HIDDEN OPPORTUNITIES

"Analyzing possible breakups by providing sum-of-the-parts valuations."

Steve Ferazani, CFA **Michael Wolleben**

- ✓ Gannett Co. (NYSE: GCI), a local media company with broadcasting, publishing, and digital segments, is in the process of acquiring fellow local broadcaster Belo Corp. (NYSE: BLC), in a $2.2 billion deal expected to close by the end of 2013. GCI is among a handful of remaining diversified media companies following a series of breakups.

- ✓ In coming years, local broadcasters may benefit from expanding retransmission fees from cable companies, the potential sale of spectrum through an FCC auction, and increased expenditures on political campaigns, as well as an ongoing shift to television as the most popular advertising medium. Local broadcasting stocks are likely to benefit from increasingly positive earnings projections, as well as rising multiples, as local broadcasting multiples still significantly trail their national cable brethren.

- ✓ Taking into account $175 million in synergies within three years in the broadcasting segment as a result of the Belo merger, we value the business at $31 per share based on peer group and historical multiples and current growth prospects. Assuming publishing revenue and margins begin to stabilize, we reach a fair value of $12 per share for the newspapers based on a 10-12% cash flow yield and peer multiples. The stake in CareerBuilder is valued at $3 per share, while other investments total $2 per share based on book value and projected cash flow. Net debt, including $2.2 billion for the Belo acquisition, equals $3.4 billion, or $15 per share.

- ✓ On a sum-of-the-parts basis, we reach a value for GCI of $33 per share. Future potential catalysts include a spin-off or sale of the publishing segment, additional asset sales such as the 53% stake in CareerBuilder, significant growth in retransmission fees, or potential upside from spectrum sales. This SOTP valuation excludes potential benefits from the $300 million share repurchase program, which can easily be funded from free cash flow.

Gannett Co. (NYSE: GCI)

Price (11/2013): $28 / share

Broadcasting: $31 per share

Publishing: $12 per share

Digital: $3 per share

Investments: $2 per share

Net Debt*: ($15 per share)

SOTP: $33 / share

***net debt assumes $2.2 bill for BLC acquisition**

NOTE: This publication does not advocate for breakups. However, authors select companies for this report based on the potential for a future transaction. In many cases, these companies have come under activist investor pressure, media scrutiny, or general market speculation that a spin-off or asset sale is possible.

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The Background

Gannett Co. (NYSE: GCI) was founded in 1923 by Frank Gannett in Rochester, NY, as a newspaper publisher. Gannett expanded through the years into a national newspaper chain by purchasing additional local or regional publications. The company went public in 1967. Gannett expanded into broadcasting through an acquisition in 1979 and relocated to Virginia in 1986. Gannett's largest publication by daily circulation, *USA Today*, was created in 1982. In June 2013, GCI announced a deal to acquire fellow local broadcaster Belo Corp. (NYSE: BLC) for about $1.5 billion cash, plus the assumption of $715 million in debt, increasing GCI's television station count to 43 (from 23). The deal is expected to close by the end of 2013, pending regulatory approval. The company reports results in three segments: publishing, digital, and broadcasting (see Background #1). Publishing still accounted for nearly 70% of revenue in 2012 but only about 45% of segment EBITDA. The highest margins are generated by the broadcasting segment, which has been growing at the fastest rate in recent years.

Background #1 Gannett Operating Results, 2010 – September 2013
($ in thousands)

	First 9 months 2013	First 9 months 2012	2012	2011	2010	2010-2012 average
Revenue						
Publishing	$2,633,543	$2,684,595	$3,728,144	$3,831,108	$4,050,839	$3,870,030
Digital	$552,875	$531,700	$718,949	$686,471	$618,259	$674,560
Broadcasting	$608,906	$618,593	$906,104	$722,410	$769,580	$799,365
Total	$3,795,324	$3,834,888	$5,353,197	$5,239,989	$5,438,678	$5,343,955
Adjusted EBITDA						
Publishing	$339,607	$375,839	$516,394	$626,120	$817,814	$653,443
Digital	$127,730	$117,332	$165,690	$156,033	$126,668	$149,464
Broadcasting	$287,185	$306,986	$471,815	$331,066	$369,705	$390,862
Corporate	($35,228)	($30,423)	($47,976)	($57,812)	($43,607)	($49,798)
Total	$719,294	$769,734	$1,105,923	$1,055,407	$1,270,580	$1,143,970
EBITDA margin						
Publishing	12.9%	14.0%	13.9%	16.3%	20.2%	16.9%
Digital	23.1%	22.1%	23.0%	22.7%	20.5%	22.2%
Broadcasting	47.2%	49.6%	52.1%	45.8%	48.0%	48.9%
Total	19.0%	20.1%	20.7%	20.1%	23.4%	21.4%
Identifiable assets						
Publishing	N/A	N/A	$2,850,915	$3,032,605	$3,162,655	
Digital	N/A	N/A	$1,009,821	$1,014,805	$1,057,898	
Broadcasting	N/A	N/A	$2,001,979	$1,994,051	$2,003,929	
Corporate	N/A	N/A	$517,171	$574,989	$592,362	
Total	N/A	N/A	$6,379,886	$6,616,450	$6,816,844	

Source: Company reports, Institutional Research Group estimates.

Broadcasting

The Broadcasting segment currently includes 23 stations, reaching more than 18% of US households, as well as associated websites The segment marked a record year in 2012 for a combination of reasons, including increased advertising revenue from the Summer Olympics broadcast on its 12 NBC affiliates, strong political advertising in a presidential election year, and 21% higher retransmission fees generated from cable companies, as well as 11% growth in digital advertising (see Background #2). EBITDA totaled $472 million in 2012, up 43% from the previous year and nearly double the 2009 trough. Even-numbered years are typically stronger for local broadcasters (particularly NBC affiliates) due to increased political advertising and the Olympics. In 2012, the political ads (in a presidential election year) accounted for about $150 million in revenue, while the Olympics added $37 million (of which $4 million was for political ads aired during Olympic broadcasts). The Summer Olympics typically draw larger audiences than the Winter Games; the next Winter Games are scheduled to take place in Sochi, Russia, in 2014.

Background #2 Broadcasting Segment Operating Results, 2007 – 2012
($ in millions)

	2012	2011	2010	2009	2008	2007
Total Revenue	$906	$722	$770	$631	$773	$789
Operating expenses	$462	$420	$440	$415	$467	$474
Operating income	$444	$302	$330	$216	$306	$315
Depreciation and amortization	$28	$29	$31	$34	$35	$34
EBITDA	$472	$331	$361	$250	$341	$349
TV Stations	23	23	23	23	23	23
Market size (millions)	21.0	21.0	21.0	20.9	20.8	20.8
US population coverage (%)	18.1	18.1	18.2	18.2	18.2	18.2

Source: Company reports, Institutional Research Group estimates.

