

Newspapers: What They Teach Us About the Future



Content's Migration to Digital Platforms

Newspaper market capitalizations are down >80% since 2000, despite being the earliest adaptors of online content delivery. It has been said that the only thing we know about the Internet is that content companies can't make money on the Internet. We disagree. What lessons can film, TV and other premium content providers learn from the cautionary tale provided by newspapers?

In this report, we highlight eight key lessons that come out of the newspaper industry's migration to digital platforms:

1. Unbundling Destroys Economics
2. Pricing Flexibility Is Critical to Value Creation
3. In a Fracturing World, Hits Make More Money
4. Why the Internet Drives "Winner Take All" Economics
5. Move Up the Purchase Funnel
6. The Internet Commoditizes Niche Audiences
7. A Culture of Free
8. This Cycle Was Brutal

We recommend that investors purchase NewsCorp (NWSA, Buy) because it is inexpensive, EPS estimates are likely too low as the economic cycle continues to improve, and several secular growth drivers suggest valuation multiple expansion potential.

Other Reports by Laura Martin

TV's NPV

May 2, 2010

In 2009, the TV ecosystem generated approximately \$140 billion of revenue and had about \$330 billion of public market capitalization. We believe that the biggest economic threat to the NPV of the TV ecosystem comes from “unbundling” risk. That is, about 100 million U.S. households pay an average of \$70 per month for about 300 video channels. If premium TV content creators allow their programs to become available individually on the Internet (a la carte), this “unbundling of content” threatens the value of the TV ecosystem in three primary ways:

1. Subscription revenue would decline by about 15-20%, according to our proprietary survey of 200 TV viewers.
2. Advertising revenue would fall by about 75%, as there are about 16 minutes of advertising per hour on TV compared with 4 minutes per hour on the web. Pricing is similar on both devices.
3. Disintermediation adds costs. If content companies deliver content directly to consumers, they must incur customer service costs, which we estimate at \$50 per customer per year, or \$5 billion nationally.

Advertising Wars – Who Wins?

April 2, 2010

1. To date, audience has de-coupled from monetization on the Internet with 15% of time but only 8% of advertising dollars spent on the web. A purchase funnel framework lends insights into monetization shifts and suggests structural barriers that weaken the link between audience and money on digital platforms.
2. Internet advertising spending meets certain advertiser goals better than any other medium, but sequential entrants appear to take share from prior Internet advertising alternatives. Social Networks achieve two-way dialog that can deepen a customer's relationship with a brand, but it is unclear whether advertising growth (if achieved) on these platforms will grow the pie, take advertising dollars away from old media silos, or displace predecessor digital advertising alternatives.

Music's Emerging Economics

March 2, 2010

1. We believe that the music “ecosystem” is the best unit of analysis by which to judge the emerging economics of the music business because live performance revenue plus unmeasured long-tail music revenue may be larger than dissipating physical music sales.
2. Music value destruction was primarily (in our view) the result of “unbundling” (i.e., the transition from purchasing albums to a la carte songs via iTunes). By implication, re-bundling through subscription services holds out the promise of re-linking economics to growing music demand.
3. We suggest that theft is a proxy for incremental music demand. Adding together “paid-for” plus “stolen” music implies that consumer demand for music has more than doubled since 2003. Linking monetization to healthy consumer demand fundamentals is far easier than growing revenue when consumer demand is falling.

That Was Then – What We Know So Far

The most widely publicized trends that narrate the demise of the U.S. newspaper industry include:

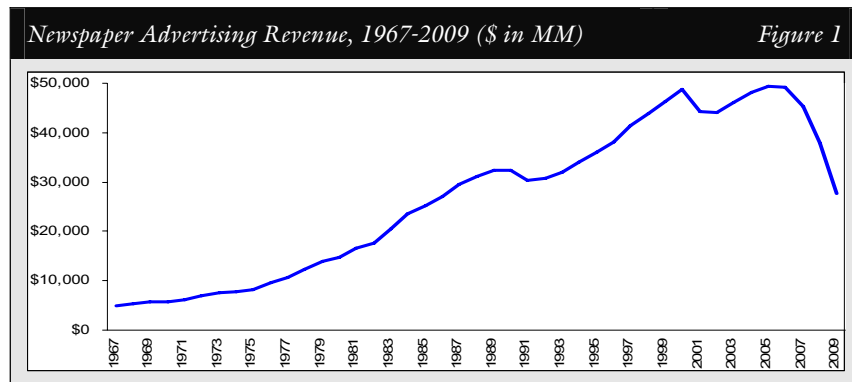
Shifting Consumer Demand Fundamentals

Although U.S. newspapers still have 48.6 million readers paying for a newspaper every day, circulation is down dramatically. The young are getting their news online, not from the printed newspaper. Consumers almost never pay for online news content and online readers have shorter attention spans, jumping from story to story. Subscription fee revenue fell to 13% of total U.S. newspaper industry revenue in 2008, according to the OECD, down from 20-30% of total revenue in 2000.

