

Fairfax Media

(FXJ.AX / FXJ AU)

Rating	OUTPERFORM*
Price (26 Aug 08)	2.98 (A\$)
Target price (12M)	3.85 (A\$)
Market cap:	4,792 (A\$m)
Year avg. monthly trading value	529 (A\$m)
Last month's trading value	616 (A\$m)
Projected return:	
Capital gain (%)	29.2%
Gross yield (%)	10.0%
Total return (%)	39.2%
Excess return** (%)	11.7%
52-week price range (A\$)	2.64-4.95

* Stock ratings are relative to the relevant country index.
** Relative to market. (see disclosure appendix for full description of CSEA rating system.)

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COMPANY ANALYSIS/UPDATES

Shifting gears

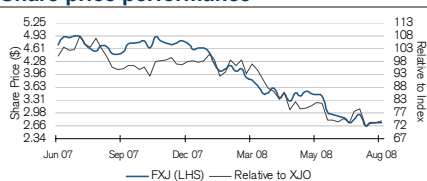
- **Event:** Fairfax Media has announced that it has embarked on a program that will result in a head count reduction of 5% or 550 full time employees. The program is expected to deliver around \$50mn in annualised savings with \$25mn forecasted to flow into the FY09 financial year. FXJ expects to book a once-off charge of around \$50mn for redundancy and associated costs.
- **View:** We view this as a significant gear-change for FXJ and one will redefine the company culturally and financially in the medium to long term. Our proprietary research on the Australian research sector has revealed FXJ's metro mastheads as laggards among their peers when it comes to editorial productivity levels. This came with the territory of being premium broadsheets but in our view needed to change with the structural shifts taking place in the sector. But our research shows that a reduction of staff numbers does not necessarily have a negative impact on editorial quality.
- **Outlook:** We have incorporated an additional \$20mn in cost savings in our forecasts for FY09F, having already factored in an expectation for cost savings from redundancies at Fairfax New Zealand which has been more advanced in its adoption of new production technology and practices.
- **Valuation:** Our DCF derived target price remains unchanged at \$3.85 per share. We maintain our Outperform rating. At the current price, FXJ is trading at a 12% discount to the broader market.

Figure 1: Earnings revisions

	CS FY09F			CS FY10F			CS FY11F		
	Old	New	Ch %	Old	New	Ch %	Old	New	Ch %
NPAT (\$mn)	407	413	1.3%	446	465	4.3%	484	498	2.8%
EPS Pre-GW (¢)	27	27	1.3%	29	31	4.3%	32	33	2.8%
DPS (¢)	22	22	0.0%	24	25	4.2%	26	26	0.0%

Source: Company data, Credit Suisse estimates.

Share price performance



The price relative chart measures performance against the S&P/ASX 200 index, which closed at 5007.50 on 26 Aug 08. On 26 Aug 08 the spot exchange rate was A\$1.15/1\$/US\$1

Performance	1M	3M	12M
Absolute (%)	1.4%	-13.1%	-32.2%
Relative (%)	-0.1%	-1.9%	-18.1%

Financial and valuation metrics

Year to Jun 30		06/07A	06/08A	06/09F	06/10F	06/11F
NPAT	\$mn	251.2	378.1	412.7	464.7	497.8
Credit Suisse Profit*	\$mn	251.2	378.1	412.7	464.7	497.8
Credit Suisse EPS*	c	23.2	25.0	27.3	30.7	32.9
EPS Growth*	%	-5.4	7.6	9.1	12.6	7.1
P/E*	x	12.8	11.9	10.9	9.7	9.1
Relative P/E*	%	109.3	90.2	87.5	84.5	85.1
Dividend	c	20.0	20.0	22.0	25.0	26.0
Div Yield	%	6.7	6.7	7.4	8.4	8.7
Franking	%	100	75	75	75	75

Source: Company data, ASX, Credit Suisse estimates. * Adj. for goodwill, notional interest and unusual items. Relative P/E against ASX/S&P200 based on pre GW in AUD. Company PE calculation is based on displayed EPS currency

