairfax claim that UBs are growing at 15% with 3.0 million UBs for July 2012 for the SMH, Fairfax claimed in March 2008 that the UBs for smh.com.au were 4.2 million a substantial loss of viewers over 4 years. Though this seems illogical Fairfax's most recent figures show a decrease in video plays on a service with supposedly far more viewers and a much improved video service.

Time Spent Viewing

Unique browsers in theory should be the equivalent of Reach in TV or radio, how many non-duplicated people viewed your service. However, it is a measure of sampling not how much people used the service. The time spent reading the printed paper is not well measured but research in Australia, the UK and the US seems to be 25 minutes and upwards. In comparison the average time spent reading online is about one minute a day meaning that the growth of online only provides a fraction of the time lost from printed readers.

Online penetration

The number of unique browsers to the SMH and Sun-Herald of 3 million a month, even with some readers from other areas, is already over 50% of the NSW population aged 18+.



The number of mobiles, phone apps and tablet apps useage is growing but from a low base and with unrealistic number of page views.

As 75% of news readers are aged over 35 the penetration of the target population is already very high with limited potential for the future.

The chart shows the disproportionate level of advertising spending in newspapers in the US compared to other media, in particular the internet and mobile. There is the same potential for the newspaper industry to lose further market share in Australia.

CONCLUSION

The Chairman in this year's 2012 annual report says "we know that our digital businesses are going to become increasingly more significant in terms of the overall revenue mix...we believe we have very good reason to be confident about this fast growing part of our business"

As you have seen above the digital transaction business is mature, small and with low growth EBIT.

The Metro digital online business is low growth with no profitability and expectations are based on false assumptions.

In contrast to the Chairman's claims the business is not fast growing and the optimism that Mr Corbett holds for digital seem to be unfounded.

Fairfax Broadcasting

Peter Cox has had a long standing interest in the radio industry since 1979 when he was CEO and founding Managing Director for the building and establishment of 2DAY-FM in Sydney, one of the most successful radio stations in Australia. He subsequently was a Director of Associated Communications Enterprises for nearly ten years as it expanded into acquiring regional radio stations and wrote two seminal papers published in the Australian Financial Review and Australian Business in the 1980s "Concern over profitability of radio" and "Did Wesgo overreach itself?". Peter also wrote a valuation of a radio station for a bank that later became one of Fairfax's stations. Here is his brief synopsis on the Fairfax Broadcasting situation.

The Radio industry has a number of characteristics including:

- Radio is a mature, low growth business facing cyclical and structural challenges
- Radio advertising revenue faces increasing competition from the internet for advertising and from new distribution technologies
- FTA multichannels have increased advertising inventory, with lower prices aimed at niche markets and increasingly competitive rates to radio
- Radio ownership is highly concentrated between the Macquarie Radio Network, Australian Radio Network, DMG, Southern Cross Austereo and Fairfax Broadcasting
- These networks are highly competitive with professional management
- Common programming formats provide cost efficiency from national networking
- Largely aimed at demographics aged 18-54 that appeal to advertisers
- Music stations are more suited to the FM band
- The two station rule often prevents these networks from buying additional channels

Chart 1

Fairfax Broadcasting Metropolitan Radio Stations
Share of Ratings Survey 6 2011 and 2012

Metro Market	Station		Format	Aud Age	Rating (Shr of all stations in market) 2011	2012	Pt Chge 2011/2012	% Change 2011/2012
Sydney	2UE	AM	Talk	55+	6.0	4.9	-1.1	-22%
Melbourne	3AW	AM	Talk	55+	16.9	16.2	-0.7	-4%
	Magic	AM	Easy listening	55+	5.7	5.1	-0.6	-12%
Brisbane	4BC	AM	Talk	55+	7.9	6.0	-1.9	-32%
	4BH	AM	Easy listening	55+	5.0	5.9	0.9	15%
Perth	6PR	AM	Talk	55+	11.5	9.1	-2.4	-26%
	96FM	FM	Rock Music	18-54	10.0	10.4	0.4	4%

Source: Nielsen Ratings and Commercial Radio Australia Survey 6 2011 and 2012

The Fairfax radio stations have particular weaknesses including:

- The Fairfax stations are performing poorly with nearly all in the bottom half of the ratings with the exception of 3AW in Melbourne
- 2UE comes 10th of 14 stations in Sydney and 2nd last of the commercial stations
- Magic comes 8th of 14 in Melbourne and 2nd last of the commercial music stations
- 4BC and 4BH come 7th and 8th out of 12 stations in Brisbane and 4BH comes last of the commercial music stations
- 96FM and 6PR come 5th and 6th of 11 stations in Perth and 6PR is second last of the commercial music stations
- Magic and 4BH are music stations broadcasting on the AM band which is very difficult
- Five Fairfax stations have lost market share in Survey 6 of 2012 compared to the previous corresponding survey in 2011, 6PR in Perth is marginally higher and 4BH in Brisbane is up on a low base and the poorest rating station outside of 2UE in Sydney
- The Fairfax stations are a mix of different formats-talk, easy listening and rock with no synergy and requiring differing management skills
- Talk shows do not syndicate well between different cities with no economy of scale
- The easy listening stations appeal to 55+ audience which is less attractive to advertisers
- The talk stations also attract an older demographic aged 55+
- 3AW is the one very successful Fairfax station but talk stations are expensive to operate, employ highly paid stars and support staff and difficult to maximise profit
- 2UE has all the expenses of a talk station but with low ratings operates at a considerable loss
- Difficult to sell the stations as a group because the major potential Australian radio buyers already have two stations in a market
- All stations except 96FM in Perth have lost market share in the last two years
- Few or No synergistic benefits with other Fairfax businesses
- Distracting to Fairfax corporate management and the board

