



Wednesday 27 August 2008

**FXJ AU** **Outperform**

Relative to top 100  
Volatility index low/medium

Stock price as of 26 Aug 08	A\$	2.98
12-month target	A\$	3.57
12-month TSR	%	+26.8
Valuation	A\$	3.28
- EV/EBITDA		

GICS sector		media
Market cap	A\$m	4,510
30-day avg turnover	A\$m	26.9
Number shares on issue	m	1,514

**Investment fundamentals**

Year end 30 Jun		2008A	2009E	2010E	2011E
Sales revenue	m	2,917.8	2,984.7	3,092.9	3,264.8
EBIT	m	722.4	741.9	794.2	859.5
Reported profit	m	387.2	403.7	441.9	489.6
Adjusted profit	m	378.4	387.1	425.3	473.0
Gross cashflow	m	505.3	519.3	561.3	613.1
CFPS	¢	33.6	34.3	37.1	40.5
CFPS growth	%	0.1	2.2	8.1	9.2
PGCFPS	x	8.9	8.7	8.0	7.4
PGCFPS rel	x	0.90	1.07	1.11	1.09
EPS adj	¢	25.1	25.6	28.1	31.3
EPS adj growth	%	8.1	1.7	9.9	11.2
PE adj	x	11.9	11.6	10.6	9.5
PE rel	x	0.86	1.03	1.06	1.03
Total DPS	¢	20.0	20.5	22.5	25.0
Total div yield	%	6.7	6.9	7.5	8.4
Franking	%	75	75	75	75
ROA	%	8.9	9.0	9.7	10.5
ROE	%	7.6	7.8	8.4	9.2
EV/EBITDA	x	8.3	8.1	7.6	7.1
Net debt/equity	%	48.7	45.9	42.4	38.4
Price/book	x	0.9	0.9	0.9	0.9

**FXJ AU vs top 100, & rec history**



Source: ASX, Macquarie Research, August 2008 (all figures in AUD unless noted)

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# Fairfax Media

## Tough environment hastens job cuts

### Event

- Fairfax Media (FXJ) yesterday announced a program to cut 550 full time jobs, representing 5% of the workforce across Australia and New Zealand, with cost savings targeted of \$50m over two years (\$25m in 2009 and \$25m the following year). This year's cuts are in addition to the \$23m savings following the RUP merger, which FXJ will pick up in 2009.

### Impact

- In EPS terms, this would normally generate an increase of around 4% after tax (treating the \$50m redundancy payments as a one-off) for 2009 and 8% in 2010, however, we will not change our numbers at this stage, pending further data on whether the slowdown in advertising bites harder than we expected. We expect to be in a position to know this when the company gives its next commentary, most likely at the AGM in Melbourne on 25 November.

### Earnings revision

- No change to earnings.

### Price catalyst

- 12-month price target: A\$3.57 based on an EV/EBITDA methodology.
- Catalyst: Operational update at the AGM on the 25 November.

### Action and recommendation

- We are maintaining the Outperform recommendation on FXJ, which is rallying as the PEs for the sector start to expand on reduced earnings, with the market increasingly viewing 2009 as bottom of the cycle.
- The cuts are aimed at improving the production process, rather than cutting back on editorial quality, which feeds the paper and the on-line product, both of which are critical to the success of the company.



## Analysis

- Around 160 staff will be offered payouts from NZ, with the balance in Australia, across all areas, including circulation, editorial, library, business group services and corporate.
- 300 of the staff cuts will come from Brian McCarthy's Australian Publishing and Printing, which covers the legacy business of FXJ including the metros, as well as regionals, communities and specialist publications, but with the cuts outside of regional ie in Sydney/Melbourne. The company will be looking for voluntary redundancies in editorial.
- Of the editorial staff, the company is looking for 160 job cuts, 115 of which will be in the Australian publications and 45 in NZ. Of the 115 Australian editorial cuts, 80% of these will be among sub-editors, with 20% reporters. The mix is likely to be similar in NZ, so around 25 all up.
- Total labour bill is around \$1bn, so the \$50m reduction is a 5% reduction, leading to flat labour costs in the coming two years. Cost growth will be a little less than inflation, less the \$50m. NZ employees account for around 2500, while Australia is 9000.