GCI has high operating margins compared to other non-network-owned local broadcasters due to its mix of major markets and leading affiliates in those markets. Obviously, more eyeballs on programming results in higher advertising rates. GCI operates NBC affiliates in large urban areas, including Atlanta, GA, Cleveland, OH, Denver, CO, Minneapolis, MN, and Phoenix, AZ, as well as CBS affiliates in Washington, DC, and Tampa, FL. GCI also benefits from scale. By operating in 23 relatively large markets, it lowers overhead costs (as a percentage of station revenue). The addition of the Belo stations should enhance these benefits. In June 2013, GCI announced a deal to acquire Belo Corp. (NYSE: BLC) for $1.5 billion cash plus the assumption of $715 million in debt. The $13.75 per share offer was a 29% premium to the previous day's closing price. In September, Belo shareholders approved the deal. It is expected to close in late 2013, pending regulatory approval. While the transaction values BLC at about 9.4x 2011/2102 EBITDA, it would be about 5.4x assuming $175 million in synergies expected by GCI within three years, with about $75 million achievable in year one, making the acquisition accretive in

the first year. Simultaneous to the deal announcement, GCI authorized a new $300 million share buyback program. BLC owns 20 television stations covering about 14% of US households. It previously spun off its newspaper operations as A.H. Belo Corp. (NYSE: AHC) in 2008.

Gannett management estimates that the company's pro forma EBITDA margin in 2011/2012 would have been 24.3% with synergies from the Belo merger, about 390 basis points above the actual margin (see Background #3). Synergies would have generated $150 million in higher annual sales. These benefits should be generated entirely at the broadcast segment level, resulting in segment EBITDA margin of 49.1%, only modestly below the EBITDA margin of 49.4% for the standalone GCI broadcast segment over the same period. Belo's broadcasting segment generates lower margins due to a number of factors, including market size, affiliate mix, and timing of retransmission negotiations.

FCC rules dictate that local broadcasters are limited to reaching only 39% of US households, which would appear to reduce the potential for future GCI acquisition activity following the BLC acquisition, at which point the merged company will stand close to 33%. However, the FCC currently counts UHF stations at 50% of the reach of VHF stations. Given GCI-BLC's significant number of UHF stations owned, GCI-BLC will reach about one quarter of US homes on a recalculated basis. Given recent industry consolidation, the FCC is considering eliminating the UHF rule, which would put the GCI-BLC's reach back at more than 30%. The rule is worth monitoring as it could have a major impact on potential, future purchases following merger closure.

Background #3 Gannett-Belo Merger Synergies

($ in millions)

2011/2012 Averages for Gannett and Belo

	Gannett	Belo	Synergies	Combined
Sales	$5,297	$682	$150	$6,129
EBITDA	$1,081	$232	$175	$1,488
EBITDA margin	20.4%	34.0%		24.3%

Source: Company presentation.

2011/2012 Averages for Gannett Broadcasting Segment and Belo

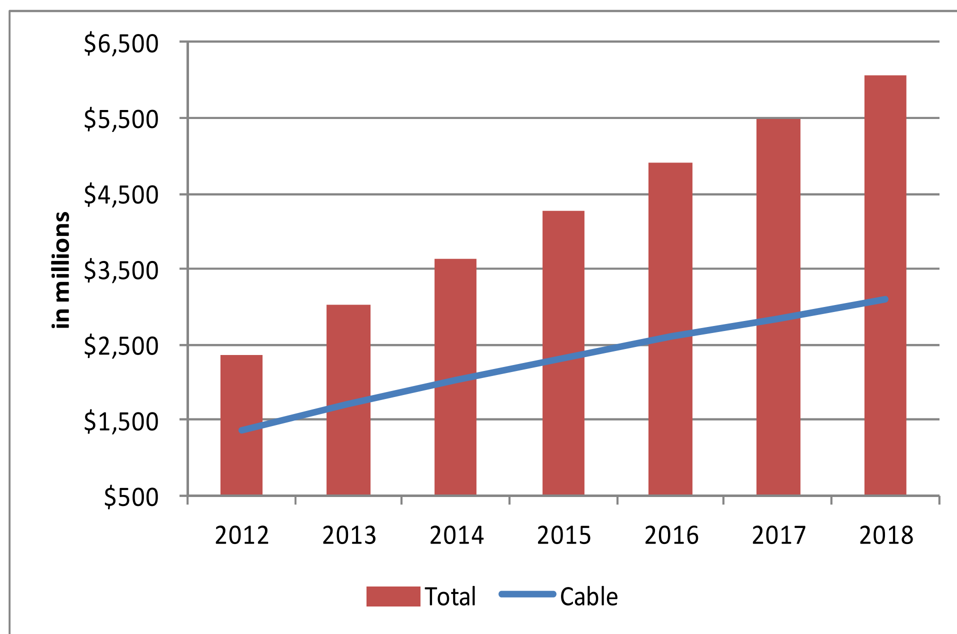
	Broadcasting	Belo	Synergies	Combined
Sales	$814	$682	$150	$1,646
EBITDA	$402	$232	$175	$809
EBITDA margin	49.4%	34.0%		49.1%

Source: Institutional Research Group estimates.

About $75 million of the synergies are potentially achievable in year one of the three-year plan, due primarily to the status of retransmission agreements. Belo has renegotiated fewer new retransmission agreements with the larger cable companies. In fact, rising retransmission fees from cable companies are a significant factor in growing local broadcaster revenue and margins. This circumstance was highlighted by the impasse and eventual perceived victory by CBS Corp. (NYSE: CBS) in its battle with leading cable company Time Warner Cable Inc. (NYSE: TWC) in

the fall of 2013. After CBS-owned stations were blacked out to TWC subscribers for nearly a month, the two sides finally agreed. While details of the deal were not publicly disclosed, various media sources reported that the deal nearly doubled CBS retransmission fees from TWC to almost $2 per subscriber/monthly, while maintaining CBS's rights to digital ownership, enabling the company to reach separate deals with Netflix Inc. (NASDAQ: NFLX), Amazon.com Inc. (NASDAQ: AMZN), or others. Retransmission fees were once a key revenue driver primarily for operators of cable networks, but these opportunities have been expanded to local broadcasters. In fact, industry forecaster SNL Kagan predicts that annual retransmission fees will double to about $6 billion in 2018 (see Background #4). A percentage of these fees will be passed back to the networks (i.e. NBC, ABC, or CBS) as reverse retrans as affiliate agreements are renewed.

Background #4 Retransmission Fee Forecast, 2012 – 2018E
($ in millions)



Source: SNL Kagan.

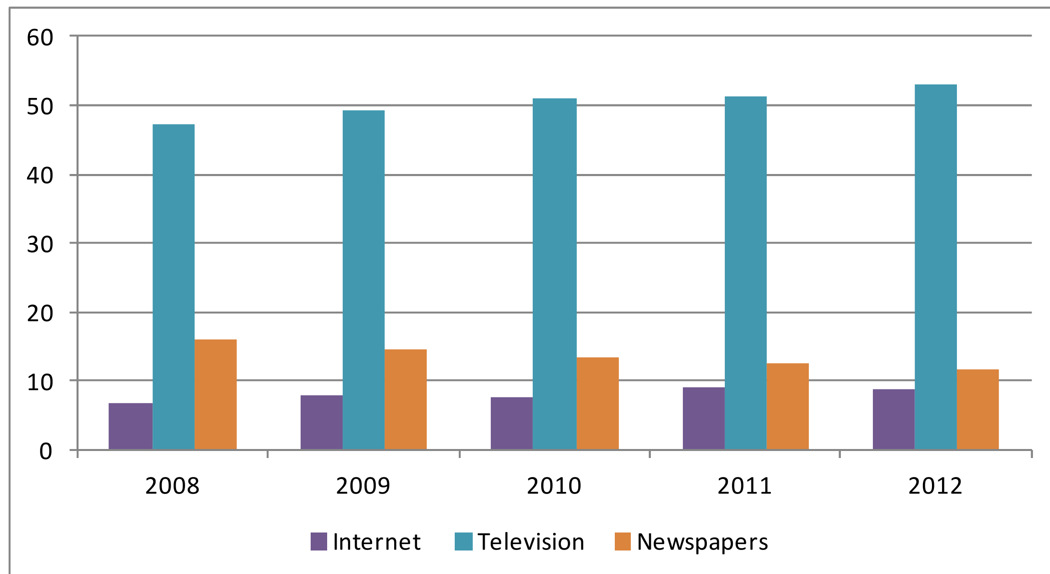
In 2Q 2013, GCI increased retransmission fees 62% year-over-year to nearly $37 million, accounting for about 17% of segment revenue. Segment revenue was up 6% in the first half of 2013 compared to the year-earlier period, and operating income rose 9%, due in large part to higher retransmission fees offsetting losses in political ads. Second half 2013 comparables will be weaker due to the Olympics in 2H 2012 and stronger political ad spending in 4Q 2012.

