COMSTOCK'S

MAR
2007

CAN BANKING SAVE HEALTHCARE?

SACRAMENTO'S SHANGRI-LAS

BEST BATHROOMS

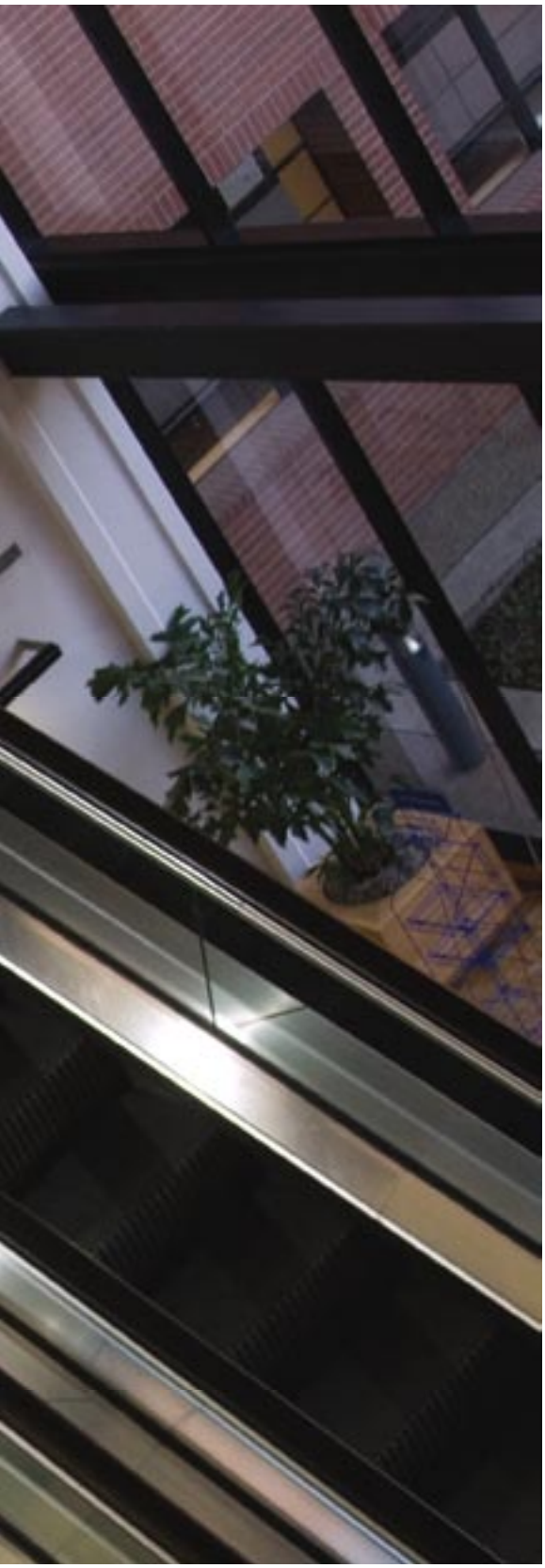
business insight for the capital region

IS GARY PRUITT'S BIG ACQUISITION REALLY A THREAT TO MCCLATCHY'S BOTTOM LINE — AND JOURNALISM'S FUTURE?

PAPER TIGER

$3.95
0 3
6 49241 83560 8
comstocksbusiness.com

PHOTO: NOEL NEUBURGER



1

MCCLATCHY MOVES UP THE PAPER CHAIN

BY RICH EHISEN

Any number of things make a business transaction a "big deal." For one, size does matter, as does a touch of controversy and the potential to dramatically alter an industry. In 2006, the Sacramento region's biggest deal — the McClatchy Co.'s $6.5 billion March purchase of the Knight Ridder newspaper chain — had all of that and more, most notably the rapidly growing star power of the industry's golden boy du jour, McClatchy CEO Gary Pruitt.

The 32-paper Knight Ridder chain was undoubtedly one of the industry's heavyweights, led by crown jewels like the Philadelphia Inquirer, the Miami Herald and the San Jose Mercury News. But while Knight Ridder papers earned kudos and Pulitzer prizes by the score, the company itself wasn't winning any awards from shareholders.

For much of the last decade, Knight Ridder's profit margins hovered between 15 and 20 percent — great for some industries, but not really close to many of its newspaper brethren, including McClatchy, which regularly topped the 20 percent mark.

Faced with growing shareholder pressure to either grow the margins or sell the company, Knight Ridder CEO Anthony Ridder finally put the chain on the market last year. And although Pruitt has consistently called the Knight Ridder purchase a deal "we didn't feel was essential to do," he nevertheless pounced on the opportunity.