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Figure 2: Financial summary

FAIRFAX MEDIA LIMITED

	Year ending 30 Jun				
Profit and loss (\$mn)	2007A	2008A	2009F	2010F	2011F
Sales revenue	2,111	2,901	3,022	3,172	3,290
EBITDA	568	822	891	966	1,005
Depr. & Amort.	94	108	115	116	115
Goodwill amort.	0	0	0	0	0
EBIT	474	713	776	850	890
Net interest	111	187	205	195	180
Profit before tax	363	526	571	655	710
Income tax	97	139	146	176	198
Profit after tax	266	387	425	478	512
Minorities	1	1	1	1	1
Equity adjustment	3	9	6	5	4
Net profit after tax	268	395	430	483	516
Preferred dividends	17	17	18	18	18
Net profit after tax	251	378	413	465	498
Unusual item after tax	-4	-16	-35	0	0
Reported profit after tax	247	362	378	465	498
Balance sheet (\$mn)	2007A	2008A	2009F	2010F	2011F
Cash & equivalents	366	94	94	94	94
Inventories	49	45	47	49	51
Receivables	409	499	520	546	566
Other current assets	1	17	17	17	17
Current assets	824	655	678	706	728
Property, plant & equip.	860	875	910	900	894
Intangibles	6,131	6,493	6,469	6,445	6,422
Other non-current assets	185	270	276	281	285
Non-current assets	7,176	7,638	7,655	7,627	7,601
Total assets	8,001	8,293	8,333	8,333	8,329
Payables	290	330	344	361	374
Interest bearing debt	2,348	2,512	2,395	2,219	2,037
Other liabilities	402	486	486	486	486
Total liabilities	3,040	3,328	3,225	3,066	2,897
Net assets	4,961	4,965	5,108	5,267	5,432
Ordinary equity	4,948	4,954	5,097	5,254	5,419
Minority interests	13	11	12	12	13
Preferred capital	0	0	0	0	0
Total shareholder funds	4,961	4,965	5,108	5,267	5,432
Cashflow (\$mn)	2007A	2008A	2009F	2010F	2011F
EBIT	474	713	776	850	890
Net interest	-91	-184	-205	-195	-180
Depr & Amort	94	108	115	116	115
Tax paid	-89	-136	-146	-176	-198
Working capital	-37	-60	-11	-14	-11
Other	14	-21	0	0	0
Operating cashflow	365	420	529	581	616
Capex	-80	-131	-127	-82	-86
Acquisitions & Invest	-582	-595	0	0	0
Asset sale proceeds	88	5	0	0	0
Other	-1	6	2	3	2
Investing cashflow	-575	-714	-124	-80	-83
Dividends paid	-176	-269	-270	-307	-333
Equity raised	0	77	0	0	0
Other	0	0	-18	-18	-18
Financing cashflow	-177	-192	-288	-325	-351
Net cashflow	-387	-486	116	176	182

Share Price: \$2.98 12-month target price: \$3.85

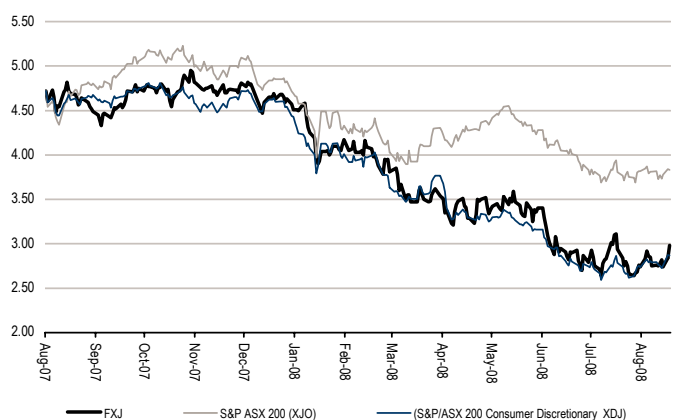
Financial summary		2007A	2008A	2009F	2010F	2011F
NPAT	\$mn	251	378	413	465	498
Credit Suisse NPAT	\$mn	251	378	413	465	498
Credit Suisse EPS	c	23.2	25.0	27.3	30.7	32.9
EPS growth	%	-5.4	7.6	9.1	12.6	7.1
P/E	x	12.8	11.9	10.9	9.7	9.1
P/Earnings Growth	x		1.1	1.1	1.3	1.0
Dividend payout ratio	%	86.2	80.1	80.7	81.4	79.1
Dividend	c	20.0	20.0	22.0	25.0	26.0
Yield	%	6.7	6.7	7.4	8.4	8.7
Franking	%	100	75	75	75	75
Operating CFPS	c	33.7	27.7	35.0	38.4	40.7
P/OCF	x	8.8	10.7	8.5	7.8	7.3
EV/EBITDA	x	12.7	8.8	8.1	7.5	7.2
FCF yield	%	8.8	6.4	8.9	11.0	11.8