Publishing

While GCI's broadcasting segment is benefiting from growing retransmission fees, increased ad spending, and likely future synergies from the Belo acquisition, the newspaper business continues to struggle with lower ad spending, weaker circulation, and the general movement of readers to online sources. In fact, from 2008 through 2012, as television's share of media ad spending grew to more than 53% from 47%, newspapers' piece declined to 11.8% from 15.9%.

Meanwhile, advertisers chose online sources for about 8.7% of their budgets in 2012, up 200 basis points from 2008 (see Background #5). The shift in advertisers' spending focus is a major reason why television and online revenue has grown since the financial crisis, while newspaper industry revenue has been flat to down. It is also the leading culprit in the low valuation of newspaper stocks compared to broadcaster equities.

Background #5 Share of Media Ad Spending, 2008 – 2012



Source: Kantar Media Intelligence.

GCI publishes 82 daily newspapers, including *USA Today*, and 480 non-daily products in the US. Newspapers with large daily circulations include *The Arizona Republic*, *Indianapolis Star*, *Detroit Free Press*, and *The Cincinnati Enquirer*. In the UK, GCI's Newsquest produces 17 daily publications and more than 200 weekly publications, magazines, and trade publications. GCI has not been immune to advertising trends; since 2008, GCI's annual newspaper advertising revenue declined 43% to less than $2.4 billion (see Background #6). The newspaper industry has tried to adapt to the new environment by lowering headcount, increasing efficiencies where possible, and generally cutting operating costs. Thus far, the cuts have not been made fast enough to offset declining revenue. For GCI's newspaper business, EBITDA has declined to $516 million in 2012 from $781 million in 2009, even though annual operating expenses were reduced by more than $400 million to less than $3.4 billion over that period. More recently, GCI and other newspaper publishers have tried yet again to establish paywalls, essentially blocking certain online content from non-subscribers. Earlier efforts by newspapers to establish paywalls failed, but thus far, GCI has reported early success. It has established paywalls for many of its local publications, although *USA Today*'s online content remains free. The paywalls are part of new subscription plans that set one rate for all content, rather than breaking out print or online subscriptions. The single rate gives subscribers access to content from all sources at a modestly higher price. Notably, circulation revenue was up modestly in 2012 and trended higher in the first half of 2013. Loss of subscribers has been more than offset by the price increase.

Background #6 Newspaper Segment Operating Results, 2007 – 2012
($ in millions)

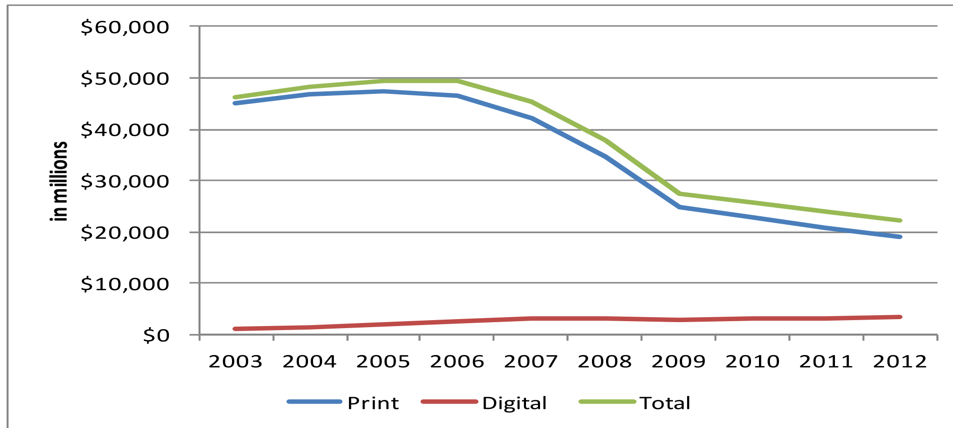
	2012	2011	2010	2009	2008	2007
Advertising	$2,356	$2,511	$2,711	$2,966	$4,146	$4,937
Retail	*$1,230*	*$1,303*	*$1,384*	*$1,533*	*$1,964*	*$2,184*
National	*$396*	*$446*	*$501*	*$524*	*$672*	*$751*
Classified	*$730*	*$762*	*$826*	*$909*	*$1,510*	*$2,002*
Circulation	$1,117	$1,064	$1,087	$1,167	$1,217	$1,252
Commercial Printing/Other	$255	$256	$254	$262	$352	$390
Total Revenue	$3,728	$3,831	$4,051	$4,396	$5,714	$6,580
Operating expenses	$3,360	$3,354	$3,403	$3,786	$4,723	$5,054
Operating income	$368	$477	$648	$523	($7,026)	$1,390
Depreciation and amortization*	$148	$149	$170	$258	$8,148	$300
EBITDA	$516	$626	$818	$781	$1,122	$1,690
Daily publications	3,417	3,705	3,929	4,333	4,913	5,227

*also includes asset impairment and non-cash charges

Source: Company reports, Institutional Research Group estimates.

While paywalls and single-price subscriptions may help to stabilize newspaper industry circulation revenue, these efforts have not offset ad spending declines. According to the industry trade association, newspaper annual ad revenue has been cut in half in the decade since 2003 to about $22 billion. Over the same period, ad spending for digital newspaper editions has increased dramatically to $3.4 billion from only $1.2 billion. However, this significant growth does not come close to offsetting the decline in spending in print versions (see Background #7).