Advertising Shifts

Advertising has moved online, but not to newspapers' websites. The U.S. newspaper industry generated only about \$3 billion from online ads in 2009. This represents about 10% of total U.S. newspaper industry revenue, despite being the earliest media industry to adopt the Internet. Figure 1 includes newspaper industry advertising revenue since 1967. Pressures include:

1. **Consumers:** Ad revenue coming from consumers is being ravaged by free and low-cost websites such as craigslist, eBay, employment websites, and auto sites.
2. **Business:** Newspapers are also seeing business advertising shift online. National advertisers are shifting dollars into a wide variety of digital platforms, including websites, rich media and mobile. Search engine marketing has also taken share of business advertising from newspapers.
3. **Trading Digital Dimes for Analogue Dollars.** Readers shifting from print to online lowers newspaper revenue as time and attention spans are shortened, discovery is limited, and online readers do not command the premium ad rates that print can charge. We estimate that an online reader is worth about 1/10th a print reader to a newspaper company.



Source: Newspaper Association of America.

Cost Structures Are Too High

Newspapers have chronically high fixed cost structures, consisting mostly of journalists, printing presses and the buildings to house them.

Competitive Pressures

Beginning in the 1990s, news became more competitive owing to 24-hour news cable channels. The rise of the Internet has exacerbated the competitive environment for viewers time and ad dollars spent.

Vicious Ad Cycle

2009 witnessed one of the worst advertising recessions in 30 years. Most of the largest advertising categories for newspapers were decimated, reporting double-digit declines in ad spending: autos, employment, real estate, retail, and financial services.

This Is Now – What We Can Learn from Newspapers

1. Unbundling Destroys Economics

Music

We've written that "unbundling" was the primary source of value destruction for the music business (see our report, *Music's Emerging Economics*, March 2, 2010). That is, in the physical world, consumers were forced to pay about \$15 for an album that packaged the A-title songs they wanted with many B and C titles that they didn't want. The pricing of \$7-8 for each song the customer actually wanted (assuming 2 songs on an album of 10) was too high a price umbrella when iTunes began offering individual songs at \$0.99. The music industry had to accept the iTunes version of unbundling because between 2000 and 2003, the audience unbundled music by stealing the songs they wanted to hear. In the end, \$0.69, \$0.99 and \$1.29 per song (x 70% to the music labels) from iTunes were better than nothing. We are skeptical about the notion that digital piracy is solely responsible for the destruction of the music business because before people stole songs one at a time over the Internet, they bought entire albums via CDs made offshore illegally (zero dollars paid to the music labels). That value chain has been decimated by digital. Why pay \$1 for an illegal CD if you can legally pay \$1.29 for the only song you want on the CD anyway?

TV

We've also published that the biggest threat to the \$140 billion of annual revenue associated with the TV ecosystem is the prospect of "unbundling" (see our report, *TV's NPV*, May 2, 2010). That is, about 100 million U.S. households pay an average of \$70 per month for about 300 video channels. If premium TV content creators allow their programs to become available individually on the Internet (a la carte), this "unbundling of content" threatens the value of the TV ecosystem in three primary ways: 1) subscription revenue would decline by about 15-20%, according to our research; 2) advertising revenue would fall by about 75%, as there are about 16 minutes of advertising per hour on TV compared with 4 minutes per hour on the web; and 3) if content companies deliver content directly to consumers, they must incur customer service costs, which we estimate at \$50 per customer per year, or \$5 billion nationally.

Newspapers

The unbundling of newspapers into individual articles available on-demand online destroyed value for the newspapers, even when the dollars and readers stayed on the newspaper's website:

- **Volume Cutbacks.** Business advertisers used to pay for 100% of circulation, even though 10-20% of readers are probably in the market to buy a particular product on any specific day. When ad dollars move online, advertisers pay only for "click-throughs," representing the 10-20% of people interested in buying the product at that moment in time.
- **Pricing Pressure.** The Internet has infinite advertising inventory which limits pricing power. Aggressive competition for ad dollars from infinite online channels puts enormous downward pressure on advertising prices. Online ads typically command lower pricing than the equivalent ad in the physical world and the views are much lower online, so revenue is much lower.
- **Discovery Undermined.** Consumers used to peruse more content when they held a paper in their hands. Readers would stumble upon issues and writers in the physical paper that added perceived value to the price/value relationship. Time spent is equated to value in the consumers mind. On the Internet, time spent with any one newspaper is lowered. This undermines the brand, and it's harder for a newspaper to introduce readers to new columnists and ideas. Discovery and "stickiness" are undermined because articles are called up one at a time, there is more choice, attention spans are shorter, and viewing is often multi-tasked (shared).

