

# FINANCIAL REVIEW

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## Is the Murdoch family willing to give up control of News to unlock \$4.7bn?



News executive chairman Rupert Murdoch and CEO Robert Thomson under pressure to squeeze more out of News. David Rowe



by Tony Boyd

The Murdoch family has the power to engineer a 40 per cent uplift in value for shareholders in News Corporation and REA Group according to a tantalising proposal put forward by a Sydney fund manager.

The idea from Lanyon Asset Management's Dave Prescott comes a couple of weeks after the largest institutional investor in News Corp, Perpetual Investments, cranked up the pressure on the Murdochs to do something about the chronic under performance of News relative to REA Group.

The REA Group is 64 per cent owned by News. But shares in News have consistently under performed those in REA.

Perpetual pointed out in note to unitholders in its Perpetual Pure Equity Alpha fund that in the last 12 months that the REA Group share price has gone up by 50.4 per cent while, over the same period, the News share price has gone down by 19 per cent.

"That is an 86 per cent outperformance of REA Group relative to News Corp," the fund manager said.

"Market participants are happy to chase REA Group because it has share price momentum and it has earnings growth (EPS is forecast to grow by 11 per cent in fiscal 2016)," the fund manager.

"However, the market does not want to touch News Corp given its share price momentum is negative and its EPS is forecast to go backwards by 7 per cent in fiscal 2016. This is a microcosm for the overall market."

Prescott says he wants to make it clear that Lanyon does not own any REA or News shares.

Also, he admits there is a fundamental problem with his proposal but more on that later.

His value creation idea is for REA to make a nil premium merger proposal for News.

Immediately after the merger the "New REA" would cancel the REA shares held by NWS.

This would have the same effect as conducting a massive buyback equal to 28 per cent of the issued capital.

The core idea is to unlock the value so that the premium paid for REA is applied to all of News.

At the moment News with 581 million shares on issue has an enterprise value of \$7.9 billion. Within that REA is worth \$5 billion. In other words the News stub trades at an EV to EBITDA of 3.69 times. REA, which has 131.7 million shares on issue, trades at an EV to EBITDA of 26.2 times.

The News stub includes a portfolio of media assets including *The Wall Street Journal*, Foxtel, Fox Sports, *The Australian*, *Vogue Magazine*, Harper Collins and 80 per cent stake in Move Inc, the No. 2 player in US property classifieds market.

The merger mechanics would see 156.7 shares issued by REA taking the pro-forma number of shares on issue to 288.4 million. After cancelling 81.1 million shares owned by News in REA the final share count would be 207.2 million.

The old REA had a market cap of \$8.2 billion, net cash of \$79 million, revenue of \$554 million and EBITDA of \$310 million.

The new REA would have a market cap of \$12.88 billion, net cash of \$1.87 billion, revenue of \$7.65 billion and EBITDA of \$1 billion.

The end result would be a 57 per cent increase in shares issued, increase in EBITDA of 253 per cent and a possible valuation of \$86 for each REA share.

Prescott says the sale of REA shares by News followed by a buyback would not be the optimal option because it may have adverse tax consequences and News could be "selling the flowers and watering the weeds".

"Even a distribution of REA shares to News, whilst theoretically valid, seems unrealistic given the size of News's REA holding and both companies would still lose the strategic nature of their relationship," Prescott says.

Of course, the one big, and most likely insurmountable, stumbling block is the Murdoch family, which has control of News through a dual share-voting structure.

Rupert Murdoch is executive chairman of News, his son Lachlan is non-executive co-chairman and son James is a non-executive director. There are no Murdochs on the board of REA.

The family has 13 per cent of the News issued capital but controls 38.4 per cent of the voting stock. The critical player in any deal would be News Corp chief executive Robert Thomson.

One consequence of a nil premium merger between REA and News would be to end the dual class shareholding arrangements.

The Murdoch family would end up with only 11 per cent of "new REA" in a structure with one vote one share.

The question is: would the Murdoch family be willing to take this radical step to unlock about \$4.7 billion in value?