

An Analysis of the Financial Crisis Facing California Local, Daily Newspapers

April 22, 2020

Local journalism and newspapers specifically have never faced a challenge like today. COVID-19 continues its broad and deep impact to the United States economy and the unknown changes to customer and consumer behavior will likely not be understood until 2021. The Great Recession in 2008 and 2009 was difficult for newspapers but did not have the associated impacts that the current pandemic has. And back then newspapers were coming off some of their best years and had some ability to adjust. Today newspapers have battled declining top-line revenue year over year and have little ability to absorb any major shock, and certainly not the *perfect storm* of COVID-19 and the *Dynamex* decision combined with AB 5 [newspapers currently have an exception until the end of 2020] that will mandate that newspaper delivery be done by employees, not independent contractors.

Our analysis suggests the California newspaper industry faces an unprecedented financial impact from these factors.

Current Financial State of the Industry: Instable and Unsustainable

The current local newspaper business has migrated from an 80% advertising driven model to one where many newspapers are 50% advertising – print and digital – and 50% consumer revenue. This points out two important points. Advertising is still important, so significant declines are impactful. Second, consumer revenue dominated by physical delivery of newspapers to subscribers is equally essential to survival. Digital subscribers while growing are a very small percentage of total consumer revenue.

Today, delivery of the newspaper is fundamentally done by distributors who contract with independent third parties to deliver to homes and retail locations. Each local delivery carrier essentially runs their own business to deliver newspapers generally being paid a fee to deliver each copy. Why does the industry use independent contractors? For one, their job is to deliver papers before 6:00 AM each day across broad geographies that would be very difficult to supervise. Using entrepreneurial carriers

that are often rewarded for meeting certain customer service goals just makes sense. Many of the carriers use their pay to supplement other income and jobs due to the part-time nature of the job being completed before 6:00 AM most days. This arrangement has allowed carriers a flexible opportunity to supplement income while providing a delivery cost that is reasonable for newspapers already under economic stress. In most operations, actual delivery of the printed newspaper is second only to payroll as the largest cost center so even small increases in delivery costs amid still declining revenue in a non-COVID year is extremely challenging to accommodate.

The challenging economics of the industry can be seen in the ever-declining stock prices and even more drastic measures such as bankruptcies. Nearly all major newspaper companies in the United States have succumbed to bankruptcy over the last decade. *‘McClatchy’s [recent] filing foreshadows further cost-cutting and retrenchment for one of the biggest players in local journalism, at a time when most U.S. newsrooms already are straining to cover their communities amid declining*

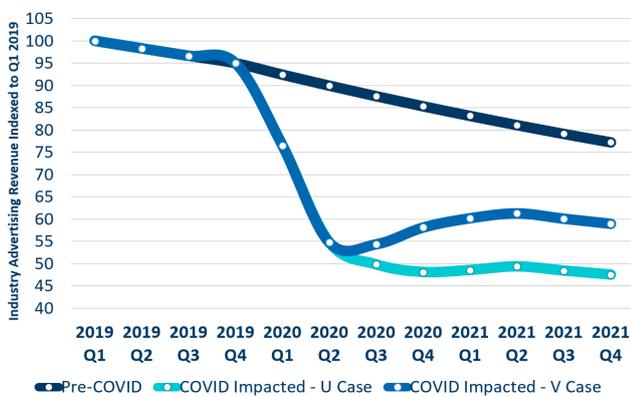
ad revenue and dwindling resources. Twenty percent of all U.S. newspapers have closed since 2004, according to a recent report from [PEN America](#), and the sector has shed 47 percent of its jobs.’ [Washington Post, February 13, 2020]

Impact of COVID-19 and Decline in Advertising Revenues

FTI has decades of experience working with newspapers. Based on actual results from numerous newspaper publishers, public and private sources coupled with our views, we have developed a ‘U’-shaped and a ‘V’-shaped recover model. We believe the ‘V’ to be aspirational and has little likelihood of materializing as it assumes by the 3rd quarter of 2020 digital advertising comes back and print advertising in the 4th quarter. When digital and print advertising comes back, they experience year-over-year growth for two quarters due to pent up demand. Even this optimistic ‘V’-shaped model loses over 15 points of advertising revenue vs. the expected pre-COVID forecast.

The more realistic ‘U’-shaped model suggests digital advertising will begin to rebound towards the end of 2020 and print advertising not until 2021. Print subscribers will remain generally stable and digital subscriptions will grow faster than before. The advertising projections are stark. By the end of 2021, a full 25 points of additional loss is estimated above an already declining advertising base as digital advertising growth falls far short of making up for print advertising declines.

