Title:
An Analysis Of Journal Communications (JRN)

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Summary:
Journal Communications (JRN) is comprised of seven essentially separate businesses: The Milwaukee Sentinel, Community Newspapers, Television Stations, Radio Stations, Telecommunications, Printing Services, and Direct Marketing. The company’s five reportable segments do not exactly match these seven businesses; however, I believe an investor should analyze JRN on the basis of these seven businesses and their constituent properties, rather than as a single going concern with fi...

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Article Body:
Journal Communications (JRN) is comprised of seven essentially separate businesses: The Milwaukee Sentinel, Community Newspapers, Television Stations, Radio Stations, Telecommunications, Printing Services, and Direct Marketing. The company’s five reportable segments do not exactly match these seven businesses; however, I believe an investor should analyze JRN on the basis of these seven businesses and their constituent properties, rather than as a single going concern with five reportable business segments. Additional reasons for this belief will be outlined below. For now, it is sufficient to say that if Journal Communications were to divide into seven separate public companies, the combined market value of those companies would be substantially greater than JRN’s current enterprise value. Simply put, the sum of the parts would be valued more highly than the whole.

Journal Communications has an enterprise value of just under $1 billion. Pre-tax owner’s earnings are probably around $125 million. So, JRN trades at eight times pre-tax owner’s earnings. That’s cheap.

Journal’s effective tax rate is 40%. That is an unusually high rate. Journal’s media properties would likely generate more after-tax income under different ownership. The difference would be material; but, for anyone other than a highly leveraged buyer, tax savings would not be a primary consideration. When evaluating Journal as a going concern, it is perfectly appropriate to treat the full 40% tax burden as a reality. These taxes reduce owner's earnings by $50 million.

With after-tax owner's earnings of $75 million and an enterprise value of $1 billion, Journal's owner's earnings yield is 7.5%. Remember, this is the after-tax yield. The pre-tax yield is 12.5%. When evaluating a company, it's best to use the pre-tax yield for purposes of comparison. Last I checked, the 30 – year Treasury bond was yielding 4.63%. So, looking at JRN's current earnings alone, the stock appears to offer a large margin of safety.

This is especially true if you consider the fact that earnings yields offer more protection against inflation than bond yields. They don't offer perfect protection. But, with stocks, there is at least the possibility that nominal cash flows will increase along with inflation. The cash flows generated by bonds are fixed in nominal terms, and therefore offer no protection against inflation.

When evaluating a long-term investment, such as a stock, I do not use a discount rate of less than 8%. This reduces JRN's margin of safety considerably. Instead of being the difference between 12.5% and 4.63%, Journal's margin of safety is the difference between 12.5% and 8%. Is such a margin of safety sufficient? Maybe.

When evaluating a prospective investment, I first look at the risk of a catastrophic loss. What is the magnitude? And what is the probability? For my purposes, a catastrophic loss is defined as any permanent loss of principal. The risk that I've overvalued a business is always greater than my risk of catastrophic loss, because I insist upon a margin of safety. A catastrophic loss is one that wipes out the entire margin of safety.

I can make a bad investment without suffering a catastrophic loss. For instance, most mutual funds are bad investments, because they underperform alternatives. However, mutual funds do not usually carry a high risk of catastrophic loss. In fact, they generally have a low risk of catastrophic loss, because they are highly correlated to the overall market.

It's easiest to understand this concept if you think of valuing companies as being a lot like writing insurance. Even if reality exceeds your expectations in nine out of every ten cases, a terrible misjudgment in the tenth case can cause you great harm. It isn't just how many mistake you make. It's also how big they are.

Some stocks, like Google (GOOG), trade at prices that allow for catastrophic losses of considerable magnitude. Other stocks, like Journal Communications, trade at prices that only allow for very small losses to principal. However, there is also the matter of probability. How likely is it that a Google shareholder will suffer a catastrophic loss? I don’t know. I’m not even willing to hazard a guess.

In the case of Journal Communications, I am willing to stick my neck out.

I believe an investment in JRN carries a very low risk to principal – considerably less than, say, an investment in the S&P 500. Why? Because Journal Communications is trading at a very modest owner’s earnings multiple. But, that isn’t the only reason. You shouldn’t look at Journal solely from a going concern perspective. JRN mainly consists of readily saleable properties. The assets backing shares JRN are quite substantial:

Publishing

The Milwaukee Journal Sentinel: Milwaukee’s only major daily and Sunday newspaper. The Sunday edition has the highest penetration rate (72%) of any Sunday newspaper in the top 50 U.S. markets. The daily edition has the third highest penetration rate (49%) of any daily newspaper in the top 50 U.S. markets. The paper has a daily circulation of 240,000 and a Sunday circulation of 425,000.

The Milwaukee Journal Sentinel also operates three websites. JSOnline.com and OnWisconsin.com generate advertising revenue. PackerInsider.com is a subscription – based website.

Over the last three years, both daily circulation and Sunday circulation have decreased by about 1% annually. Full run advertising linage has also fallen by a similar amount; however, after accounting for increases in part run advertising and preprint pieces, it appears there has been no real decrease in total advertising.

The Journal Sentinel generates approximately $230 million in revenue. Advertising accounts for 80% of the Journal Sentinel’s revenue (the other 20% is circulation revenue). Advertising revenue is somewhat cyclical, and may currently be above “normal” levels.