Background #7 Newspaper Annual Ad Revenue, 2003 – 2012

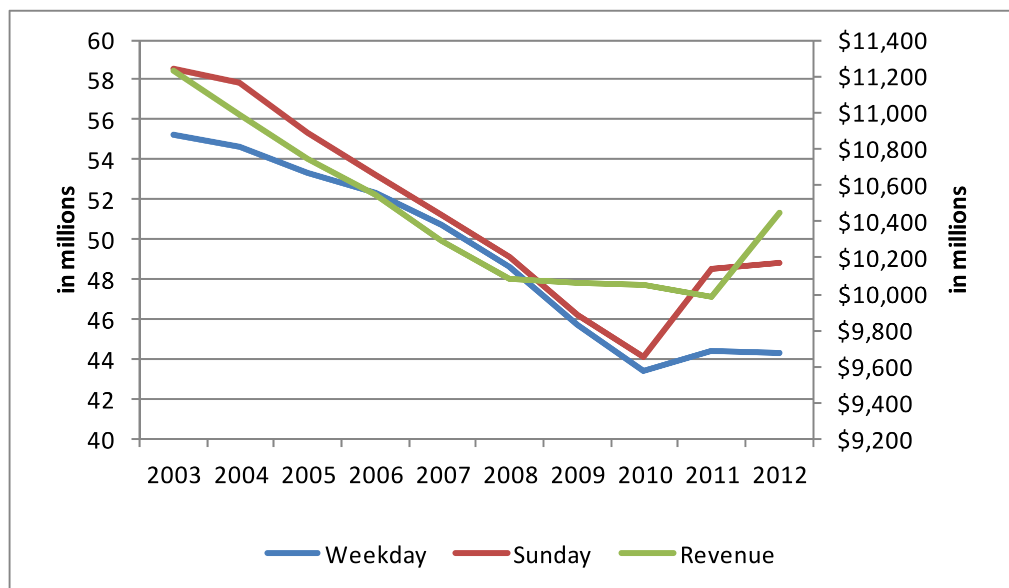


Source: Newspaper Association of America.

Moving forward, the key issue for the newspaper industry is how to generate increased revenue from digital sources even as much of online news is digested for free by an audience unaccustomed to paying for digital subscriptions. In addition, ongoing cost cuts look set to become an annual tradition. Consolidation may help the industry, as benefits from scale may offset continuing ad declines. The reduction in the number of available newspapers in each major market, leading to reduced competition, also may benefit the overall industry. Standalone publicly traded print companies acknowledge that the key for these entities is finding a way to become more entrenched in a digital world. Newly-installed Time Inc. CEO Joseph Rapp told a conference in fall 2013 that acquisitions to expand Time Inc.'s digital presence are a likely focal point following its spin-off from Time Warner Inc. (NYSE: TWX), planned for early 2014.

Perhaps the most encouraging sign for the industry is improving circulation revenue and stabilization of subscribers. From 2010 to 2012, daily subscribers to newspapers increased 900,000 to 44.3 million, while Sunday circulation rose to 48.8 million from 44.1 million. Despite a modest decline in daily subscribers in 2012 (from 2011), circulation revenue rose to $10.4 billion from less than $10 billion (See Background #8). The stickiness of circulation amid ongoing price hikes remains critical for the industry if it is to offset ad declines and increase spending for the digital transformation. However, given the ongoing uncertainty, these stocks are still likely to trade at significant discounts to broadcasters or even mixed-media companies.

Background #8 **Newspaper Industry Paid Circulation, 2003 – 2012**



Source: Editor & Publisher Yearbook, Pew Research Center.

GCI's *USA Today* recently lost its position as the second largest (after *The New York Times*) US paper by circulation (see Background #9). Founded in 1982, the national newspaper has a unique business model in that about half of its circulation comes from hotels and airports and about half of newspaper copies are supplied free of charge to guests. Of particular importance is its long-term deal with Blackstone Group LP's (NYSE: BX) Hilton Worldwide. While paid circulation expanded for the two other leading national newspapers (in the year through March 2013), circulation for *USA Today* declined, likely the result of lost contracts with certain hotels. Its ties to the travel industry may provide certain advantages, as hotels, airlines, and restaurants may see advantages in advertising in a paper read by tourists or business travelers. The newspaper is looking for other ways to expand its digital presence to reach this particular niche.

Background #9 **Leading US Daily Newspapers by Circulation**
(As of March 2013)

	Paid circulation in thousands	% annual change
Wall Street Journal	2,379	12.3
New York Times	1,865	17.6
USA Today	1,674	(7.9)
Los Angeles Times	654	6.0
New York Daily News	516	(11.0)

Source: Alliance for Audited Media.

According to a PricewaterhouseCoopers media forecast, global newspaper revenue should stabilize from the 2012 level after several years of decline. However, by comparison, global

television advertising will grow at an annual compound rate of more than 5% through 2017. This mirrors many other forecasts that see moderating declines or stabilization for print, but continued strong growth for video and broadcasting.

Digital

GCI's third reporting segment, digital, primarily comprises its nearly 53% stake in jobs site CareerBuilder.com. Tribune Co. (OTC: TRBAA) and The McClatchy Co. (NYSE: MNI) hold the remaining interests. The segment also includes PointRoll, ShopLocal, and Reviewed.com. Revenue has increased primarily through direct sales efforts by CareerBuilder and growing market share. Operating results for CareerBuilder are consolidated. Segment EBITDA increased from $109 million in 2009 to $166 million in 2012 on 23% revenue growth over that period to $719 million (see Background #10). Net income attributable to non-controlling interests totaled $51 million in 2012. CareerBuilder primarily generates revenue in North America but has additional web sites in South America and Europe.

Background #10 Digital Segment Operating Results, 2009 – 2012
($ in millions)

	2012	2011	2010	2009
Total Revenue	$719	$686	$618	$586
Operating expenses	$587	$561	$521	$518
Operating income	$132	$125	$97	$68
Deprecation and amortization	$34	$31	$30	$41
EBITDA	$166	$156	$127	$109
EBITDA (52.9%)	$88	$83	$67	$58
Net income attributable to non-controlling interests	$51	$41	$35	$27
Noncontrolling interests (balance sheet)	$189	$184	$170	$144

Source: Company reports, Institutional Research Group estimates.

The Breakup

At the time of the Belo acquisition announcement, GCI management would not rule out a potential future spin-off of its newspapers. Industry trends would seem to favor a potential split. Notably, Tribune has announced it would spin off its newspaper segment in 2014, while News Corp. (NASDAQ: NWSA) separated its newspapers, which kept the name, while renaming its cable channels and film production unit Twenty-First Century Fox Inc. (NASDAQ: FOXA) in 2013. Investors appeared to applaud those efforts. On June 26, 2012, when FOXA management acknowledged a newspaper spin-off was under consideration, the stock rose more than 8% on heavy volume. Likewise, in the week following TRBAA's spin-off announcement, the stock traded about 8.5% higher. Similarly, Time Warner Inc. (NYSE: TWX) announced plans to spin off its slow-growth magazine business in 2014 as Time Inc. The broadcasters appear poised to generate higher multiples by jettisoning the declining businesses that are faced with greater uncertainty. The lower cost of capital would better position these companies in a period of consolidation. If cap-ex continues to decline in the print segment, they could be sought by dividend-seeking investors because of their stabilizing cash flow. Perhaps the best model for this transaction is BLC, which spun off its newspapers as A.H. Belo in 2008, perhaps a forerunner to today's movement. The timing of the spin in the midst of the financial crisis obviously makes judging the short-term success difficult in investors' terms. However, longer term, one could rule the transaction successful even before the announced acquisition of BLC by GCI.