Chart 2

Fairfax Broadcasting Metropolitan Radio Stations
Parity Projections for Revenue and Ratings Share - Survey 6, 2012

Market	Station		Format	Aud	Place in Market	Stations / Market	Ratings Share	Total Com Shr	Station Com Shr	Adv Market Yr	If Adv Shr =rat Shr*
Metro				Age	No	No	%	%	%	$M	$M
Sydney	2UE	AM	Talk	55+	10	14	4.9	62.5	8%	209.3	16.4
Melb	3AW	AM	Talk	55+	1	14	16.2	69.0	23%	204.9	48.1
	Magic	AM	Easy listening	55+	7	14	5.1	69.0	7%	204.9	15.1
Brisbane	4BC	AM	Talk	55+	8	12	6.0	65.4	9%	109.6	10.1
	4BH	AM	Easy listening	55+	9	12	5.9	65.4	9%	109.6	9.9
Perth	6PR	AM	Talk	55+	6	11	9.1	61.9	15%	90.7	13.3
	96FM	FM	Rock Music	18-54	5	11	10.4	61.9	17%	90.7	15.2
Total	7 stations									614.5	128.2

*Advertising share will be less than rating share for easy listening stations, 3AW will get premium, 2UE penallty
Source: Nielsen Ratings and Metro Market Advertising Revenue from Commercial Radio Australia

- The above chart demonstrates that revenue of about $128 million that would be obtained if Fairfax achieved advertising share in line with ratings share in a perfect world
- The actual 2012 Fairfax radio revenue was $93.1 million
- Fairfax radio underperformed by 27% and were $36 million under their pro-rata potential revenue
- These calculations are only indicative without the financial figures for each of the stations.
- 3AW would definitely over index on revenue and presumably 2UE would underperform and certainly on profitability
- The easy listening stations will have lower revenue than postulated due to +55 audience demo

Valuation

- It was reported at the time that Fairfax paid between $480 million and $520 million for the Southern Cross Broadcasting radio interests in 2007 including narrowcast licences and Satellite Music Australia. This was in addition to the 8 regional stations that Fairfax owned.
- The deal included the Southern Star TV production business for $112 million which Fairfax quickly sold on for a loss of $39 million
- The resultant price for the SC radio assets was about $370 million and Fairfax has subsequently sold the regional stations and SMA for an undisclosed sum but presumably not more than $20 million
- The EDITDA earned by the radio assets was $25.9 million in 2009 on revenue of $112 million placing an EBITDA multiple on the radio acquisitions of about 14 times
- By 2012 the EBITDA of Fairfax radio had declined to $13.9 million with revenue and profits continuing to fall

Fairfax Radio Valuation Scenarios

	$ Millions		
All Stations	Low	Med	High
EBITDA $M	10	14	20
EBITDA Multiple			
4	40	56	80
6	60	84	120
Exclude 2UE losses	5	10	15
EBITDA Adj	15	24	35
EBITDA Multiple			
6	90	144	210
8	120	192	280

- A trade sale multiple of 4-6x could be expected to value the radio assets at between $40 million and $120 million, a loss of up to $300 million
- However, if 2UE was closed or sold and the losses of say $5-15 million per year were eliminated then EBITDA would be more like $15-35 million and the EDITDA ratio could improve to 6-8 times valuing the assets at $90 million to $280 million
- Unfortunately at the low end the cash flow received would do little to reduce the Fairfax net debt of $912 million and total debt of $1.2 billion but on eliminating 2UE losses the proceeds could make a substantial reduction in the overall debt level
- The danger is that profits will continue to deteriorate as in the low scenario further reducing the value of the group

The Peter Cox plan

- The Fairfax stations are largely poorly performing and losing market share despite a specialist radio executive, Michael Anderson, being appointed to the board in 2010 to provide radio expertise
- The radio stations offer no synergistic benefits to Fairfax, are consuming of resources and not necessary to the core Fairfax business
- The Minister should be lobbied to achieve a lifting of the two station rule to provide a market from the other Australian radio networks
- DMG and Clear are both international companies that have entered the Australian radio market and recently the Bauer group from Germany have made an offer for the ACP magazine group
- Interest should be sought including from international media groups looking for expansion and regional operators
- The sale of individual stations should be considered to maximise the value of the group
- The more attractive 96FM station in Perth could be expected to be sold in Western Australia at a EBITDA multiple of at least 7x

- The second placed talk station in Melbourne or Sydney has traditionally run at a substantial loss and the situation is unlikely to improve for 2UE unless they outlaid substantial sums to buy Jones and Hadley off 2GB which will not happen and even if it did would not deliver substantial profits
- 3AW should be sold while it is on top of the ratings and attractive to a buyer such as Singleton's MRN group for whom it has extra value
- The most likely option is to sell 2UE or close it down, reducing losses and improving group EBITDA and enterprise value
- The easy listening music stations should be run as a highly automated and networked group or sold individually or collectively
- Fairfax should exit the radio business and use the funds to reduce debt and protect the viability of the company
- It is believed that Singleton offered up to $200 million for the group which may be difficult to achieve in the current market
- Fairfax directors Greg Hywood and Michael Anderson claimed the stations were "terrific media businesses" and went with a new strategic plan which would not appear to be working in the ratings at this time as most stations have lost rating share, profitability and value