Financial ratios		2007A	2008A	2009F	2010F	2011F
Profitability Ratios						
EBITDA margin	%	26.9	28.3	29.5	30.4	30.6
EBIT margin	%	22.5	24.6	25.7	26.8	27.0
Return on equity	%	5.1	7.6	8.1	8.8	9.2
Return on assets	%	6.2	8.7	9.4	10.3	10.8
ROCE	%	9.0	10.0	10.5	11.5	12.1
Effective tax rate	%	26.8	26.5	25.5	27.0	27.9

Balance Sheet Ratios		2007A	2008A	2009F	2010F	2011F
Net debt	\$mn	1981.4	2418.1	2301.6	2125.5	1943.4
Net debt/Equity	%	39.9	48.7	45.1	40.4	35.8
Net debt/Capital	%	28.5	32.8	31.1	28.8	26.4
Interest cover	x	4.3	3.8	3.8	4.4	4.9
Capex/Sales	%	-3.8	-4.5	-4.2	-2.6	-2.6
Capex/Depn	%	-0.8	-1.2	-1.1	-0.7	-0.7
Working capital/Sales	%	-1.8	-2.1	-0.4	-0.4	-0.3

Share Items		2007A	2008A	2009F	2010F	2011F
Equiv. FPO (period avg.)	mn	1082	1514	1514	1514	1514

Share price performance 52 week range: \$2.64 - \$4.95



Source: ASX, Company data, Credit Suisse estimates

Shifting gears

Fairfax Media has announced a far reaching business improvement program which we view as a real step change for the business.

The program will result in a head count reduction of around 550 employees or 5% of the full time workforce, saving FXJ \$50mn on an annualised basis by FY10F.

The company will book a once off charge in 1H09F of \$50mn from the initiative.

FXJ said these cost savings were over and above the \$45mn identified from the merger with Rural Press and \$8mn saved in the takeover of Southern Cross's radio and television production assets. The company confirmed that these cost synergies would be realised by the end of FY09F.

We estimate that \$25mn of the cost savings from this new program will also flow into FY09F with \$20mn from Australia and around \$5mn from New Zealand. The redundancies will result in around 130 editorial FTEs being made redundant in Australia and another 40 in New Zealand with the remaining 380 positions being culled from other parts of the business.

Figure 3: FXJ: proposed redundancies by editorial/non editorial

	FTE positions
Australian editorial	130
Australian non-editorial	260
New Zealand editorial	40
New Zealand non-editorial	120
Total positions	550

Source: Company data, Credit Suisse estimates

Long-term benefits

We believe this program will have far reaching and long-term benefits to FXJ, with the prospect of changing work practices and culture throughout the group. Proprietary research undertaken by Credit Suisse over the past four years has demonstrated what can be achieved with a smaller head count. Our recently published report, "*Credit Suisse's Editorial Productivity Index – What the pages tell us*" (23 July 2008) demonstrated that FXJ's two metro daily mastheads, *The Sydney Morning Herald* and *The Age* both lag their competitors, *The Daily Telegraph*, and *The Herald Sun*, and their premium broadsheet rival, *The Australian*, in terms of editorial pages produced per full time equivalent each week. This is despite improvements in 2008 on the prior study.

Figure 4: Editorial productivity levels by masthead (pages per editorial FTE per week)

Publication	2002/03	2004/05	2005/06	2006/07	2007/08
The Age	1.46	1.45	1.63	1.52	1.58
The Australian	2.02	2.00	1.80	1.81	1.91
Australian Financial Review	1.81	1.81	1.73	2.15	2.23
The Canberra Times	3.85	3.56	3.41	3.67	3.92
Daily Telegraph	2.15	2.19	1.66	1.74	2.21
Herald Sun				1.52	1.66
New Zealand Herald	2.17	2.57	2.33	2.64	2.94
Sydney Morning Herald	1.50	1.20	1.17	1.41	1.49
The West Australian	2.26	2.51	1.98	1.90	2.61
Average	2.15	2.16	1.96	2.04	2.28

Source: Credit Suisse estimates

Our report highlighted that *The Age* and *SMH* have consistently published a similar number of editorial pages to their premium broadsheet rival, *The Australian*, with respectively 25% and 20% more editorial full-time equivalents. We estimated that if FXJ were to reduce its editorial FTEs to that of *The Australian's*, around 130 FTE positions would be made redundant, saving the company an estimated \$17mn per year.