From an operational standpoint, the impact of the spin-off on the two entities is unclear in terms of standalone costs and loss of synergies, given the timing in the midst of economic chaos and declining ad revenue on both sides of the transaction. Even before the separation, BLC's operating margin was trending lower due to declining ad spending on the print side. Post-spin Belo showed a significantly higher operating margin in 2010 (from 2008) despite the fact that 2008 was a presidential election and Summer Olympics year. Meanwhile, A.H. Belo made progress toward operating at breakeven status by 2010 despite a significant revenue decline. By 2010, the combined entities had a higher operating margin than was achieved by the single company prior to the separation (see Breakup #1)

Breakup #1 **Belo Pre- and Post-Spin Operating Results, 2005 – 2010**
($ in millions)

		2005	2006	2007	2008	2009	2010
Pre-spin Belo							
	Revenue	$1,526	$1,588	$1,516			
	Operating income	$296	$288	$256			
	Operating margin	**19.4%**	**18.1%**	**16.9%**			
	Production, Distribution and other op costs	**$446**	**$489**	**$494**			
	P,D and other op costs/revenue	**29.2%**	**30.8%**	**32.6%**			
Post-spin Belo							
	Revenue				$733	$590	$687
	Operating income				$209	$127	$225
	Operating margin				28.5%	21.5%	32.8%
	Production, Distribution and other op costs				$250	$230	$236
	P,D and other op costs/revenue				34.1%	39.0%	34.4%
AH Belo							
	Revenue				$484	$352	$310
	Operating income				($43)	($12)	($2)
	Operating margin				-8.9%	-3.4%	-0.7%
	Production, Distribution and other op costs				$248	$209	$183
	P,D and other op costs/revenue				51.2%	59.4%	59.0%
Post-spin Total							
	Revenue				$1,217	$942	$997
	Operating income				$166	$115	$223
	Operating margin				**13.6%**	**12.2%**	**22.3%**
	Production, Distribution and other op costs				**$498**	**$439**	**$419**
	P,D and other op costs/revenue				**40.9%**	**46.6%**	**42.0%**

Excludes asset impairment charges, separation costs and pension plan contributions.

Source: Company reports, Institutional Research Group estimates.

The performance of the stocks following the separation certainly reflects the macro environment, industry trends, and finally individual company performance over the five-year period following the transaction.

In the first year, BLC shares declined more than 54%, while AHC stock was down more than 42%, massively underperforming the S&P 500. However, when compared to other broadcasters and newspaper publishers, the stocks actually modestly outperformed (see Breakup #2). Over five years, BLC was up 56% and AHC up nearly 32%, significantly outperforming peers and the broader S&P 500 as operations improved. The one better performer, Nexstar Broadcasting Group (NASDAQ: NXST), has benefited in recent years from synergies through acquisitions of other small local broadcasters, and the resulting improved operating margins. GCI was up only 3% in the same five-year period, still encumbered by its weak publishing segment and its conglomerate discount as a diversified media company.

Breakup #2 Belo Post-Separation Stock Performance

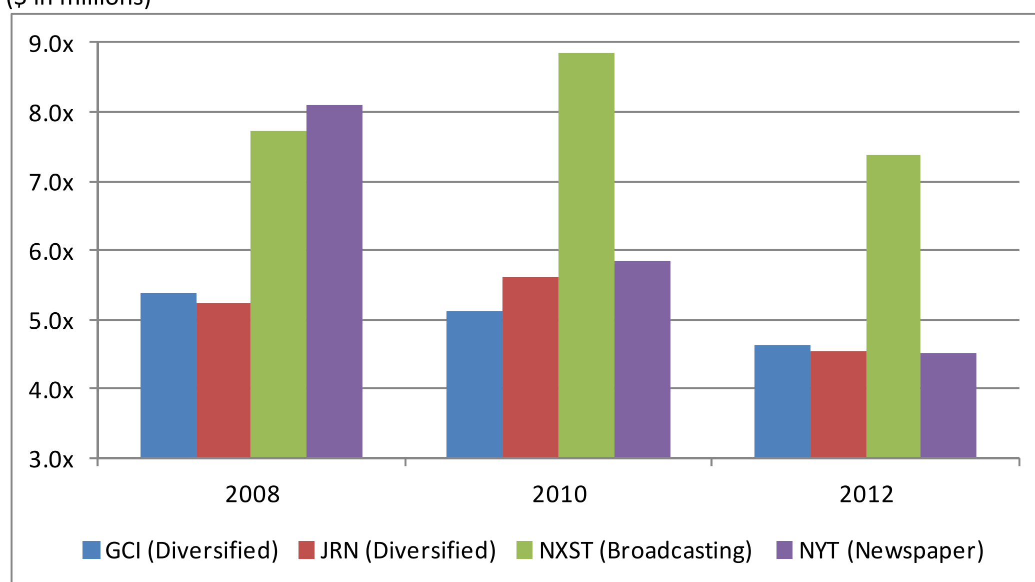
	BLC	AHC	GCI	NYT	NXST	S&P 500
1 year	-54.4%	-42.1%	-59.4%	-43.3%	-62.9%	-23.1%
2 year	-26.6%	28.5%	-36.4%	-45.0%	35.2%	-17.3%
3 year	-24.2%	6.1%	-48.9%	-47.1%	127.8%	-9.7%
Through 6/7/2013	**56.1%**	**31.8%**	**2.7%**	**-27.1%**	**767.8%**	**25.9%**

Source: Bloomberg.

The discount is made clear when considering EV/EBITDA multiples from 2008 through 2012 of a series of media companies, including GCI and Journal Communications (NYSE: JRN), representing diversifieds, NXST as a proxy for standalone broadcasters and NYT for the newspapers. Until 2012, GCI and JRN traded at sharp discounts to both broadcasters and newspapers. But as newspapers have continued to struggle and broadcasting outlooks have improved, multiples for the diversifieds finally surpassed or came into line with NYT (see Breakup #3). The exhibit is probably the most concrete argument for a separation of the newspapers from broadcasting operations.

Breakup #3 EV/EBITDA Multiples for Media Companies, 2008 – 2012

($ in millions)



Source: Bloomberg.

The Breakdown

In our sum-of-the-parts calculations for each business, we consider peer group multiples, historical valuations, potential growth rates, free cash flow, fixed assets, and margins for each business as a standalone. Several segments must be valued to reach a SOTP for GCI, including broadcast, newspapers, digital (primarily the stake in CareerBuilder), and minority investments in newspaper and other media ventures. We also consider the optionality of the spectrum owned by its local stations. As a starting point, we consider the valuations of comparables in broadcast, newspapers, digital, and diversified media (see Breakdown #1). It is important to note, for GCI, that we exclude estimates from the consensus that do not appear to model in the BLC acquisition for 2014; we also add to net debt the full cost of the purchase, to provide a better comparison for New GCI.

HIDDEN OPPORTUNITIES

"Analyzing possible breakups by providing sum-of-the-parts valuations."