"We felt we could have been a good company staying the size we were, but when Knight Ridder became available, we felt that if we could get it at an attractive price and we could sell the papers we didn't want, that this could be a deal we could make work," Pruitt says. "We weren't going to stretch too far or put ourselves at risk, because we didn't need it. But if we could get it, it would definitely make the company stronger."

Just over $4.5 billion in cash and stock later, plus another $2 billion in assumed Knight Ridder debt, McClatchy was not only stronger, it was also firmly established in the land of the giants. Even after selling off a dozen of the Knight Ridder papers that it didn't want, McClatchy still raised total circulation for its remaining 32 daily papers to more than 3 million.

That moved the 150-year-old company from its respectable but unspectacular position as the nation's ninth largest newspaper chain to second place overall, trailing only the Gannet Co. at the top of the daily newspaper world. The sale of the 12 "orphans" — papers like the Inquirer and Mercury News that Pruitt says did not fit the McClatchy model of being dominant entities in high-growth markets — also returned a cool $1.6 billion to help pay down the more than $3 billion the company borrowed to finance the Knight Ridder deal.

But Pruitt's wheeling and dealing didn't end there. Just days before Christmas, Pruitt sold another high-profile McClatchy asset, the Minneapo-

lis Star Tribune, for $690 million in cash to Avista Capital Partners, a New York-based private equity firm.

That is significantly less than the $1.2 billion McClatchy paid for it in 1998, but as with seemingly all things Pruitt touches these days, the sale had a pronounced silver lining: the big financial hit on the Tribune sale will ultimately allow McClatchy to offset about $160 million of the approximately $500 million in capital gains taxes it incurred from selling the Knight Ridder papers it didn't want in the first place. The only negative, per se, was that the sale dropped McClatchy to third in size behind the Tribune Co., which owns such industry luminaries as the Los Angeles Times and the Chicago Tribune.

While everyone knew well beforehand that Knight Ridder was in play, few saw the Star Tribune deal coming. But Pruitt says the circumstances were a perfect storm of opportunity: the paper's advertising sales and circulation had fallen dramatically, and the tax benefits of moving it now were too good to pass up.

"We applied the same kind of clear-eyed strategic tests to the Star Tribune that we applied to the Knight Ridder papers," he says. "We felt by selling it we could reduce debt, improve performance and increase our operational flexibility. And, of course, it was the only paper that offered a tax advantage to the structure such that it would enhance the purchase price significantly. So while it was a difficult decision, it was also a clear decision."

Not everyone has Pruitt's clarity about his recent moves. From the moment the original Knight Ridder purchase came to light, observers within the industry and on Wall Street wondered aloud why Pruitt was willing to so boldly risk both his reputation and the company's financial well-being during a time when many of those same observers consider the industry to be on the wane.

> "McClatchy has abandoned its employees and readers, for profit, not principle."
>
> *—Nick Coleman, columnist, Minneapolis Star Tribune*

It is a question with some merit. The daily newspaper business, faced with rising competition from the Internet and 24-hour cable news channels, has been in decline for years, particularly among younger readers. With smaller circulation has come stagnant ad revenue, a knife to the jugular given that most papers derive as much as 80 percent of their revenue from ads. That stagnation has also placed virtually all publicly held newspapers under the shareholder microscope, including such luminaries as the Tribune Co., which shareholders forced onto the market almost before the ink was dry on the Knight Ridder sale.

Others have also questioned whether McClatchy's newfound debt would lead to staff layoffs and reduced newsroom budgets, in essence watering down the company's journalistic credibility in deference to its own shareholders' demands to pump up the bottom line.

In that regard, few failed to notice that virtually all of the dozen Knight Ridder papers that Pruitt moved were heavily unionized, as was the Star Tribune. And everyone certainly took note when the Sacramento Bee closed its Los Angeles and San Francisco bureaus and, in spite of Pruitt's assurances that the company "has no plans for across-the-board layoffs or buyout programs," steered around 3 percent of its editorial staff toward buyouts.

Gary Pruitt

ROOTS: Born in Alexandria, Va., on July 3, 1957.

JOB: Chairman, president and CEO of the McClatchy Co.

FAMILY: Pruitt and his wife, Abby, live in Sacramento with their two daughters, Katherine, 17, and Allison, 15.

EDUCATION: BA from the University of Florida; MA in public policy and law degree from the University of California, Berkeley.

HOBBIES: Tennis, swimming, body surfing, hiking and reading.

WORK ETHIC: "Think about the values of the company and try to personify them. I have high expectations of myself and my company and the people who work for me, but I also respect other people and what they're doing professionally. There's no reason to be nasty or mean."

LIFE PHILOSPHY: "I think it's important to lead a balanced life and not let work become the be-all and end-all of your existence."