Companies Mentioned (Price as of 26 Aug 08)

Fairfax Media Limited (FXJ.AX, A\$2.98, OUTPERFORM, TP A\$3.85)

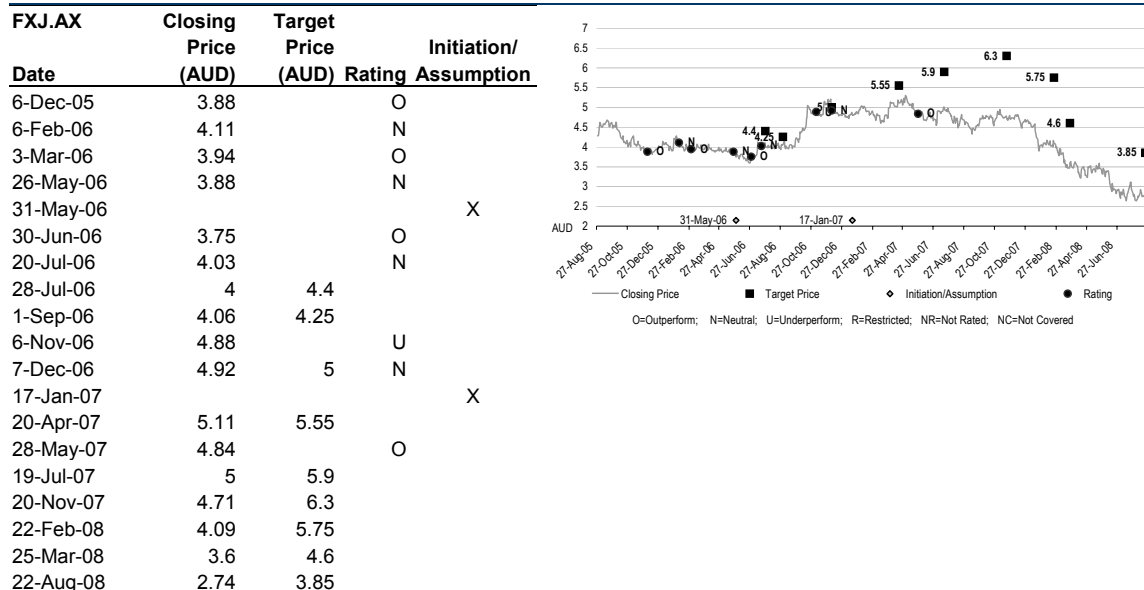
Disclosure Appendix

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See the *Companies Mentioned* section for full company names.

3-Year Price, Target Price and Rating Change History Chart for FXJ.AX



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Restricted	2%	

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Price Target: (12 months) for (FXJ.AX)

Method: We have set our target price on Fairfax Media (FXJ.AX) at \$3.85 a share to reflect our DCF valuation. We use a discounted cash flow (DCF) valuation to value FXJ at \$3.84 per share and this is arrived at using a weighted cost of capital (WACC) of 10.4%, a BETA of 1.0, a Risk Free Rate of 5.7%, a Market Rate of Return of 7.6%, and a terminal growth rate of 3.0%. We believe such a valuation best captures the long term cashflow benefits arising from the acquisition of RUP and SBC that it is the most appropriate valuation methodology for media assets given the cyclical nature of the business.

Risks: Our \$3.85 target price on FXJ.AX is predicated on the broader share markets not recovering significantly in the near term. Our target price also captures a marked downturn in advertising in 2009 in the metropolitan newspaper markets and a slowdown in regional advertising. We also have slows the pace of growth in online advertising. We believe we believe there is potential further downside risk should FXJ's management fail to extract the cost and revenue synergies that we anticipate can be extracted from the merger with RUP. There is also potential risk that the advertising market will weaken further than forecast. The recent acquisition of SBC's radio and TV production business also creates increased, albeit small, currency risk arising from the TV distribution business in the UK.

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