Lessons Learned

The best solution to the negative economic impact of unbundling is to "re-bundle" or "bundle-up." A bundle of services allows each consumer to attribute value to components of the bundle differently, thereby capturing maximum economics per person.

2. Pricing Flexibility Is Critical to Value Creation

In the digital world, there are important new platforms that deliver premium content to consumers. Beware! Digital platforms that make the bulk of their profits from selling devices have different goals than content creators. They want to maximize consumer adoption (purchases) of their devices. They *must* have premium content to drive new-device adoption. If they “give away” premium content, that drives device sales. If consumers are charged a lower price than in the physical world, that drives device sales. If premium content is priced at the same low price point across an industry (making it least confusing for consumers), that drives device sales.

The inflexibility of a single price point destroys value for content owners in several ways:

- The digital price point might end up being too low vis-à-vis physical alternatives. If it can't be adjusted, this potentially destroys enormous value in the premium content creator's core business. Prices are harder to raise the longer consumers have access to lower price points.
- Stagnant price points rob the content owner of important feedback loops from consumers.
- Value destruction is exacerbated if unbundling is combined with pricing *inflexibility*. That is, in theory as a content creator unbundles his product into its component pieces, pricing pieces should be able to make him indifferent as to how much the consumer elects to purchase in a la carte or in bundled form. But if there is no ability to adjust prices, the content creator will be condemned to either sell too little (because he overpriced his a la carte products) or too much (he underpriced his a la carte choices vis-à-vis the bundled alternatives) on digital platforms vs. the physical world. There is a delicate balance between the digital and physical platforms, and pricing is a key value driver that is dangerous to give away.

Some of the best work in this area is being done by Anita Elberse at Harvard Business School. Her quantitative research contains the following interesting insights:

- Unbundling in and of itself is *not* bad, so long as the a la carte sum of goods is not too much lower than the bundled product. Different pricing alternatives meet a broader range of customer needs. Small changes in a la carte price points often push consumers back into the bundle. And the great thing about digital platforms is that information is nearly instantaneous. (LAM Note: We agree. In April 2009, iTunes finally instituted tiered pricing at \$0.69, \$0.99 and \$1.29 per song. This small change in pricing strategy drove a large re-bundling shift by consumers. In 1Q10, digital album sales grew 16% year/year whereas single track sales fell 1% year/year.)
- The most interesting finding (in our view) from Elberse's academic work is that consumers pick the bundle over the a la carte choices the more consistent the appeal of the items in the bundle. That is, if there is one clear hit or two, consumers will just buy the hits and nothing else, if given that choice. If there are no standout hits, consumers are more likely to pick the bundle. Said differently, if the bundled product is all the same quality (i.e., less distinguishable), people are more inclined to buy the entire bundle to sample them all. One implication of this finding is that perhaps hits should be sold stand-alone, but non-hits should be sold only in bundles (at a lower price point per song but a higher price point than a single song) to drive discovery.

Lessons Learned

- Digital platforms are disruptive and content owners *must* retain pricing power in this rapidly changing environment in order to maximize value (and/or minimize value destruction of their core business).
- Perhaps not all content should be sold a la carte. Perhaps lesser known content should be only sold only in bundled form (at a discount), while hits are sold a la carte at a high price point.
- Digital platforms have immediate feedback loops about demand at different price points. Achieving maximum value for a content owner using different pricing strategies can be accomplished within months (not years) on digital platforms.

3. In a Fracturing World, Hits Make More Money

In 2006, Chris Anderson wrote a book entitled *The Long Tail*, which highlighted that in a digital world, far more product choices would be available to consumers because physical shelf space would no longer be a constraint. This explosion of choices would allow consumers to buy more products down the long tail (non-hits) than they had in the past, which might imply a shift of economics away from the hits (head) toward the long tail of less popular (non-hits) choices. Anderson posited that the economics of the long tail could actually be larger than the revenue from hits in the physical world. Figure 2 illustrates the promise of the “Long Tail” theory.



What have we learned since 2006? So far, in media at least, the data suggests that Anderson had it exactly backwards. In a fracturing world, money is moving towards the “head” (the hits). The gap between the economics of hits and average content appears to be widening in the digital age:

- Of the 97,000 music albums released in 2009, 2% of them accounted for 90% of total revenue.
- The Top 10 TV shows today garner a record share of ad revenue because they deliver a huge (14-25 million per week) audience.
- 2009 was the worst ad recession in 30 years, with advertising down 15-30% across all ad-driven media silos; however, the Super Bowl and Oscars achieved flat ad prices.
- Rhapsody (an online music service) has about 300,000 artists available on its service. Of these, we estimate that the top 200 artists make millions, the next 4,800 make around \$250,000 per year, the next 5,000 make around \$50,000 per year, and 290,000 make nothing.
- Aggregated audiences are valuable even on the web. For example, premium site homepage CPMs (cost per thousand) are about \$30 vs. approximately \$1 for run-of-schedule Internet space.

