

Fairfax Media Limited

Announces Restructuring Program; Confirms Tough Industry Outlook

Consumer Discretionary | Media | Australia

Conviction list stock

Event:

- FXJ today announced a restructuring and redundancy (R&R) program in response to what CEO Mr David Kirk described as the "cyclical and structural challenges" facing the company. Key points:
 - FXJ will eliminate 550 positions or c.5% of its workforce.
 - The R&R program will deliver annualised cost savings of \$50m from FY10. Approximately \$25m of benefits will flow into FY09.
 - FXJ will book a "one-off" R&R charge of \$50m in FY09.

Key Take-outs:

- R&R program not a surprise:** In our view, the R&R program has been widely anticipated by the market given FXJ's comments at its FY08 result that it saw "further opportunities for cost reductions and continuous business improvement".
- R&R program confirms tough industry outlook:** The R&R program is FXJ's largest this decade (refer Exhibit 1 overleaf). In our minds, the R&R program's magnitude reflects the management team's recognition of the issues facing FXJ. Quite simply, in the face of challenging industry dynamics, FXJ has little choice but to: (1) grow online revenues; and (2) reduce costs and embark on restructuring programs.

Earnings and Valuation Impact:

- Since FY00, FXJ has undergone R&R programs every year except for FY03 and FY05 (refer Exhibit 1 overleaf). Thus, given the regularity with which FXJ announces R&R programs, our preference is to treat the \$50m charge as a cost of doing business in what is a structurally challenged industry, as opposed to treating it as a non-recurring item.
- Unfortunately, market practice dictates that we: (1) treat the \$50m as an NRI; and (2) take the benefits above the line. So, we have upgraded our forecasts to reflect the R&R program. This results in FY09-11 EBIT upgrades of 3-5% and FY09-11 EPS upgrades of 4-7%.

Investment View:

- No change to SELL recommendation or \$3.05 price target given:
 - Earnings risk:** We still see risk to FY09 consensus earnings forecasts.
 - Valuation:** At c.9x FY09 EBITDA, we continue to view FXJ as expensive given: (1) it is not trading anywhere near its historical floor valuation of 7.5x EBITDA; and (2) it is expensive compared with global peers. Moreover, we believe FXJ's 'real' FY09 EV/EBITDA multiple (i.e. taking the \$50m R&R charge above the line) is more like 9.5x FY09 EBITDA. We believe FXJ's multiples are unsustainable given the cyclical and structural headwinds facing the stock.

Christian Guerra | +61 3 9679 1302 | christian.guerra@gsjw.com
Owen Birrell | +61 3 9679 1217 | owen.birrell@gsjw.com

SELL

Key Information

Stock Code	FXJ
Share Price	\$2.98
12 Month Price Target	\$3.05
Expected 12M Total Return	9.1%

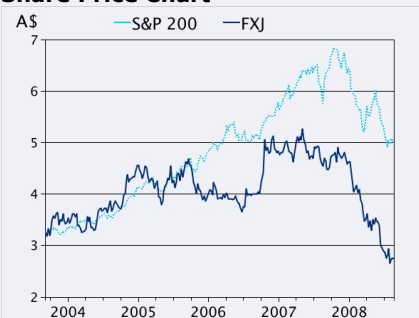
Investment Data

Issued Capital	1513.5m
Market Capitalisation	\$4510m
% of S&P 200 Index	0.4%
Free Float	87%
Turnover	\$523.9m/month
12 Month Price Range	499¢-257¢
Debt/Equity	47.5%

Investment Arithmetic

Jun year end	08A	09E	10E	11E
Net Profit Rep. (\$m)	369.7	349.1	410.2	448.7
NPAT Adj. (\$m)	378.1	349.1	410.2	448.7
EPS Adj. (¢)	25.1	23.1	27.1	29.6
EPS Growth (%)	8.7	-8.0	17.3	9.2
PER (x)	11.9	12.9	11.0	10.1
Relative PER (%)	-15.0	14.8	9.3	11.1
Dividend (¢)	20.0	20.0	21.6	23.8
Yield (%)	6.7	6.7	7.2	8.0
Franking (%)	75	80	85	90
FCFPS (¢)	17.9	21.9	27.2	30.0
P:FCFPS (x)	16.6	13.6	11.0	9.9
EV/EBITDA (x)	8.4	8.5	7.5	7.0
BV (¢)	308	310	315	322
P/BV (x)	1.0	1.0	0.9	0.9
Av. Full Dil. Shares (m)	1506	1513	1513	1513