The reaction after the Star Tribune sale was particularly harsh, at least from those affected most. In a piece printed just days after the sale was announced, Star Tribune columnist Nick Coleman claimed McClatchy had "abandoned its employees and readers, for profit, not principle." Coleman also accused Pruitt of providing "lip service to the cause of quality journalism" and said that "in the end McClatchy folded like a cheap lawn chair under a steady gale of Wall Street demands." Still more howling followed after Pruitt's annual salary was bumped to just over $1 million in December, a figure that could double if the company hits certain benchmarks this year.

Pruitt's colleagues, however, have been quick to his defense. "Gary Pruitt's job almost tripled in complexity at mid-year, and I don't think he got a raise then," says David Zeek, president of the American Society of Newspaper Editors and executive editor of the News Tribune, a 128,000-daily-circulation paper in Tacoma, Wash. (The News Tribune is also a McClatchy-owned paper) "If I went from being the editor of the Tacoma News-Tribune to being the editor of the Los Angeles Times, I guess I would expect a pay increase."

Zeek also defends Pruitt's choices on the 12 Knight Ridder papers McClatchy sold off, saying, "I think the issue is not unionization, I think it is about flexibility to react quickly as the competition changes or the market changes. The newspaper business has historically had a correlation between heavily unionized businesses and the inability to be flexible and to move rapidly and to adapt."

Karen Dunlap, president of the Poynter Institute, a Florida school for professional journalists and journalism teachers that is funded by the Times Publishing Co., the corporate parent to the St. Petersburg Times and Congressional Quarterly, understands the negative reaction from some circles of the industry, but says Pruitt is in a particularly difficult situation because he is trying to balance the needs of both corporate and news interests.

"Gary is pragmatic in an industry that would like more idealism," Dunlap says. "Journalists want more emphasis on just the journalism, no matter what. He is pragmatic in that he stands for sound journalism, but he also recognizes the economic pressures of the industry."

Facing doubt is nothing new to Pruitt, who has heard most of it since his ascendancy to McClatchy CEO in 1996 at the ripe old age of 36. A lawyer by training and trade, he had been with the company for only a dozen years, starting as a fairly nondescript in-house attorney working on First Amendment issues and, he says, "making sure we didn't get sued for libel, squashing subpoenas, opening courtrooms, public records — all that stuff."

But he also had a keen eye for business transactions, something that caught the attention of his bosses. A rapidly expanding list of responsibilities followed, including a stint as the publisher of the Fresno Bee, before Pruitt eventually rose to company president in 1995 and CEO a year later, earning the golden-boy tag that has followed him ever since.

> "Gary is pragmatic in an industry that would like more idealism."
>
> *— Karen Dunlap, president, the Poynter Institute for professional journalists*

That moniker has been used derisively more than once by those who believe his interests in corporate success outweigh his interest in good journalism. But if any of the recent turmoil bothers him, you would never know it from Pruitt's demeanor.

Tall, trim and blessed with youthful good looks that easily belie his 49 years, Pruitt appears a lot more like a Southern California surfer than a seven-figure corporate CEO. That persona is amplified by his somewhat laid-back, cheerful manner, as well as a tendency to quote rock 'n' roll lyrics to begin and close board meetings.

But while Pruitt does count surfing among his many hobbies, he is quick to point out that he is a newspaper guy through and through. He is also undeterred by those who might question his bona fides, either as a media guy or as a savvy businessman. The reason for that, he says, is simple: He has done his homework, particularly in regard to where he believes the industry is going. And while he acknowledges that the industry is changing, Pruitt scoffs at the idea that newspapers have become a relic doomed to extinction.

"The newspaper form is about 400 years old, but the predictions for our demise are about 399 years old," he says. "People have predicted the end of newspapers forever. And most of those people are dead and newspapers carry on.

"We still regard the newspaper as critically important and as having the ability to grow," he says. "Maybe not in circulation, but I think revenues and profitability can grow over time because in each of our markets there is only one daily newspaper, and every year there's more of everything else — more TV stations, more cable channels, more radio stations, more magazines, more websites. So our competition actually faces even more fragmentation of their audience because they have a proliferation of outlets within their medium."

That said, Pruitt does acknowledge "that the newspaper is not sufficient anymore. It's not enough. We have to do more than that." Along those lines, Pruitt notes that "our strategy for more than a decade has been to be the leading local Internet site in each of our newspaper markets, and we are that. In Sacramento it is Sacbee.com, Sacticket.com and Sacramento.com, all of which are the local leader. In fact, when you look at the unduplicated reach of the Sacramento Bee and our websites, our audience is actually growing."