Elberse’s academic research mirrors these conclusions:

- Quickflix. Of 16,000 movie titles, the top 10% of DVDs rented accounted for 48% of all rentals and the top 1% for 18% of all rentals.
- Rhapsody. When 600,000 subscribers could choose from >1M tracks of music over 3 months, of the 32M played, the top 10% represented 78% of all plays and the top 1% represented 32%.

Lessons Learned

- The best of A content (the super hits) monetizes at a greater gap above average content in the digital world vs. the old world because big audiences are worth more in a fracturing context.
- The clutter of the Internet makes discovery difficult. Premium content creators, with their high-quality brands and strong relationships with customers, have the opportunity to drive usage of their content.

4. Why the Internet Drives “Winner Take All” Economics

Academic research explaining the trend toward consolidation of value in the head was written decades ago. In 1963, William McPhee wrote a book entitled *Formal Theories of Mass Behavior*. Several of his decades-old insights have important applicability to media stocks in the digital age:

- **What Makes a Hit?** One of McPhee’s most important points (in our view) is a discussion of how hits are made. McPhee believes that hit products have a “natural monopoly” with positive consumer feedback loops. That is, heavy users of books or TV watch everything, including long-tail product. Light users are a relatively large proportion of total demand for any cultural item, including media. Light users are interested in joining the conversation with the highest number of people for the least time invested; therefore, hits become self-reinforcing. Because hit products “monopolize” light consumers, McPhee concludes that hits have a “natural monopoly.”
- **Why Aren’t There More Hits?** McPhee found that people who choose obscure products tend to be the most familiar with products on the long tail, but these are the very people who “know better.” He called this concept “double jeopardy” because the large majority of products have the double disadvantage of not being well known and when they are discovered, the folks that find them know about many other products so it’s hard to excel above that large dataset.

In 1981, Sherwin Rosen wrote a paper published in the *American Economic Review* entitled “The Economics of Superstars,” where he discusses the “convexity of service activities.” Convexity means that small differences in talent in service businesses become magnified into huge revenue differences. His academic analysis shows that a core underlying assumption of supply vs. demand economics comes unraveled in service businesses because people are not perfect substitutes. Examples include:

- A surgeon that is 10% more likely to save a life is worth multiples more than surgeon #2.
- Lawyers that have a higher win ratio in court command large premiums, because the legal costs are often a mere fraction of what’s at stake in a lawsuit.
- Hit bands demand huge ticket price premiums vs. average bands, because listening to five average bands is not substitutable with listening to one Superstar band.
- Top film stars make multiples more than average competent film actors because they “sell tickets” by bringing audiences into theatres.

In 1995, Robert Frank and Philip Cook wrote a book entitled *The Winner-Take-All Society*. They posited that widespread fast communication coupled with a low cost of trial would drive convergence in tastes and buying habits. That is exactly what appears to have happened in the digital age. They offer three reasons for this consumer convergence around hits:

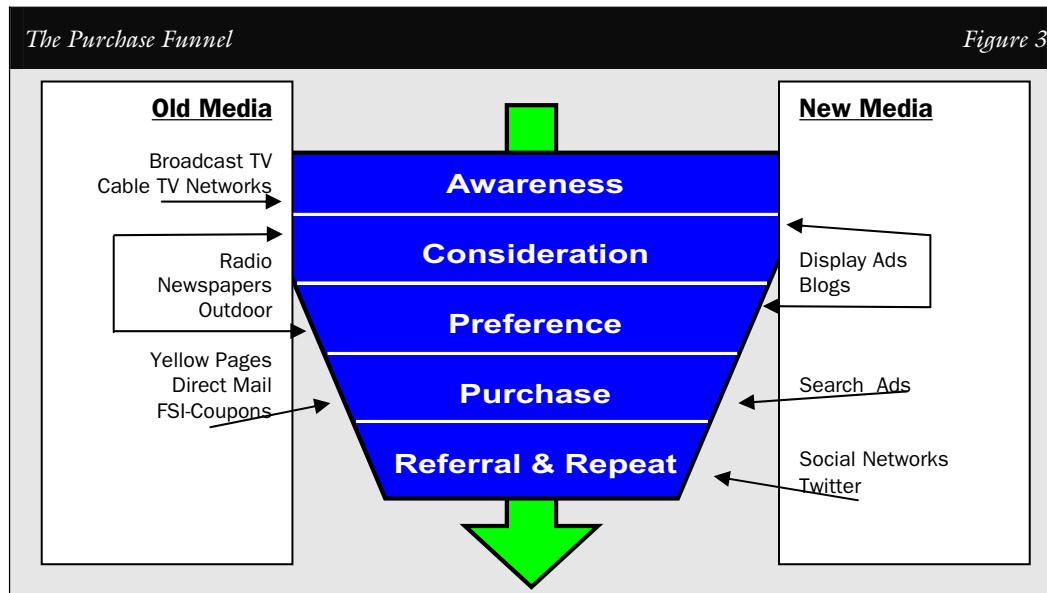
- In a digital world, where information is perfect and trial is inexpensive, why would anyone buy the second best? With ubiquitous information, it’s easy to determine whether you are reading or listening or watching the best available. Social networks, search engines, customer reviews, recommendation engines, etc. all push consumers toward the best product (super-hits) available.
- People are inherently social animals and therefore they find value in reading, watching and listening to the same things that other people do. Therefore, hits reinforce themselves.
- Because the marginal cost of creating the next copy is low in the digital world, the profit margins of hits are large. This makes suppliers want to create “hit” content because the upside is huge.