Breakdown #1 Peer Group Comparables Table

($ in millions, except per share amounts; shares in millions)

	Television					Newspapers		Local Media		Digital		
as of 10/30/2013	**Gannett**	**Sinclair**	**Nexstar**	**Gray**	**LIN**	**The New York**	**News**	**Journal**	**The E.W.**	**AOL**	**Monster**	**IAC/**
Company	**Corp.**	**Broadcasting**	**Broadcasting**	**Television**	**Media**	**Times Co.**	**Corp.***	**Communications**	**Scripps Co.**	**Inc.**	**Worldwide**	**InterActive**
Ticker	**GCI**	**SBGI**	**NXST**	**GTN**	**LIN**	**NYT**	**NWSA**	**JRN**	**SSP**	**AOL**	**MWW**	**IACI**
Price	$27.81	$31.98	$43.52	$8.33	$24.67	$13.78	$17.35	$8.40	$19.25	$36.19	$4.35	$52.97
Shares outstanding	229	100	30	58	52	149	579	51	57	77	113	83
Mkt Cap	$6,371	$3,192	$1,306	$480	$1,290	$2,059	$10,046	$428	$1,099	$2,778	$492	$4,397
Net Debt	$3,411	$1,898	$949	$810	$939	($221)	($2,540)	$230	($30)	($367)	$60	$9
EV	$9,782	$5,090	$2,255	$1,290	$2,229	$1,838	$7,506	$658	$1,069	$2,411	$552	$4,406
Equity	$2,465	$379	$6	$152	($63)	$702	$14,146	$218	$538	$1,365	$828	$1,631
Price/Book	2.6x	8.4x	218.0x	3.2x	N/A	2.9x	0.7x	2.0x	2.0x	2.0x	0.6x	2.7x
Average ex. GCI	**24.3x**					**1.9x**				**1.3x**		**2.7x**
F2012 EPS	$2.33	$1.78	$0.92	$0.95	$1.50	$0.47	N/A	$0.70	$0.89	$1.39	$0.38	$2.28
F2013E EPS	$2.06	$1.13	$0.94	$0.25	$0.56	$0.34	$0.38	$0.54	$0.05	$2.03	$0.34	$4.02
F2014E EPS	$2.84	$2.90	$3.68	$0.84	$1.70	$0.39	$0.45	$0.72	$0.94	$2.26	$0.37	$4.49
P/F2014E EPS	9.8x	11.0x	11.8x	9.9x	14.5x	35.3x	38.6x	11.7x	20.5x	16.0x	11.8x	11.8x
Average ex. GCI	**11.8x**					**36.9x**		**16.1x**		**13.2x**		
2-year EPS growth 12-14	21.9%	62.9%	300.0%	-11.6%	13.3%	-17.0%	N/A	2.9%	5.6%	62.6%	-2.6%	96.9%
Average ex. GCI	**91.2%**					**-17.0%**		**4.2%**		**52.3%**		
F2013E EBITDA	$1,104	$519	$181	$103	$172	$239	$777	$80	$61	$465	$149	$597
EV/F2013E EBITDA	8.9x	9.8x	12.5x	12.5x	13.0x	7.7x	9.7x	8.2x	17.5x	5.2x	3.7x	7.4x
Average ex. GCI	**11.9x**					**8.7x**		**12.9x**		**5.4x**		
F2014E EBITDA	$1,436	$861	$305	$160	$292	$242	$816	$94	$144	$501	$153	$680
EV/F2014E EBITDA	6.8x	5.9x	7.4x	8.1x	7.6x	7.6x	9.2x	7.0x	7.4x	4.8x	3.6x	6.5x
Average ex. GCI	**7.3x**					**8.4x**		**7.2x**		**5.0x**		
2014E Sales	$6,100	$2,111	$720	$411	$771	$1,747	$8,790	$436	$921	$2,452	$804	$3,345
2014E EBITDA margin	23.5%	40.8%	42.4%	38.9%	37.9%	13.9%	9.3%	21.6%	15.6%	20.4%	19.0%	20.3%
Average ex. GCI	**40.0%**					**11.6%**		**18.6%**		**19.9%**		

Source: Bloomberg.

*shares outstanding include Class B shares.

GCI low estimates are excluded from consensus as they do not appear to model BLC acquisition yet. EV for GCI assumes BLC acquisition closes.

Publishing

One may consider valuing the newspaper segment against other leading national newspapers *The New York Times* or News Corp.'s *Wall Street Journal*. However, GCI also generates significant revenue from its local newspapers in 30 states. Newspapers will likely continue to invest in digital transformation to generate growth in bundled, higher-priced subscriptions to offset ongoing weakness in advertising. Ultimately, investors may consider these investments for dividends, much like utilities over the longer term, provided the ongoing bleed from advertising declines is eventually halted. Valuing on stable EBITDA and free cash flow appears appropriate.

Assuming the newspaper segment can stabilize EBITDA at around $490 million (in line with the 2013 segment projection), adding $24 million (about 50%) of the shared annual corporate costs, and applying the 2013E NYT/NWSA multiples of 7.6x and 9.2x, we reach a price target range of $15 to $19 per share (see Breakdown #2).

Breakdown #2 Newspapers: Value Based on Peer Group Multiples
($ in millions, except per share amounts; shares in millions)

EBITDA	$466		
NYT Multiple	7.6x	9.2x	NWSA Multiple
Newspaper EV	$3,542	$4,287	
Shares outstanding	229		
EV per share	**$15.46**	**$18.71**	

Source: Bloomberg, company reports, Institutional Research Group estimates.

Notably, the NWSA multiple would likely overvalue GCI's newspaper segment, for a number of reasons. *The Wall Street Journal* is the one US paper that has shown long-term success with paywalls due to the exclusivity of a certain portion of its content as well as its ongoing status as a "must daily read" for a large segment of financial market participants. In addition, NWSA was well capitalized following its separation, and its cash mound is positively viewed by the investor community, which may look at newspapers as cash-generating vehicles. While the industry has seen acquisitions of major newspapers in the last year, notably Jeff Bezos's purchase of *The Washington Post* and John Henry's acquisition of *The Boston Globe* from NYT, one could argue these were "trophy" buys and could not provide a fair approximation of value for GCI's newspaper business. *USA Today* arguably does not have the same cachet for a trophy hunter.

As a result, this valuation process heavily relies on the assumption of steady cash flows for the newspaper business. To reach a reasonable assessment of the cash flow potential of the newspaper segment, we start with projected 2013 operating income of $318 million, assume a 36% tax rate, add back $148 million in D&A, and subtract $57 million in capital expenditures. Interest expense is excluded from the equation, as we are attempting to reach an EV per share. Utilizing a 10% cash flow yield, we reach a price target of $13 per share for the newspapers. Assuming investors want additional protection from potential ongoing ad weakness, a 12% yield results in an $11 price target (see Breakdown #3).

Breakdown #3 Publishing: Value Based on Free Cash Flow Yield

($ in millions, except per share amounts; shares in millions)

Operating income		$318	
Effective tax rate		36%	
Net income		$204	
D&A		$148	
Capital expenditures		($57)	
Free cash flow		**$295**	
10% yield	**$2,945**	**$2,454**	**12% yield**
Shares outstanding		229	
EV per share	**$12.86**	**$10.71**	

Source: Company reports, Institutional Research Group estimates.

Alternatively, US newspaper stocks, including AHC, The McClatchy Co. (NYSE: MNI), and Lee Enterprises Inc. (NYSE: LEE) trade about 0.9x total assets. As of year-end 2012, GCI's publishing segment had identifiable assets of nearly $2.9 billion, placing the value of the segment at slightly more than $11 per share. Considering the value reached from applying the NYT multiple, valuations from the 10-12% free cash flow exercise, and the modest discount to total assets, ***a price target of $12 per share for the publishing segment appears reasonable.***

Broadcasting

Because of the significant contribution from political advertising and the Olympics in even years, broadcasters are typically valued on a two-year blended average. The challenge in valuing GCI is making assumptions about the timing of synergistic benefits from BLC over the three-year period following completion of the proposed merger. To provide a proper valuation, one has to make certain assumptions about the success of the merger. If investors believe there could be significant issues, whether cultural or otherwise, when meshing the two pieces, GCI will not appear attractive.

