

Heard on the Street: New beginning for newspapers?

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By Joseph T. Hallinan and Joe Hagan, The Wall Street Journal

A potential sale of Knight Ridder Inc. might be the first shoe to drop in the long-talked-about consolidation of the newspaper industry.

If so, somebody better deliver the news to prospective buyers. There don't seem to be many out there, at this point.

Knight Ridder's biggest shareholder, Legg Mason Inc.'s Private Capital Management LP, this week called for the sale of the San Jose, Calif., company, the nation's second-largest publisher of daily newspapers by total circulation, behind Gannett Co. In a letter to the company's board, PCM Chief Executive Bruce Sherman said that Knight Ridder has determined that its breakup value far exceeds its stock price, and that directors should "aggressively pursue the competitive sale of the company." PCM owns a 19 percent stake in the company.

Some analysts and investors suggest that the pressure could finally stimulate consolidation across the beleaguered industry. "I think it could be a catalyst," says John Miller, a portfolio manager for Ariel Capital Management LLC, which owns large stakes in newspaper companies, including Tribune Co. and McClatchy Co.

Along with steel, autos and airlines, daily newspapers would seem to be yet another mature U.S. industry that is prime for consolidation. Analysts are increasingly pessimistic about the prospects for growth as advertising revenue continues to move online. Stocks of many newspaper companies now trade near multiyear lows.

But as Knight Ridder's stock jumped 8.7 percent after Mr. Sherman's demand became public Tuesday and continued to rise moderately Wednesday to \$59.08 a share on the New York Stock Exchange, industry observers scratched their heads about who might want to buy the company, or even parts of it. For one, Prudential analyst Steven N. Barlow -- who has Knight Ridder shares rated "neutral" -- says he sees "few, if any, potential buyers."

The stock prices of other newspaper companies also rose Wednesday, including shares of New York Times Co. and Dow Jones & Co., publisher of The Wall Street Journal. Dow Jones, which like the New York Times company is family-controlled, has been the subject of takeover speculation in recent months. Dow Jones declined to comment.

Knight Ridder did not comment on Mr. Sherman's demand. But the company appears amenable to discussing the possibility.

In Mr. Sherman's letter, he said he addressed directors in July about his concerns about the company's stock price -- at the invitation of Knight Ridder CEO Tony Ridder, who holds 1.9 percent of the company. Full ownership of the Ridder family isn't disclosed in the company's proxy, but no member of the Knight or Ridder families is listed as owning more than 5 percent.

Conventional wisdom holds that Gannett, the largest newspaper company, might be a good suitor for Knight Ridder. Others think a consortium of private-equity investors is more likely, since newspapers are considered cheap, but remain good cash-flow vehicles that would help finance a leveraged buyout. Some think a new-media company such as Yahoo Inc. or eBay Inc. might be interested.

Newspapers still dominate local news and advertising in many markets. That could attract a company such as Yahoo, which has moved increasingly into original content and would like to develop its local reach. Meanwhile, Google Inc. has expressed interest in entering the classified-ad market, where newspapers have deep relationships and continue to play a dominant role. Knight Ridder is part-owner of CareerBuilder Inc., the online classified Web site that competes with Monster.com.

"We don't comment on rumor or speculation," says Brian Nelson, a spokesman for Yahoo. A Google spokesman also offered no comment.

"You're potentially opening up a Pandora's box in the (leveraged buyout) world, and the debate rages on about what these things are worth," says Douglas Arthur, a newspaper analyst for Morgan Stanley. Mr. Arthur has a "buy" rating on the stock, and Morgan Stanley has a business relationship with Knight Ridder. "I think they're cheap; most people don't." He figures the situation will "test" the value of local media, where newspapers still dominate. "The gauntlet has been thrown down."

Pieces of Knight Ridder, which publishes 32 dailies in 29 markets, might attract some buyers. Gannett, for instance, might look at Kentucky's Lexington Herald-Leader, which would complement its papers in Louisville, Ky., Cincinnati and Indianapolis. McClatchy, based in Sacramento, Calif., might like the nearby Contra Costa Times and Knight Ridder's papers in the Carolinas, where McClatchy also has papers.

But Knight Ridder's larger papers are the ones buyers are most likely to balk at. These papers, like those at many newspaper companies, are dragging down the company. Big-city papers have taken it on the chin as urban advertisers and readers have defected to the Internet. Knight Ridder has distressed papers in Philadelphia, Miami and San Jose, Calif. Circulation in those markets is falling, and big advertisers such as department stores are consolidating.

Lately, some of the most successful newspaper companies have stayed in the newspaper business by getting out of it. Washington Post Co. and E.W. Scripps Co., for instance, have both diversified into other industries. The Post bought the Kaplan Inc. educational-preparation business, and Scripps got into cable television with HGTV and other

ventures. Post stock is up nearly 40 percent in the past five years, and Scripps has risen about 60 percent.

In a filing with the Securities and Exchange Commission, Mr. Sherman said PCM, based in Naples, Fla., has been investing in Knight Ridder since April 2000. That looked smart as shares rose to almost \$80 and Mr. Sherman built up a stake of nearly 19 percent of the company's shares. But the stock price has fallen more than 30 percent in the past two years.

Mr. Sherman has arguably become the single-most-important investor in the newspaper industry. Private Capital -- which was founded by him in 1986 and became a wholly owned subsidiary of Legg Mason in 2001 -- owns large amounts of stock in nearly all publicly traded major newspaper chains, including 37 percent of McClatchy, 23 percent of Belo Corp., 23 percent of Lee Enterprises Inc. and 13 percent of New York Times.

Yet he has until now remained largely in the background of these companies.

"We have had very little contact with PCM," says Dan Hayes, spokesman for Lee Enterprises. McClatchy Chairman and CEO Gary Pruitt says Mr. Sherman "has been a good, supportive long-term shareholder" who hasn't been active in the management of the company. "I don't have a sense of what his (investment) criteria are, what he's looking for, goals ... he has never shared that with me."

In his letter, Mr. Sherman warned Knight Ridder's board that if it doesn't go along with his proposal, he will "strongly consider supporting more aggressive efforts." He has declined to be interviewed.

It is difficult to determine what price Knight Ridder might fetch, either in whole or in pieces. A reasonable valuation range for newspaper companies is between 11 and 13 times earnings before interest, taxes, depreciation and amortization. That would put Knight Ridder's price in a range of \$70 to \$100 a share. But few observers expect the company to fetch that much, given the dim outlook for the industry and Knight Ridder in particular.