Lessons Learned

- The more things change, the more they stay the same. Hits always garnered more economics than average media content. Digital platforms appear to drive “winner-take-all” economics.
- The comparative advantage of the Internet for media is that it marries content with communication through social networks, twitter, blogs, etc. Premium content should be worth *more* on digital platforms because hits are what everyone wants to talk about on the Internet.

5. Move Up the Purchase Funnel

We believe that a useful framework to think about long-term shifts in monetization between old and new media is the purchase funnel, which encapsulates marketers' goals when they spend advertising dollars. Figure 3 shows a sample purchase funnel with the old economy advertising-driven silos on the left and the new economy advertising silos on the right—spread out to approximate their primary channel strength in an advertiser's marketing campaign. We note that most forms of advertising meet many goals within the purchase funnel, but we only show each media's primary channel strength.



Source: Needham & Co., LLC.

Awareness: When an advertiser introduces a new product, its first task is to inform consumers that the new product exists. Creating awareness is typically an advertiser's first goal.

Consideration and Preference: After creating awareness, the consumer must be convinced to consider buying the product by explaining product attributes through messaging and a brand promise. This drive to preference is often achieved by hitting frequency (immersion) goals. Radio, outdoor, newspapers, magazines, search, social networks, and display all compete here.

Purchase: The drive to purchase is typically the primary goal of advertising. Couponing, in-store, yellow pages, check-out line TVs, and point-of-purchase advertising all work well to achieve these goals in the physical world. In the digital world, search and online commerce are great ways to achieve these advertiser goals.

Referral and Repeat: Referral and Repeat is a cost-effective method of elongating marketing dollars. This type of spending seeks to instill loyalty and word-of-mouth referral to get others to buy the product over time. Social networks, blogs, chat rooms, etc. can play a big role here.

Lessons Learned

Move up the purchase funnel. The new digital technologies are best at the bottom end, closer to the point of purchase. They also have no platform to bundle in with their digital offering, no relationships with customers, and no cash from other sources to fund R&D. The more a newspaper (or any media) can saturate a particular target audience, the more demand and pricing power they should have with advertisers. If super-serving a client base can be coupled with hitting reach goals, this promises strong revenue growth.

6. The Internet Commoditizes Niche Audiences

Advertising spending is very concentrated in the U.S. In fact, in 2009, the largest 10 advertisers represented about 35% of total U.S. advertising spending, and the largest 100 advertisers alone accounted for about 60% of total U.S. advertising spending, according to *Ad Age*.

These largest of advertisers must reach a broad swath of potential purchasers. As the audience fractures to the infinite choices on the Internet (social networks, gaming, chat, blogs, news, sports, search, etc.), audiences fall to hundreds of thousands. Re-aggregating this world back to millions of ad impressions is cumbersome for advertisers and their agencies, and can be counterproductive if an ad reaches the same person 20 times.

Value of Reach Rises

Disaggregating audience is highly value destructive to the largest advertisers. It is this conclusion that informs our view that advertising will never be a major driver of revenue over the Internet for most websites because the audiences are too small and there are too many ways to reach the same niche audience (substitutes).

In this sense, the Internet commoditizes fractured audiences. That is, there are 5 ways for advertisers to reach women 18-34 that drive Cameros, so there is little pricing power for that ad inventory. Also, the aggregated audiences on any one website are up to hundreds of thousands of people, whereas the product creators need to sell millions of cars annually. Finally, although money is moving to the Internet, it is moving to millions of new sites that have enormous unsold ad inventory, which depresses advertising prices on the web.