Since we will be utilizing a blended 2013/2014 average to reach a fair value, and the merger will not be completed until early 2014, we will simply consider reasonable GCI broadcasting segment EBITDA assumptions for 2013, adding back the $2.2 billion GCI has agreed to pay Belo. Based on first nine months results and management guidance for 4Q, one can reach a reasonable 2013 broadcasting EBITDA projection of $425 million. This will mark a $47 million drop from 2012, resulting from the loss of $183 million in political/Olympics ads offset by about $60 million in higher retransmission fees and growth in other advertising. In 3Q 2013, television revenue (excluding 2012 benefit of Olympics and political ads) was up almost 14%, driven in part by 63% retransmission fee growth to about $37 million (growth of about $14 million compared to the year-earlier quarter, $56 million annualized). Other pure-play broadcasters are trading about 12.5x 2013E EBITDA. Applying that multiple to $401 million (projected segment EBITDA minus about 50% of shared corporate costs, or $24 million) and adding the $2.2 billion for the Belo acquisition results in an enterprise value for the segment of $7.2 billion (see Breakdown #4).

Breakdown #4 Broadcasting: Valuation Based on 2013E EBITDA and Belo Acquisition Price

($ in millions, except per share amounts; shares in millions)

GCI Broadcast EBITDA	$401
Multiple	12.5x
GCI Broadccast EV	**$5,013**
Belo acquisition	**$2,215**
Broadcast EV	**$7,228**

Source: Company reports, Institutional Research Group estimates.

Providing an estimate for 2014, following the completion of the acquisition, obviously is more challenging. One can start by assuming about $75 million in synergies, primarily through higher retransmission fees, when considering the combined businesses. In addition, political/Olympics ads totaled $107 million in 2010 for just standalone GCI in the last congressional election/Winter Olympics year, while the economy was still in a nascent recovery. It might be fair to assume stronger spending from those two components, in addition to the benefit of the Belo stations in a higher spending year. Belo generated about $42 million in political ads in 2010. It also owns four NBC affiliates (Seattle, Portland, Boise, and Charlotte), which will benefit from Olympics broadcasts. Expecting a $260 million bump does not appear unreasonable assuming high single-digit improvement in core ad revenue. Less clarity surrounds the timing of GCI's cable contracts, which could lead to further retransmission fee growth. Considering all these issues, and excluding any merger-related costs that may persist into 2014, we reach a revenue estimate of around $1.78 billion and EBITDA of $820 million. We utilize an 8.3x multiple to 2014E EBITDA, a slight premium to the peer group's 7.8x, to reflect future synergy benefits, which results in an EV of $6.8 billion. If one gave GCI-BLC full credit for $175 million in synergies and applied a 7.8x multiple, the valuation would be $7.2 billion, only slightly below the value generated in Breakdown #4. Essentially, the merged entity loses $400 million ($2 per share) in EV due to realization of less than half the synergies (see Breakdown #5).

Breakdown #5 Broadcasting Valuation Based on Merged GCI-BLC 2014E

($ in millions, except per share amounts; shares in millions)

Gannett Broadcasting 2013E Revenue	$830	
Belo	$688	
GCI-BLC Broadcasting 2013E Revenue	**$1,518**	
2014 Politics/Olympics/other	$260	
2014E GCI-BLC Broadcasting Revenue	**$1,778**	
GCI Broadcasting 2013E EBITDA	$401	
BLC 2013E EBITDA	$214	**Full synergies**
Synergies	**$75**	**$175**
50% Margin on Political/Olympics/Other	$130	
2014 E EBITDA	**$820**	**$920**
Multiple	**8.3x**	**7.8x**
GCI-BLC Broadcasting EV	**$6,806**	**$7,176**

Source: Company reports, Institutional Research Group estimates.

When blending the EV calculations from the 2013 and 2014 estimates, ***we reach a broadcast price target of about $31 per share***.

(in millions)	
Breakdown #4	$7,228
Breakdown #5	$6,806
Average	$7,017
Shares outstanding	229
Broadcasting EV per share	**$30.63**

However, this valuation fails to account for the potential value of the GCI/BLC spectrum, which could be part of a voluntary auction by the Federal Communications Commission (FCC), scheduled for next year (but almost certainly likely to be delayed). The FCC intends to auction off spectrum voluntarily relinquished by broadcasters to wireless carriers such as Verizon (NYSE: VZ) and AT&T (NYSE: T). These carriers may need spectrum to meet growing demands for wireless data access. However, the actual format for the auction is still up for debate, and the actual impact on broadcasters remains unclear, to say the least. What is known is that broadcasters in more crowded, urban areas possess more valuable spectrum, while rural, small stations hold spectrum that is in less demand. To auction the wireless spectrum, the FCC must create a band of channels in a region (such as UHF channels 31-40, for example) to create value. In one possible exercise, a broadcaster could forsake its current channel for a new designation and benefit from the auction proceeds. It is likely that the auction will be exclusively, or largely exclusively, of UHF channels, which are more advantageous for wireless carriers.

This report is not geared to scientific explanations of spectrum, and a reader with greater interest may refer to trade publications or the FCC web site. For our purposes, we simply seek to consider the optionality of GCI-BLC UHF channels. To generate a basic value, we consider the largest previous FCC wireless spectrum auction, conducted in 2008. Known as Auction 73, it

raised more than $19 billion by selling spectrum at an average $1.22/MHz pop (bandwidth measured in megahertz multiplied by the population reached under the license). Each broadcast station is allotted 6 MHz of spectrum. To prove a very basic value of the spectrum, we utilized the $1.22 price from the auction and multiplied it by each GCI-BLC UHF station and the population each station reaches. There are a number of problems with this formula. First, spectrum may be worth considerably more now than it was in 2008. Second, as noted earlier, all spectrum is not considered equal, and some of the stations' spectrum may be of no interest to the carriers. Finally, the broadcasters may get only a small percentage of the proceeds from the auction if it ever takes place. However, it seems worthwhile to at least complete this exercise. By our calculation, the degree of optionality from the merged companies' spectrum is about $1.96 per share using these conservative assumptions (see Breakdown #6).

Breakdown #6 Spectrum Optionality

	Station	Channel	City	State	DMA	Households
Gannett	WATL	36	Atlanta	Georgia	9	2,326,840
	KTVD	20	Denver	Colorado	17	1,566,460
	WKYC	17	Cleveland	Ohio	18	1,485,140
	KSDK	35	St. Louis	Missouri	21	1,243,490
	WFMY	51	Greensboro	North Carolina	46	695,100
	WJXX	25	Jacksonville	Florida	50	659,170
	WGRZ	33	Buffalo	New York	52	632,150
	WLTX	19	Columbia	South Carolina	77	398,510
	WCSH	44	Portland	Maine	80	389,530
						9,396,390
Belo	KONG	31	Seattle	Washington	12	1,818,900
	KING	48	Seattle	Washington	12	1,818,900
	KTVK	24	Phoenix	Arizona	13	1,812,040
	KASW	61	Phoenix	Arizona	13	1,812,040
	KMOV	24	St. Louis	Missouri	21	1,243,490
	WCNC	22	Charlotte	North Carolina	25	1,136,420
	KENS	39	San Antonio	Texas	36	881,050
	KVUE	33	Austin	Texas	45	705,280
	WWL	36	New Orleans	Louisiana	51	641,550
	WUPL	54	New Orleans	Louisiana	51	641,550
	KMSB	25	Tucson	Arizona	70	438,440
	KTTU	20	Tucson	Arizona	70	438,440
	KREM	20	Spokane	Washington	73	420,640
	KSKN	22	Spokane	Washington	73	420,640
						14,229,380

Households reached	23,625,770
Persons per household	2.6
Population reached (est.)	61,427,002
Spectrum per channel (MHz)	6
Price per MHzPop	$1.22
Spectrum value	**$449,645,655**
GCI share count	229,140,000
Optionality per share	**$1.96**

Source: Company reports, FCC, Institutional Research Group estimates.