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## Fairfax Media (ASX: FXJ AU)

Year End 30 June		1H/06A	2H/06A	1H/07A	2H/07A	1H/08A	2H/08A	2006A	2007A	2008A	2009E	2010E
<b>Sales</b>												
+ Sales Revenue	\$m	978.1	929.6	1017.7	1102.7	1478.0	1513.9	1907.7	2120.4	2580.7	2984.7	3092.9
+ Other Revenue	\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Revenue	\$m	978.1	929.6	1017.7	1102.7	1478.0	1513.9	1907.7	2120.4	2580.7	2984.7	3092.9
Operating Costs	\$m	715.2	687.5	744.1	805.1	1059.6	1101.1	1402.6	1549.2	1864.7	2127.8	2179.8
Operating Surplus	\$m	262.9	242.2	273.6	297.6	418.4	412.8	505.1	571.2	716.0	856.9	913.0
- Depreciation	\$m	39.4	40.3	41.4	52.6	53.3	55.8	79.8	94.0	105.9	115.0	118.9
- Amortisation	\$m	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EBIT consolidated	\$m	223.5	201.8	232.2	242.2	363.1	350.3	425.3	474.4	605.3	733.9	786.2
EBIT non-recurring	\$m	-8.9	-2.7	13.2	-41.1	-12.3	0.3	-11.7	-27.9	-53.4	0.0	0.0
Share of associates profits	\$m	0.0	0.0	0.2	2.8	2.0	6.7	0.0	2.9	4.8	8.0	8.0
Total EBIT	\$m	214.6	199.1	245.6	203.8	352.8	357.3	413.7	449.5	556.6	741.9	794.2
- Interest Expense	\$m	49.4	49.9	53.4	59.5	84.2	102.7	99.3	112.9	143.7	191.0	191.0
+ Interest Income	\$m	0.6	1.5	1.7	0.0	0.0	0.0	2.1	1.7	0.0	0.0	0.0
Pretax Profit	\$m	165.8	150.7	193.9	144.3	268.6	254.6	316.5	338.3	412.9	550.9	603.2
Tax ordinary	\$m	49.6	43.7	48.1	49.2	76.0	63.3	93.3	97.3	125.2	146.6	160.7
Tax non-recurring	\$m	-4.0	-0.8	0.0	-20.7	-3.7	0.1	-4.8	-20.7	-24.4	0.0	0.0
Total tax expense	\$m	45.6	42.9	48.1	28.5	72.3	63.4	88.5	76.6	100.8	146.6	160.7
Net Profit	\$m	120.2	107.7	145.8	115.8	196.3	191.2	228.0	261.6	312.1	404.3	442.5
- Minority Interests	\$m	0.3	0.3	0.4	-2.3	0.3	0.3	0.6	-1.9	-2.0	0.6	0.6
Reported NPAT	\$m	119.9	107.4	145.4	118.1	196.0	190.9	227.3	263.5	314.1	403.7	441.9
- Preference dividends (PRESSES, SPS)	\$m	0.0	5.8	7.5	12.1	8.3	8.9	5.8	19.6	20.4	16.6	16.6
- NRIs, net of tax	\$m	-4.9	-2.0	13.2	-20.4	-8.6	0.2	-6.9	-7.2	-29.0	0.0	0.0
Adjusted NPAT	\$m	124.8	103.6	124.7	126.5	196.3	181.9	228.4	251.1	322.8	387.1	425.3
Gross Cashflow	\$m	164.5	150.1	173.9	188.9	258.2	246.8	314.6	362.8	447.1	519.3	561.3
<b>EPS (adj)</b>												
EPS Growth	%	5.0%	-14.2%	-7.8%	0.9%	0.1	0.1	-5.2%	4.3%	5.2%	9.9%	
CFPS	¢	17.7	16.1	17.3	16.3	17.2	16.3	33.8	33.6	33.5	34.3	37.1
DPS	¢	8.0	11.5	10.0	10.0	10.0	19.5	20.0	20.0	20.5	22.5	
Franking	%	100	100	100	100	75.0	75.0	100	100	75	75	
Franking Tax Rate	%	30	30	30	30			30	30			
<b>PE (adj, tax effected)</b>												
PGCFPS	x							12.1	12.8	12.3	11.6	10.6
Price/Free Cash Flow	x							8.8	8.9	8.9	8.7	8.0
Yield	%							11.8	11.1	6.4	5.8	5.0
EFPOWA	m	928.9	933.6	1,005.7	1,160.0	1497.6	1514	931.2	1,082.9	1,505.8	1,513.4	1,513.4
<b>Cashflow Analysis</b>												
EBBIT	\$m	262.9	242.2	273.6	297.6	418.4	412.8	505.1	571.2	831.2	856.9	913.0