Share Price Chart



Relative Price Performance

	1m	3m	12m
vs. S&P 200:	-4.3%	-5.1%	-21.8%
vs. MSCI - World:	-9.7%	-15.7%	-20.5%

Source: Company data, IRESS, and GSJBW Research estimates.

Further Details on FXJ's Restructuring Program

FXJ today announced a R&R program in response to what CEO Mr David Kirk described as the "cyclical and structural challenges" facing FXJ. Key points:

- Overview:** FXJ will eliminate 550 positions or c.5% of its workforce. The table below illustrates where the redundancies will come from.
- Cost savings:** The R&R program will deliver annualised cost savings of \$50m from FY10. Approximately \$25m of benefits will flow into FY09 (i.e. partial year benefit).
- Restructuring charges:** FXJ will book a "one-off" R&R charge of \$50m in FY09.
- Impact on product quality:** FXJ indicated that c.30% of the redundancies will come from editorial (with the bulk of the Australian redundancies coming from its metro newspapers). FXJ is confident: (1) the staff cuts in editorial will not affect the quality of its newspapers; and (2) the staff cuts in its Australian metro newspapers will not affect the newspapers' competitive positioning against rival News Limited. We are a little more circumspect. In our view, the company cannot undertake staff costs of this magnitude without affecting the quality of the product. The key question is whether or not Fairfax Media's readers will notice the difference. This is likely to be visible in circulation data over the coming 12-18 months.
- Industrial action:** FXJ is yet to discuss the R&R program with trade unions; it plans to do this as soon as possible. FXJ is not expecting industrial action as a result.

GSJBW CME RESEARCH FXJ - August 2008 R&R Program	Australia	NZ	Total	COMMENTS
Comprising:				
Head office	90	0	90	90 corporate office employees; all in Australia
Editorial	115	45	160	Australian redundancies largely in metro papers
Other	185	115	300	Production, printing, etc
Total redundancies	390	160	550	

Source: Company data, GSJBW Research estimates.

Exhibit 1: FXJ Restructuring Programs

The following table illustrates FXJ's NRIs since FY00. The table shows that FXJ has taken R&R charges as 'NRIs' every year except FY03 and FY05.

GSJBW CME RESEARCH FXJ - R&R Programs	Mkt Ticker	Act. FY00	Act. FY01	Act. FY02	Act. FY03	Act. FY04	Act. FY05	Act. FY06	Act. FY07	Est. FY08	Est. FY09
Goodwill impairment		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Masthead impairment		0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.7	0.0	0.0
Other asset impairment		24.9	3.2	0.0	0.0	0.0	0.0	0.0	17.3	-0.8	0.0
Restructuring & Redundancies		5.0	28.3	24.4	0.0	20.5	0.0	16.1	9.3	10.4	50.0
Fairfax Media	FXJ	29.9	31.6	24.4	0.0	20.5	0.0	16.1	30.3	9.6	50.0

Source: Company data, GSJBW Research estimates.

Exhibit 2: GSJBW FXJ Earnings Revisions

The following table summarises our earnings revisions. We are now forecasting cost growth of: (1) in Australian Publishing, +0.4% in FY09 and +1.3% in FY10; and (2) in NZ Publishing, +0.3% in FY09 and +1.5% in FY10.