Lessons Learned

- Interestingly, Group M recently projected slowing growth of digital advertising in the future vs. the past. “Measured Internet added two points of global ad share in each of 2007, 2008 and 2009, and we think it will sustain a rate of one point a year this year (2010) and next, to reach 16 percent in 2011.” This is good for newspapers and other old economy ad-driven silos as it implies the shift to digital platforms is slowing.
- Major media companies that control premium content have the largest audiences anywhere. Aggregating their online viewing with physical viewing gives newspapers a large advantage over digital-only content creators.
- Online audiences are fractured in numbers and in time. For example, 8 million hits on a website are *not* of equal value to a TV show with a rating of 8, because each TV ratings point represents the *average millions of viewers that watched the entire show* (30-60 minutes). Premium content typically has longer engagement metrics, which maximizes monetization because it aggregates audiences over longer time periods.

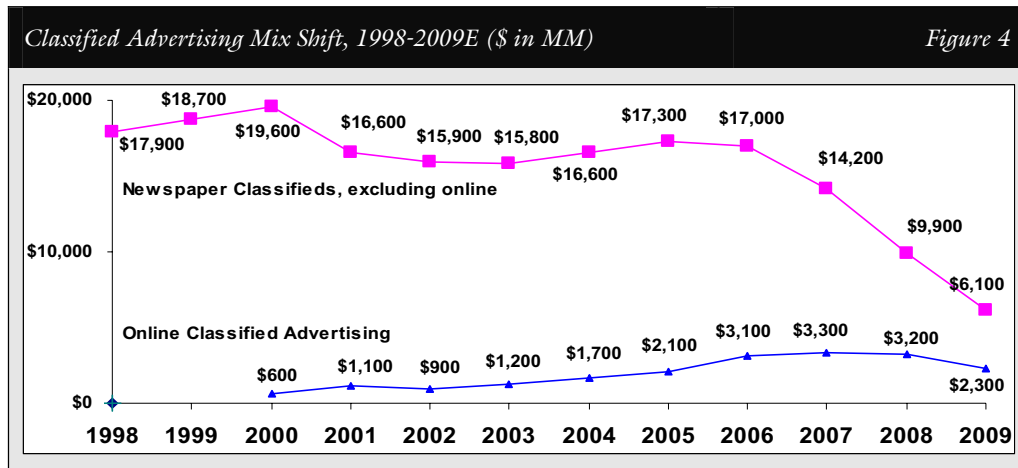
7. A Culture of Free

We hold the view that the pricing power of content is device dependent. To date, there is a culture of free on the in-home computer. We think this is the result of high consumer payments for the device and the high-speed network. That is, most households pay more than \$40 per month (nearly \$500 per year) for a high-speed Internet connection. In addition, computer life-spans are about 3-5 years, implying more than \$500 per year of “spending” on in-home computers is required to access the Internet.

The result is that the PC has developed a culture of free for content. This consumer expectation has been exacerbated by free services, such as craigslist and Wikipedia. These high-value-added services replaced large economic businesses with a better product at a price point of free to the consumer.

In the newspaper space, the best example of the culture of free is what’s happened to classified advertising. There is no business school class on Earth that could have predicted Jim Buckmaster, the CEO of craigslist. Why give away for free something that you could offer for a 50% discount to newspapers, or a 95% discount? The underlying assumption of all micro-economic theory is that competitors will behave “rationally.” What the theory missed was that different people define “rational” in different ways. Since 2000, Jim Buckmaster has led craigslist to be the most used classifieds in any medium, while maintaining its public service mission, anti-corporate culture, and staff of only 30.

The impact of craigslist on the newspaper business has been profound. Once the most profitable segment of the newspaper value chain, over the past decade, classified advertising has fallen by about \$11 billion of revenue per year and, as evidenced by Figure 4, *the money has disappeared*. This money has *not* shifted online. In fact, online classified advertising revenue has fallen for the past four years. More to the point, since 2000, online classified advertising grew \$3 billion to its peak while newspaper classified advertising has fallen \$12.6 billion from its peak. The rest of the money has disappeared. This is a value transfer from a business value chain to the consumer.



Source: LAB, Magna Global.

Lessons Learned

This example provides the most compelling learning from newspapers for other media industries. Michael Porter of Harvard Business School is credited as saying, “The only thing worse than a good competitor is a bad competitor.” With low-cost digital platforms that can reach virtually all U.S. consumers, there is no guarantee that someone somewhere in the 300 million population of the U.S. won’t define rational as giving away goods or services that used to be a meaningful part of some predecessor value chain.

8. This Cycle Was Brutal

The advertising recession of 2009 was one of the worst in decades. We would caution investors not to confuse cyclical revenue declines with the secular issues facing newspapers. Although there are many secular issues facing newspapers, as discussed above, much of the revenue deterioration in 2008 and 2009 was attributable to the largest ad categories for media coming under severe cyclical pressures. Given a choice of going out of business, cutting staff, or cutting advertising, companies cut advertising.