Finally, one might also consider the discount awarded local broadcasters compared to national cable network operators, such as FOXA, Scripps Networks (NYSE: SNI), AMC Networks Inc. (NYSE: AMCX), and Discovery Communications (NASDAQ: DISCA). This group trades at 12x-14x 2013E EBITDA and 10x-12x 2014E EBITDA despite margins that are strikingly similar to those of the local broadcasters, which trade at 12x 2013E and 7.6x 2014E. Even a modest reduction in the multiple spread could result in 10% growth in the value of the local broadcasters' share price. Given the growth prospects from higher retransmission fees, particularly in the wake of CBS's success with Time Warner, this does not seem improbable.

Digital and Other Investments

The primary contributor to the digital segment is the nearly 53% interest in CareerBuilder, which has showed significant growth in recent years. The obvious peer is Monster. However, Monster earnings are projected to shrink from 2012 levels, likely as other competitors, including CareerBuilder, take market share. As a result, a broader group of digital operators such as AOL and IAC/Interactive must be considered.

From 2009 through 2012, digital segment EBITDA grew at a 15% compound rate (see Background #10). In the first nine months of 2013, EBITDA was up about 9%. We project 2013 segment EBITDA of $183 million, based on 10% growth. Applying a 6.5x EBITDA, we reach a segment price target of $1.2 billion. However, assuming most of this value comes from GCI's interest in CareerBuilder, only about 52.9% is actually attributable to Gannett. As a result, the value is adjusted to $631 million (representing GCI's proportional share), or a ***$3 per share price target for the digital segment*** (see Breakdown #7).

Breakdown #7 Digital: Valuation Based on EV/EBITDA Multiple

($ in millions, except per share amounts; shares in millions)

EBITDA	$183
Multiple	6.5x
EV	$1,193
52.9% Interest	**$631**
Shares	229
EV per share	**$3**

Source: Company reports, Institutional Research Group estimates.

While not previously discussed in this report, GCI also holds a series of investments that are accounted for utilizing the equity method (see Breakdown #8). These investments include newspapers partnerships in which it does not have a controlling interest, as well as digital efforts, such as HotelMe, LLC, which provides verification that online review writers actually stayed at the hotels.

Breakdown #8 **Investments Accounted for Under the Equity Method**

Wanderful Media, LLC	11.36%
Ponderay Newsprint Company	13.50%
Pearl, LLC	16.20%
Garnet Media	18.10%
California Newspapers Partnership	19.49%
4Info	23.49%
Classified Ventures	23.60%
Livestream	26.60%
HotelMe, LLC	32.14%
Homefinder.com	33.33%
Topix	33.71%
Texas-New Mexico Newspapers Partnership	40.64%
Tucson Newspaper Partnership	50.00%

Source: Company reports.

The carrying value of these investments stood at $123 million at year-end 2012. Notable is the significant asset write-down during the financial crisis. Carrying value was $823 million as recently as year-end 2007. GCI generate about $33-$34 million per year in cash from the investments in the three years through 2012. In 1H 2013, cash flow totaled about $26 million due to growth in its Classified Ventures, a joint venture with other media companies, including TRBAA, BLC, and MNI, which operate web sites including cars.com, as well as other newspaper joint ventures. In late September 2013, GCI contributed the Captivate Network, a series of 10,000 video screens in elevators of hotels and office buildings that provide information and advertising, to a new joint venture with Generation Partners. GCI holds an 18% stake and will begin accounting for this interest utilizing the equity method.

Breakdown #9 **Other Investments Operating Results, 2007 – 2012**

($ in millions)

	2012	2011	2010	2009	2008	2007
Aggregate carrying value	$123	$133	$161	$189	$201	$823
Distributions from investees	$36	$53	$45	$20	$29	$43
Payments for investments	$3	$19	$11	$10	$47	$40
FCF from investments	$33	$34	$34	$10	($18)	$3

Source: Company reports, Institutional Research Group estimates.

One could value these investments purely at carrying value, but given the write-downs during the crisis, it would likely underestimate their true value. Instead, given the recent stability in cash flow generation, we think a 10% cash flow yield is more reasonable. Applying a 10% yield to

$42 million (the mid-point between annualized 1H 2013 cash flow and average 2010-2012 cash flow) and considering a 229 million share count, ***the investments are valued at $2 per share*** (see Breakdown #10).

Breakdown #10 **Investments: Valuation Based on FCF**

($ in millions, except per share amounts; shares in millions)

Free cash flow	$42
EV (10% Yield)	$420
Shares outstanding	229
EV per share	**$2**

Source: Company reports, Institutional Research Group estimates.

Debt

As of June 30, 2013, GCI had net debt of $1,196 million. For the purpose of this valuation, we include the $2.2 billion acquisition price for BLC in the net debt estimate. Using a $3.4 billion net debt figure and a share count of 229 million, ***we include $15 per share in net debt.*** The publishing segment could possibly take about $920 million ($4 per share) in net debt, or about 2x EBITDA, if the two sides were split, which would result in that business being valued at $8 per share. The $5 per share in value allotted to digital and other investments would most likely go with the publishing side, which would raise the price target to $13 per share. The other $11 per share in net debt would go with the broadcasting segment, establishing the fair value for that business at $20 per share.

The Wrap-Up

As noted on the first page of this report, the authors are not attempting to be advocates for certain management decisions by companies profiled. Instead, the report focuses on companies that for a number of reasons may be open to future breakups or other efforts to unlock value. In the case of Gannett, it is part of an industry that is going through a period of significant change. Belo chose to spin off its local newspapers in 2008, and Tribune will follow suit next year. News Corp. spun off its newspapers in 2013, and Time Warner will separate its magazines next year. In these cases, the fast-growing broadcasting arm was being weighed down by general uncertainty and malaise in those companies' print products. Gannett will nearly double the size of its broadcasting segment by finalizing its acquisition of Belo by the end of 2013. It would appear to be an opportune moment to reconsider whether continuing the diversified media approach is ideal. Many of its peers have already made that decision.

This report reaches a fair value of $33 per share for GCI on a SOTP basis, which includes $31 for the broadcasting segment, $12 for the newspapers, $3 for digital including its 53% interest in CareerBuilder, and $2 for other investments, and subtracts $15 per share for net debt (including $2.2 billion for the BLC acquisition). This valuation does not include about $2 per share in optionality from the local stations' spectrum, about $100 million in Belo acquisition-related synergies not accounted for in the broadcasting segment price target, the $300 million share buyback, which could retire about 5% of shares outstanding at current prices, and the potential for discount elimination by local broadcasters compared to national cable network operators, which could add 10% in value to the broadcasting business. The risk to this valuation is chiefly merger risk, essentially that synergies in GCI's merger with BLC will not be achieved or that cultural issues could develop between the two parties. While we do not pretend to have a crystal ball and are not forecasting a forthcoming breakup of operations, a number of tools are at GCI's disposal to increase shareholder value.