	Consolidated EBIT (\$m)			NPAT (\$m)			EPS (¢)			DPS (¢)		
	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
F2008A	713.4	713.4	0.0%	378.1	378.1	0.0%	25.1	25.1	0.0%	20.0	20.0	0.0%
F2009E	672.4	690.4	2.7%	335.6	349.1	4.0%	22.2	23.1	4.0%	20.0	20.0	0.0%
F2010E	739.7	776.2	4.9%	382.6	410.2	7.2%	25.3	27.1	7.2%	20.2	21.6	6.9%
F2011E	789.6	825.4	4.5%	421.9	448.7	6.4%	27.9	29.6	6.4%	22.2	23.8	7.2%
CAGR (08-11)	3.4%	5.0%		3.7%	5.9%		3.5%	5.7%		3.5%	6.0%	
DCF Valuation (\$/share):				Old	New	% Chg.						
				3.40	3.40	0.0%						
Target Price (\$/share):				Old	New	% Chg.						
				3.05	3.05	0.0%						

Source: Company data, GSJBW Research estimates.

Financial Summary | FXJ

Profit & Loss (A\$m)					
Year to 30 June	2007	2008	2009E	2010E	2011E
Sales	2,110.7	2,900.8	2,966.9	3,110.9	3,263.7
Operating EBITDA	568.4	821.4	804.8	896.1	949.3
D&A	94.0	109.1	114.4	119.9	123.9
Operating EBIT	474.4	712.3	690.4	776.2	825.4
Other (Non operating items)	0.0	1.1	0.0	0.0	0.0
EBIT	474.4	713.4	690.4	776.2	825.4
Net interest expense/(income)	109.4	186.9	202.9	201.2	180.0
Pre tax profit (pre NRIs)	365.0	526.5	487.5	575.0	645.4
Tax expense (pre NRIs)	97.3	139.3	129.3	156.2	188.5
Minorities (after tax)	1.1	0.6	0.6	0.6	0.6
Consolidated NPAT	266.6	386.6	357.5	418.2	456.3
Equity accounted profit/(loss)	3.0	8.7	8.7	9.2	9.6
Preference dividends	19.7	17.2	17.2	17.2	17.2
NPAT (pre NRIs, pre IFRS) ⁽¹⁾	249.8	378.1	349.1	410.2	448.7
Non Recurring Items (after tax) ⁽²⁾	(4.3)	(8.4)	0.0	0.0	0.0
IFRS Adjustments ⁽³⁾	0.0	0.0	0.0	0.0	0.0
Rpt NPAT (post NRI, IFRS)	245.6	369.7	349.1	410.2	448.7
Reported EPS (post NRIs)	22.7	24.6	23.1	27.1	29.6
NET PROFIT (Adj.) ⁽⁴⁾	249.8	378.1	349.1	410.2	448.7
EPS (Adj.)	23.1	25.1	23.1	27.1	29.6
Sales Growth (%)	10.7%	37.4%	2.3%	4.9%	4.9%
Op. EBITDA Growth (%)	13.9%	44.5%	(2.0%)	11.3%	5.9%
NPAT (Adj.) Growth (%)	9.9%	51.4%	(7.7%)	17.5%	9.4%
EPS (Adj.) Growth (%)	(3.1%)	8.8%	(8.2%)	17.5%	9.4%
Op. EBITDA Margin (%)	26.9%	28.3%	27.1%	28.9%	29.1%
Op. EBIT Margin (%)	22.5%	24.6%	23.3%	24.9%	25.3%
D&A / Sales (%)	4.5%	3.8%	3.9%	3.9%	3.8%
Interest Cover - EBIT (x)	4.3	3.8	3.4	3.9	4.6
Interest Cover - EBIT ⁽⁵⁾ (x)	3.7	3.5	3.1	3.6	4.2
Tax rate (%)	26.7%	26.5%	26.5%	27.2%	29.2%
Return on Equity ⁽⁶⁾ (%)	5.4%	8.1%	7.4%	8.5%	9.1%