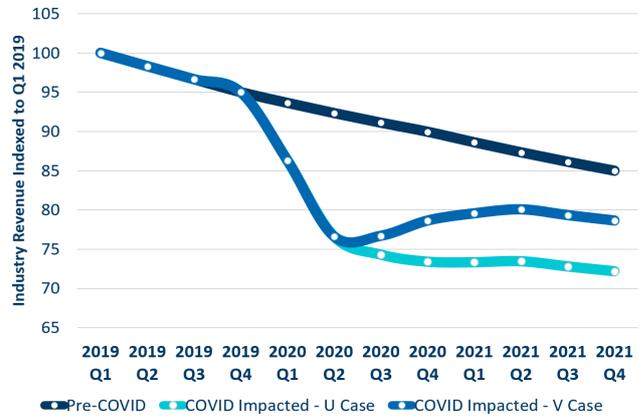
Figure 1 - Impact of COVID-19 | Newspaper Industry Advertising Revenue



When consumer revenue is included which is much more stable the forecast improves, but clearly this still results in a difficult challenge for local newspapers that will drive even further cost cutting including journalists, and difficult

decisions regarding closures for publishers.

Figure 2 - Impact of COVID-19 | Newspaper Industry Revenue



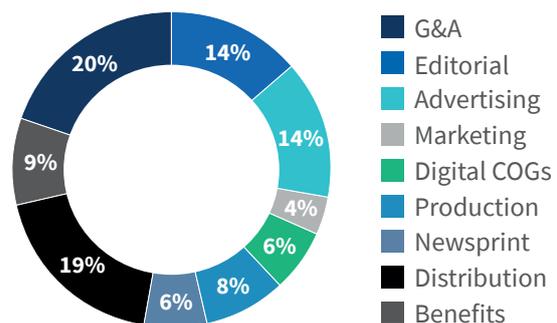
With consumer revenue added, this still results in the most likely forecast of total revenue down over 12 points by the end of 2021. And as everyone knows, profit will fall even more than revenue as businesses have fixed costs that are difficult to reduce as revenue falls. And no one knows how much it will cost for newspapers to operate in a COVID environment for weeks and months further depressing profits.

AB 5 Impacts

FTI also aggregated the expense mix of numerous newspapers to illustrate the general diversity of expenses at a local newspaper. Distribution – the expense that would be most impacted by AB 5 – is higher than any other expense segment except all of G&A. As any one function in the newspaper it is the highest cost and nearly 40% higher than editorial costs.

Clearly a substantial increase in distribution or delivery expenses will have a meaningful impact on the overall financial performance for any local newspaper.

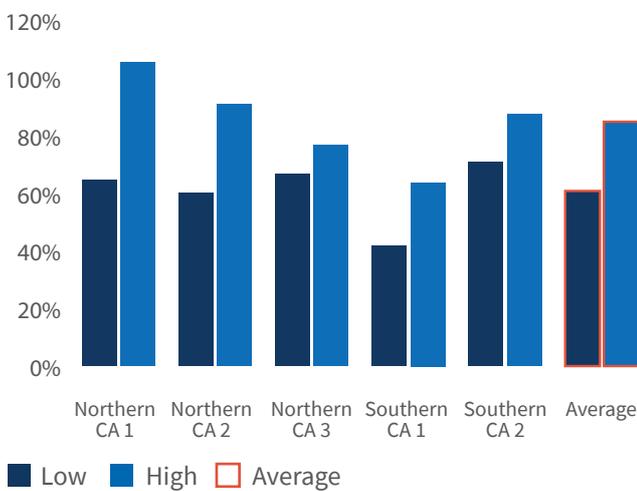
Figure 3 - General Newspaper Expense Mix



For California newspaper publishers, if AB 5 must be adhered to in 2021, FTI projects significant additional costs will be incurred. FTI has created detailed delivery models for several California publishers across the state to help them estimate additional costs assuming last-mile carriers would be employed by someone compared to the current independent contractor model now employed.

Each newspaper is different based on their current dynamics. Assuming two employee groups of carriers to cover the seven delivery days or one employee group

Figure 4 - AB5 Delivery Expense Increases



for six days and relief carriers for the seventh day off, the modeling shows that the lowest impact to be an increase of greater than 40%. The average increase in expense ranges between 60% and 85%.

Given that delivery is the highest single functional cost at a local newspaper, these increases will cause additional cost reductions that would include fewer staff in other core functions of the newspaper including the newsroom

as well as additional reductions to maintain some level of profitability or reduce losses. The result is surely to push newspapers into decisions that are hard to imagine in any other way but diminishing local news coverage and the frequency of print publications still desired by hundreds of thousands of subscribers in California.

This leads us to a logical question: Will newspapers just stop printing? FTI has built a print-to-digital transition model to forecast what any newspaper’s local economics would be with no print, or just Sunday, or a couple days per week. In most cases, under current assumptions print advertising revenue and print subscriber revenue is higher than the expense reductions associated with these changes. Moving to fewer days of a printed newspaper, or a digital-only publication for that matter, would not be a financial improvement for most newspapers and would definitely diminish the number of people that consume quality local journalism. Some print subscribers are older and don’t have a computer or internet service. These vulnerable citizens simply cannot switch to digital subscriptions.

Conclusion

What does the current environment mean to California newspapers? The combined financial impacts of COVID-19 and AB 5 will likely result in fewer local journalists, more stress on an already stressed industry leading to more business disruption, and more newspaper layoffs and closures.

Newspapers in nearly every city and community have more local reporters than any other media. They are essential to a functioning democracy. A significant increase in expenses to them via the impacts of COVID-19, and the additional burdens of AB 5 will further hasten the decline of local daily newspapers.

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