And that growth is ever more exemplified by the rise in ad dollars generated by online newspaper advertising. Online ads currently account for only about 6 percent of total newspaper ad sales, but that still equates to serious money when considering that, according to the

Newspaper Association of America, online newspaper ad sales totaled over $2 billion in 2005. Sales for 2006 were on target to climb another $500 million, with significant jumps in revenue coming in each of the first three quarters. With the Bee, for instance, 2006 third-quarter online sales jumped a nifty 7.3 percent over that same quarter in 2005, while print ads fell 2.8 percent.

Most industry experts expect the upward trend for online newspaper ad sales to continue in 2007, particularly as Internet search engines like Google and Yahoo continue with their own forays into the arena. The infusion of new Internet blood could help prop up declining print ads. Google, for instance, began a pilot program last November that allows advertisers, mostly small companies who often find traditional newspaper ads too expensive for their budgets, to access a single site to bid on and buy unsold print-ad space at the last minute from a group of more than 60 papers across the country.

But while both Google and the participating papers hope the simple one-stop shopping process will pump up those lagging print sales, Pruitt and his newspaper brethren are also clearly not holding their breath for it to happen.

In January, McClatchy reportedly entered into negotiations for creating a three-way deal with the two players above them in the newspaper food chain — the Gannet Co. and the Tribune Co. — to create their own joint Internet advertising service. If completed, the deal would allow the three titans to offer similar one-stop shopping for large national retailers to place display ads on their respective Web sites. Yahoo has a similar deal with several other media entities.

With the Knight Ridder deal, McClatchy also gained a large interest in such profitable ventures as CareerBuilder.com, which recently eclipsed Monster.com as the No. 1 online job-hunting site, as well as other popular sites like Apartments.com, Cars.com and Homescape.com. Pruitt later sold a significant chunk of CareerBuilder.com off to partners Gannet and Tribune.

Ever the forward thinker, Pruitt cheerily notes that these collective assets will not only "help our newspapers and help our newspaper websites, but they're also a long-term play in terms of valuation. If CareerBuilder.com goes public one day, we'll get a return on that as well, independent from our websites, because CareerBuilder's market capitalization could be enormous."

In the same breath, however, Pruitt adds that it isn't good enough "just having the leading Internet sites. We need to also be a 24-7 media company by delivering information to people's PDAs, BlackBerries and their cell phones; news alerts, scores, everything ... trying to deliver what information people want, when they want it."

> "We think good journalism is good business. We make no apologies for being profitable."
>
> *—Gary Pruitt*

Pruitt rejects the idea that good journalism by its nature has to mean ignoring profits. "We think good journalism is good business," he says. "The metaphor we like to use at McClatchy is to be athletic, to be trim and fit but also muscular in those places that count. Sometimes newspapers and newsrooms roll their eyes and think, 'Oh, we're too profitable.' Well, we make no apologies for being profitable and successful because ultimately we understand that the greatest insurance for our independence is business success. If we're successful as a business, our independence and our strength on the journalistic side is much less vulnerable to challenge.

"I know it sounds hokey, but the newspaper is the one that supplies most of the original reporting in a community, and a community is hurt without that," he adds. "It is very important to us to get it right on the business side so we can maintain the journalistic side."

It is undoubtedly a tall order, in part, says Poynter's Dunlap, because the end results matter to more than just Pruitt or the McClatchy shareholders. "He is in an unusually difficult position," Dunlap says of Pruitt. "In addition to migrating audiences and shareholder concerns, he faces a third challenge that nobody else in the industry has in that, in a sense, he holds the hopes of journalists everywhere because of buying Knight Ridder. The industry is now watching him in hopes that those papers still with McClatchy will continue to be strong."

The Tacoma News Tribune's Zeek says Pruitt is the perfect man to pull it off, saying his "mixture of stability and innovation" is a "kind of magical thing." Dunlap concurs, saying of Pruitt, "There are many fine leaders out there, but I don't know who could better handle the challenges he is facing."

One challenge Pruitt won't be dealing with for now is taking the company private, rumors of which have swirled around the company since before the Knight Ridder deal. Although Pruitt says going private could be an option someday, he contends it isn't an option at all right now. "We don't currently have any plans to go private, and given our debt and number of shares outstanding, we would be paying down debt and buying back shares for a while before we could even contemplate it," he says.

Pruitt says that while he fully expects to see more industry turmoil and more newspapers being sold, particularly to private equity investors, he is done with his own mergers and acquisitions for a while. For now, he says he just wants to concentrate on the continuing integration of the Knight Ridder group and making McClatchy an industry leader by finding the tricky balance between profits and quality.

"We're not going to be a deal-driven company," he says. "We just did a major acquisition, but we don't live for deals. We live for the operating side and to go forward there. McClatchy's not going to be the 'go, go, go' company that's trying to become the biggest newspaper company. That doesn't mean anything to us. Trying to be the best means something to us."