Cash Flow Analysis (A\$m)					
Year to 30 June	2007	2008	2009E	2010E	2011E
Operating EBITDA	568.4	821.4	804.8	896.1	949.3
Change in working capital	(52.1)	(46.0)	(4.5)	(9.8)	(10.4)
Other	26.8	(44.0)	0.0	0.0	0.0
Gross Cash Flow	543.1	731.4	800.3	886.2	938.9
Net interest paid	(88.8)	(184.3)	(202.9)	(201.2)	(180.0)
Tax paid	(89.1)	(136.2)	(129.3)	(156.2)	(188.5)
Presses dividends (FXJPA)	(19.7)	(17.2)	(17.2)	(17.2)	(17.2)
Operating Cash Flow	345.4	393.7	450.9	511.7	553.3
Maintenance capex	(88.7)	(115.4)	(120.0)	(100.0)	(99.1)
FREE CASH FLOW (pre Div's)	256.7	278.3	330.9	411.7	454.1
Dividends paid	(178.6)	(268.8)	(319.9)	(332.0)	(360.7)
Expansionary capex	0.0	0.0	0.0	0.0	0.0
Acquisitions	(581.8)	(594.9)	0.0	0.0	0.0
Asset sales	88.1	11.7	0.0	0.0	0.0
Dividends received	2.0	8.8	8.7	9.2	9.6
Share Issues/Repurchases	0.0	91.8	0.0	0.0	0.0
Other (FX Adj, etc.)	(1.1)	0.0	0.0	0.0	0.0
Inc. in Net Cash / (Debt)	(414.8)	(473.2)	19.8	88.9	103.0
Gross CF/Op EBITDA (x)	0.96	0.89	0.99	0.99	0.99
Maint. Capex / Sales (%)	4.2%	4.0%	4.0%	3.2%	3.0%
Total Capex / Sales (%)	4.2%	4.0%	4.0%	3.2%	3.0%
Maint. Capex / D&A (x)	0.9	1.1	1.0	0.8	0.8
Total Capex / D&A (x)	0.9	1.1	1.0	0.8	0.8
Maint. Capex / GCF (%)	16.3%	15.8%	15.0%	11.3%	10.6%
Growth Spend ⁽⁷⁾ (A\$m)	581.8	594.9	0.0	0.0	0.0

- (1) Reported NPAT (pre NRI, pre IFRS) is after PRESSES/SPS dividends
(2) NRIs include: profit/loss on asset sales/restructuring charges
(3) IFRS Adjustments include: asset impairment, derivative/hedging, pension schemes.
(4) Net Profit (Adj.) is before NRIs and IFRS adjustments
(5) Calculated as EBIT/(Net interest expense plus Preference dividends)
(6) ROE excludes preference capital
(7) Growth Spend represents acquisitions, investments & expansionary capex
(8) ROE Analysis looks only at consolidated businesses & ignores investments/associates
(9) Funds Employed includes gross property, plant and equipment
Source: Company Data; GSJBW Research estimates; IRESS

Divisional Analysis (A\$m)					
Year to 30 June	2007	2008	2009E	2010E	2011E
Sales					
Australia Publishing	1,422.6	1,958.8	1,930.3	2,002.9	2,066.3
New Zealand Publishing	501.3	508.7	461.4	469.6	496.3
Fairfax Digital	132.9	176.2	215.9	259.1	297.9
Trade Me	52.6	70.7	81.5	92.2	106.3
Radio	1.2	81.4	115.5	120.0	124.8
Southern Star	0.0	105.0	162.2	167.1	172.1
Total Sales	2,110.7	2,900.8	2,966.9	3,110.9	3,263.7
EBITDA					
Australia Publishing	326.1	510.0	475.6	529.6	544.9
New Zealand Publishing	160.8	164.2	143.5	152.0	159.7
Fairfax Digital	37.0	54.4	68.0	84.5	99.8
Trade Me	44.2	60.0	70.2	80.0	92.5
Radio	0.3	19.7	27.2	29.1	31.0
Southern Star	0.0	13.1	20.2	20.8	21.5
Total EBITDA	568.4	821.4	804.8	896.1	949.3
EBITDA Margin	26.9%	28.3%	27.1%	28.8%	29.1%