How Much Was Cyclical?

Can we estimate how much of the newspaper revenue decline reported in 2009 was cyclical? We can try. As evidenced by Figure 5, newspapers were in the middle of the pack in 2009, not the bottom. Virtually all old-economy advertising-driven media reported advertising revenue down 10-20% in 2009. Newspapers were in the middle of that range. In 2009, most TV segments reported far worse declines (owing in part to no political revenue in 2009) and newspaper declines were right in line with outdoor, where there are no secular pressures.

US Media Category	Jan-Dec 2009 vs. Jan-Dec 2008 % Change
Internet	0.10%
Spot Radio	-8.70%
Network Radio	-9.70%
Network TV	-9.90%
Local Newspaper	-10.40%
Outdoor	-11.20%
National Newspaper	-13.70%
Spot TV 101-210	-14.20%
Syndicated TV	-14.70%
Spot TV Top 100	-16.10%
National Magazine	-19.30%
Local Magazine	-23.90%
Grand Total	-9.00%

Source: AC Nielsen, February 24, 2010.

So What?

- Newspaper ad spending declines are easing. National newspapers revenues were down 13.7% in 2009, demonstrating a robust 4Q09 since the first three quarters of 2009 were down 21.6%, according to AC Nielsen. Local newspaper revenue is also improving rapidly, reporting a decline of 10.4% for the full year 2009 vs. a first nine months decline of 14%.
- The U.S. economy is rebounding, driving advertising growth. Group M last week cut its projected decline for U.S. ad spending in 2010. Their new study, "This Year, Next Year," expects U.S. ad spending to decline 1.3% to \$145 billion in 2010. That's a marked improvement vs. its last report published in December 2009, which anticipated a 4.3% decline. Group M predicts U.S. advertising spending will actually grow by 2.5% to \$149 billion in 2011.

Lessons Learned

Newspapers dramatic revenue declines in 2009 mirrored other ad-driven media that are less secularly challenged. By implication, the secular issues facing newspapers are lowering their growth nominally vs. other media, which means it's not too late. They have time. It's not over. Structurally, newspapers have great brands, strong long-term relationships with (typically wealthy) readers, subscription information, and cost structures that are coming down. It was bad luck for newspapers that they were the first to face the disruptive force of the Internet. Having said that, if any premium content owner figures out how to monetize itself better on digital platforms, newspaper companies have the option to be fast followers.

What Next? Summary and Conclusions

Adjustments So Far

Newspapers have made many value-added adjustments already, including:

- **Cost Cutting.** Staffing costs are down 20-50% over the past 3 years for most newspapers. Spending on newsprint, the second largest expense category, is down by 40% owing to falling demand and smaller papers. Many papers have stopped delivering to readers far from the urban center because they are too expensive to reach. Finally, papers are encouraging small local businesses to use technology that allows them to design their own ads (cheaper for the paper).
- **Content Shifts.** Newspapers are increasingly giving readers what they want to read. Newspapers are becoming more distinctive and customer-focused, thanks to the immediacy of feedback loops on digital platforms. Papers are carving out content niches and nurturing distinctive strengths that have pricing power. Many newspapers have focused on local news and sports, leaving other types of content to out-of-market competitors. For example, at Gannett, 46 of their local papers now get their national and international news from USA Today, Gannett's national paper.

What Can Newspapers Do Next?

- **Take advantage of interactive platforms.** For example, there is a campaign for Axe in India that gets young men to download a mobile-phone app that has a woman's voice wake them up each morning and the greeting becomes friendlier over time as men use it. Apps, ecommerce and virtual goods represent potential revenue streams for premium content creators, including newspapers.
- **Solve for multiple revenue streams.** Smart-phones, tablets, e-readers, etc.—the key to success for newspapers and other media will be to have multiple revenue streams.
- **Non-substitutable content will command the most dollars from consumers.** *The Financial Times* and the *Wall Street Journal* have leading positions in business and financial news, and both charge consumers for their content online.

How Do We Make Money? We Recommend NewsCorp (NWSA, Buy)