It’s difficult to value the Journal Sentinel, because JRN places the Journal Sentinel and its community newspapers under one reportable segment. Even if the numbers for the Journal Sentinel were broken out, I would have still have some difficulty coming up with an exact figure, because I’m not an expert on newspapers.

Having said that, I can’t see how the Journal Sentinel could be worth less than $250 million or more than $500 million. If I had to put a dollar figure on the Journal Sentinel, it would probably be in the 250 – $300 million range. I’d like to think this is a conservative estimate, but I don’t know enough about newspapers to be sure. JRN’s failure to break out the numbers for the Journal Sentinel apart from the community newspapers complicates the issue. However, I am quite confident the Journal Sentinel is worth no less than $250 million.

It’s even more difficult to value JRN’s Journal Community Publishing Group. It consists of 43 community newspapers, 41 shoppers, and 9 niche publications (automotive, boating, etc.). The group generates about $100 million in revenue. I can’t value this group apart from the Journal Sentinel, because of the aforementioned lack of disclosure (combining the group with the Journal Sentinel for reporting purposes), my inability to find enough public information on community newspaper businesses, and other such factors.

The best I can do is offer an educated guess as to the combined value of JRN’s publishing business. My best guess is that, taken together, the Journal Sentinel and the community newspapers are probably worth somewhere between $300 million and $500 million.

Broadcasting

Journal Communications owns 38 radio stations. The most important of which are: WTMJ-AM Milwaukee, KMXZ-FM Tucson, KFDI-FM Wichita, and KTTS – FM Springfield (MO). All four of these stations are number one in their market. JRN’s radio stations generate about $80 million in revenue.

Journal Communications owns seven television stations. Almost all of these stations are ranked as one of the top three in their market. Three are NBC affiliates, three are ABC affiliates, and one is a Fox affiliate. JRN owns two stations in Milwaukee, two in Idaho, one in California, one in Michigan, and one in Nevada. Journal’s TV stations generate about $90 million in revenue.

Again, it’s too hard for me to value JRN’s TV stations and radio stations separately. Taken together, I believe they’re worth somewhere between $250 and $450 million.

Telecommunications

JRN owns a 3,800 mile network in the Great Lakes region. Norlight

Telecommunications generates about $150 million in revenue. I’m very hesitant to make any attempts to value this division, because I don’t understand the telecom business well enough. Having said that, I don’t see how it could be worth much less than $350 million.

Miscellaneous

I don’t like the printing services and direct marketing business at all. I have no idea how to value them. They do have revenues though; so, they are probably worth something to someone. Revenues from these two businesses exceed $100 million, but they are not very profitable.

Real Estate

JRN owns a surprising amount of unencumbered real estate. For the most part, such properties are closely tied to one of JRN’s operating businesses. As long as JRN continues as a going concern, much of the real estate could not be sold. Just to give you some idea of the extent of these properties, it appears JRN owns a little less than two million square feet – much of which is in or around Milwaukee. I can not accurately value such real estate. As I said, much of it is closely tied to operating activities. However, buildings in urban areas can sometimes be converted to other uses.

It hardly matters though. Journal Communications is likely to remain a going concern for some time, and as long as it does, it is unlikely to dispose of such assets.

Valuation

So, what is JRN worth? It’s hard to say. The current enterprise value is around $1 billion, which is clearly too low. My most conservative estimates for the publishing, broadcasting, and telecom businesses alone add up to $900 million. I think those are very conservative estimates. Using more reasonable estimates, I can not arrive at a value of less than $1.25 billion for JRN’s constituent parts. This is true whether I perform an intrinsic value analysis on the entire company, or apply some sort of earnings, sales, or EBITDA multiple to each business separately.

Journal Communications is probably worth somewhere between $1.25 billion and $2 billion. I’m quite pessimistic about the newspaper business; therefore, I would lean towards the $1.25 billion figure (which assumes slightly declining revenues). Any sort of revenue growth would dramatically change the valuation. If such growth will occur, JRN is extremely undervalued at these levels.

However, I’m not sure there will be any growth at all.

Journal Communications voting structure will probably discourage the best course of action: breaking up the company. JRN should spin off the community newspapers, the TV stations, the radio stations, and the telecom business. The printing services and direct marketing businesses should also be disposed of in some way. These are really very different businesses. There are few good reasons for keeping them together, and many good reasons for separating them.

Newspapers, radio, and TV all face different challenges. They need different managers who have complete control over capital allocation and who are compensated based on the performance of their business, not on the performance of a hodge-podge of various media properties. Breaking JRN up will make it easier to manage and will make it easier for current owners to dispose of their shares at more favorable prices should they wish to.

If these businesses traded as five or six different public companies, it is very unlikely their combined market cap would be less than $1 billion. It may not even be necessary for them to be publicly traded. There might be buyers for such properties, if JRN’s properties were separated into common sense collections.

But, none of this is likely to happen. Employees control JRN (they maintain control through the ownership of shares with disproportionate voting rights). No one interested in shaking things up will take a stake in this company, because he would be unable to impose his will. I can’t imagine management ever embarking on such a sweeping venture without some prodding from the outside.

JRN has almost no downside. Sadly, it doesn’t seem to have a lot of upside either. There is a real danger investors will see their returns wither away as the time it takes to realize the value in Journal Communications proves costly. Time is the enemy of the investor who buys this kind of business at this kind of price.

Objectively, I have to admit JRN is undervalued. But, I’m not sure it’s grossly undervalued – and I am sure there are better long term investments.