Balance Sheet (A\$m)					
Year to 30 June	2007	2008	2009E	2010E	2011E
Cash	366.3	93.9	93.9	93.9	93.9
Trade debtors	380.0	470.2	481.0	504.3	529.1
Inventories	48.5	44.8	45.8	48.0	50.4
Property, plant & equipment (net)	860.0	875.2	880.8	860.9	836.1
Intangibles	6,131.0	6,492.6	6,492.6	6,492.6	6,492.6
Investments	34.5	45.7	45.7	45.7	45.7
Other	180.1	270.7	270.7	270.7	270.7
TOTAL ASSETS	8,000.5	8,293.1	8,310.4	8,316.1	8,318.4
Debt	2,347.7	2,511.9	2,475.0	2,368.9	2,248.7
Trade creditors	276.9	317.5	324.7	340.5	357.2
Provisions	309.4	360.6	360.6	360.6	360.6
Other	105.4	137.7	137.7	137.7	137.7
TOTAL LIABILITIES	3,039.5	3,327.8	3,298.1	3,207.8	3,104.3
Equity reserves	3,906.7	3,839.2	3,839.2	3,839.2	3,839.2
Retained profits	748.2	822.0	868.4	963.7	1,068.9
Minorities	12.9	11.0	11.6	12.3	12.9
Preference capital	293.2	293.2	293.2	293.2	293.2
TOTAL EQUITY	4,961.0	4,965.3	5,012.3	5,108.3	5,214.1
Net Debt / (Net Cash) (A\$m)	1,981.4	2,418.1	2,381.1	2,275.1	2,154.9
Net Debt / Equity (%)	40%	49%	48%	45%	41%
Net Debt / (D+E) (%)	29%	33%	32%	31%	29%
Avg. Working Capital (A\$m)	151.6	197.6	202.1	211.9	222.3
Avg. Work. Cap./ Sales (%)	7%	7%	7%	7%	7%
D&A / PPE (net) (%)	11%	12%	13%	14%	15%
Debtors Turnover (days)	66	59	59	59	59
Inventory Turnover (x)	43	65	65	65	65
Creditors Turnover (days)	48	40	40	40	40

DCF Valuation			
	(A\$m)	(\$ps)	
PV of Cash Flows	6,957	\$4.60	RF: 6.5%
Mkt value of investment:	46	\$0.03	MRP: 6.0%
(Debt) / Cash	(2,418)	(\$1.60)	KE: 12.5%
Mkt value of SPS	(300)	(\$0.20)	KD: 4.6%
Mkt value of minorities	(6)	(\$0.00)	Beta: 1.00
Equity value	4,278	\$2.83	WACC: 10.2%
Value of franking credits		\$0.59	
GSJBW DCF Value:		\$3.42	
Shares on Issue (m)	1,513.5		

ROFE Analysis ⁽⁸⁾					
Year to 30 June	2007	2008	2009E	2010E	2011E
Operating EBITDA (A\$m)	568.4	821.4	804.8	896.1	949.3
Avg. Funds Employed ⁽⁹⁾ (A\$m)	6,140.5	8,133.3	8,323.8	8,441.0	8,550.7
ROFE (%)	9.3%	10.1%	9.7%	10.6%	11.1%
WACC (pre-tax) (%)	12.6%	12.6%	12.6%	12.6%	12.6%
ROFE Spread (abs.)	(3.3%)	(2.5%)	(2.9%)	(2.0%)	(1.5%)
Change in ROFE (abs.)	(2.9%)	0.8%	(0.4%)	0.9%	0.5%

Goldman Sachs JBWere Communications, Media & Entertainment Team:

Analyst: Christian Guerra	Telecommunications, Media	christian.guerra@gsjbw.com	+61 3 9679 1302
Analyst: Adam Alexander	News Corporation, Gaming	adam.alexander@gsjbw.com	+61 3 9679 1451
Assistant Analyst: Owen Birrell	Media	owen.birrell@gsjbw.com	+61 3 9679 1217
Assistant Analyst: Raymond Tong	Telecommunications, Gaming	raymond.tong@gsjbw.com	+61 3 9679 1359

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Australia - Research Recommendation Definitions