- Increase in Working Capital	\$m	20.0	-11.2	-20.7	48.8	65.9	33.9	8.8	28.1	99.8	-10.0	-10.0
- Net Interest Paid	\$m	49.7	45.0	49.8	41.3	84.2	100.1	94.7	91.0	184.3	198.2	191.0
- Tax Paid	\$m	57.7	40.3	48.8	40.3	48.3	87.9	98.1	89.1	136.2	135.6	152.4
+ Other	\$m	3.0	-18.3	-4.4	6.4	-8.8	17.6	-15.3	2.0	8.8	-8.0	-8.0
Net Cash from Operating Activities	\$m	138.4	149.7	191.4	173.5	211.1	208.5	288.2	364.9	419.7	525.1	571.7
+ Proceeds from Sale of PP&E	\$m	-16.6	16.7	0.0	64.3	0.0	5.2	0.1	64.3	5.2	0.0	0.0
+ Proceeds from Sale of Investments and Businesses	\$m	0.0	0.0	20.8	1.9	0.0	6.5	0.0	22.7	6.5	0.0	0.0
- Capex	\$m	13.1	39.5	36.8	51.9	51.0	64.4	52.6	88.7	115.4	110.0	110.0
- Acquisitions and Investments	\$m	42.0	656.4	149.3	431.4	555.2	39.7	698.3	580.7	594.9	0.0	0.0
+ Other	\$m	0.2	-0.2	0.0	-1.1	0.0	0.0	0.0	-1.1	0.0	0.0	0.0
Net Cash Used in Investing	\$m	-71.4	-679.3	-165.4	-418.2	-606.2	-92.5	-750.7	-583.6	-698.7	-110.0	-110.0
- Dividends Paid	\$m	108.5	74.7	81.3	95.0	104.2	164.7	161.2	176.3	268.8	303.7	322.2
+ Equity Movements (inc. DRP)	\$m	1.3	293.8	0.0	0.0	91.8	-14.6	295.1	0.0	77.2	0.0	0.0
+ Debt Movements	\$m	-86.7	334.4	106.5	603.0	152.5	50.1	247.7	709.4	202.6	-150.0	-150.0
+ Other	\$m	0.0	-0.4	0.0	-0.4	0.0	0.0	-0.4	0.0	0.0	0.0	0.0
Net Cash in Financing	\$m	-193.8	553.1	25.2	507.6	140.1	-129.2	381.3	532.7	11.0	-453.7	-472.2
+ Net Exchange Rate Difference	\$m	0.0	-0.1	-0.5	0.0	1.0	-5.5	-0.1	-0.5	-4.4	0.0	0.0
Net Cash Movement	\$m	-126.8	45.4	50.7	262.8	-253.8	-18.6	-81.4	313.5	-272.4	-38.6	-10.5
<b>Key Ratios</b>												
- EBIT Interest Cover	x							4.3	4.0	3.9	3.9	4.2
- Operating Margin	%							26.5	26.9	27.7	28.7	29.5
- Pre-tax Margin	%							16.6	16.0	16.0	18.5	19.5
- Effective Tax Rate	%							28.0	22.7	24.4	26.6	26.6
- Payout Ratio	%							79.3	85.8	82.3	80.0	80.0
<b>Balance Sheet</b>												
								2006A	2007A	2008A	2009E	2010E
<b>Trading Information</b>												
Share Price	\$2.98							52.7	366.3	93.9	55.2	44.7
EFPOWA	1513.5							385.6	824.3	655.1	646.9	668.6
Market Capitalisation	\$4,510							36.5	18.5	45.7	45.7	45.7
<b>Assets</b>												
<b>Current Assets</b>												
<b>Investments</b>												
<b>Fixed Assets</b>												
<b>Intangibles</b>												
<b>Other Assets</b>												
<b>Total Assets</b>												
<b>Liabilities</b>												
<b>Short Term Debt</b>												
<b>Current Liabilities</b>												
<b>Long Term Debt</b>												
<b>Other Liabilities</b>												
<b>Total Liabilities</b>												
<b>Net Assets</b>												
<b>Minority Interests</b>												
<b>Shareholders Funds</b>												
<b>Debt/Equity</b>												
<b>NetDebt/Equity</b>												
<b>Return on Equity</b>												
<b>Return on Assets</b>												
<b>Return on Invested Capital</b>												

Source: Macquarie Research, August 2008