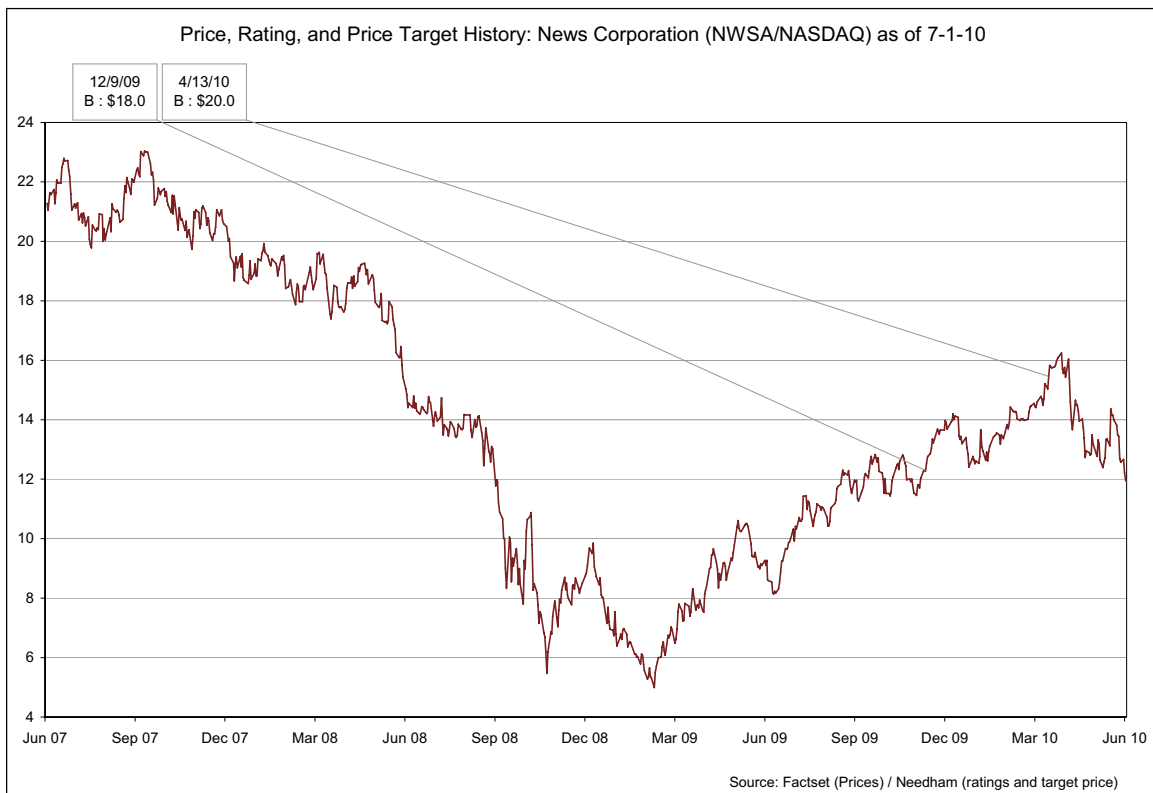
NewsCorp (NWSA, Buy) is our top pick coming out of this report. The newspaper segment of NWSA is about 20% of revenue. Our 2011 EPS estimate for NWSA is \$1.09 (vs. \$1.07 consensus) and our 12-month target price is \$20, about 55% above current price levels. We show that NWSA is valued at 13x EPS and 7x EV/EBITDA, a discount to its peers under our coverage. We believe that there are secular and cyclical reasons that suggest that investors should be buying NWSA now, especially in light of recent share price weakness driven by NWSA's announced intention of buying the 61% of BSkyB that it doesn't already own. For a detailed NWSA analysis and model, please see our report entitled, "Time to Buy NWSA," dated June 28, 2010.

ANALYST CERTIFICATION

I, Laura Martin, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company (ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

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Company	Symbol	Closing Price 7/1/10	Rating	Disclosures
NewsCorp.	NWSA	\$11.91	Buy	B, G



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	% of companies under coverage with this rating	% for which investment banking services have been provided for in the past 12 months
Strong Buy	6	9
Buy	58	12
Hold	31	3
Underperform	<1	0
Rating Suspended	3	17
Restricted	<1	100
Under Review	<1	0

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Laura Martin graduated from Stanford in 1980, Harvard Business School in 1983, and she holds a CFA designation. In 1983, Martin joined Drexel Burnham Lambert in investment banking, with a media company focus. In 1991, she moved to the “buy side” at Capital Research & Management as a media analyst, with money management responsibilities for a \$500 million media-equity portfolio. Beginning in 1994, she worked on the “sell side” at Credit Suisse First Boston as the senior media analyst publishing research on the largest U.S. entertainment and cable companies. She was nationally ranked by *Institutional Investor* magazine each year between 1999 and 2001. In 2002, Martin moved to Paris to become EVP of Financial Strategy and Investor Relations for Vivendi Universal. In 2004, she founded Capital Knowledge, LLC (www.CapKnowledge.com), a financial consulting firm providing expert witness testimony, capital markets advice, and valuation services to senior management teams. In the same year, she founded Media Metrics, LLC publishing equity research on the largest entertainment, cable and Internet stocks in the U.S., where she was nationally ranked as “Best of the Independent Research Boutiques” by *Institutional Investor* for many years. In 2009, Martin moved to Needham & Company, LLC, where she continues to publish research on large U.S. entertainment, cable and media companies.

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