Sell (S)	Stock is expected to underperform the S&P/ASX 200 for 12 months
Hold (H)	Stock is expected to perform in line with the S&P/ASX 200 for 12 months
Buy (B)	Stock is expected to outperform the S&P/ASX 200 for 12 months

Other Definitions

NR	Not Rated. The investment rating has been suspended temporarily. Such suspension is in compliance with applicable regulations and/or Goldman Sachs JBWere policies in circumstances when Goldman Sachs JBWere is acting in an advisory capacity in a merger or strategic transaction involving the company and in certain other situations
CS	Coverage Suspended. GSJBW has suspended coverage of this company.
NC	Not Covered. GSJBW does not cover this company.

Price Target

Analysts set share price targets for individual companies based on a 12 month horizon. These share price targets are subject to a range of company specific and market risks. Target prices are based on a methodology chosen by the analyst as the best predictor of the share price over the 12 month horizon.

Research Criteria Definitions

The above recommendations are primarily determined with reference to the recommendation criteria outlined below. Analysts can introduce other factors when determining their recommendation, with any material factors stated in the written research where appropriate. Each criterion is clearly defined for the research team to ensure consistent consideration of the relevant criteria in an appropriate manner.

Prior to 20 July 2007, GSJBW had a dual-horizon recommendation system: Short Term & Long Term. The Short Term factors were Relative Earnings Outlook, Earnings Momentum, News Flow, Relative Performance, and Valuation Support. The Long Term factors were Industry Structure, EVA™ Trend, Growth Option and Price/DCF.

Industry Structure:	Based on Goldman Sachs JBWere industry structure ranking. All industries relevant to the Australian equity market are ranked, based on a combination of Porter's Five Forces of industry structure as well as an industry's growth potential, relevant regulatory risk and probable technological risk. A company's specific ranking is based on the proportion of funds employed in particular industry segments, aggregated to determine an overall company rating, adjusted to reflect a view of the quality of a company's management team.
EVA™ Trend: ¹	EVA™ trend forecast for coming 2 years. Designed to reflect "turnaround stories" or to highlight companies Goldman Sachs JBWere analysts believe will allocate capital poorly in the estimated timeframe.
Earnings Momentum:	The percentage change in the current consensus EPS estimate for the stock (year 1) over the consensus EPS estimate for the stock 3 months ago. Stocks are rated according to their relative rank, effectively making it a market relative measure
Catalysts:	A qualitative and quantitative assessment of a company's long term catalysts that the analyst believes should be considered and possibly recognised by the market.
Price:Base Case DCF:	The premium or discount to base case DCF valuation at which the stock is trading relative to the average premium or discount across the market.

¹ EVA™ is a registered trademark of the U.S. consultancy firm Stern Stewart

For Insurers

EVA™ Trend: ¹	ROE is used as a proxy for EVA. Rating takes into account the expected level and trend of ROE over the next 2-3 years.
Balance Sheet:	Analyst's assessment of the quality and strength of the insurer's balance sheet, including conservatism of provisioning, sufficiency of capital, and quality of capital.

For REITs

Strategy:	Used instead of industry structure as many REIT investors are intra rather than inter sector focussed.
EPU Growth:	Ranking of Earnings Per Unit growth relative to other listed Real Estate Investment Trusts. Used instead of EVA™ Trend.
Yield:	Yield relative to the REIT sector average. Used instead of Earnings revision.

For NZ Companies

Relevant Index:	If a research report is published by the New Zealand affiliate of Goldman Sachs JBWere, the recommendation of a company or trust is based on their performance relative to the NZSX 50 Index (Gross) and not the S&P/ASX 200 index.
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Distribution of Recommendations – as at 30 June 2008

Recommendation	Overall	Corporate relationship* in last 12 months
Sell	8%	7%
Hold	63%	67%
Buy	29%	26%

* No direct linkage with overall distribution as the latter relates to the full Goldman Sachs JBWere stock coverage (>250 companies). The above table combines the corporate relationships and recommendations of both Goldman Sachs JBWere Pty Ltd and its affiliate in New Zealand, Goldman Sachs JBWere (NZ) Limited.