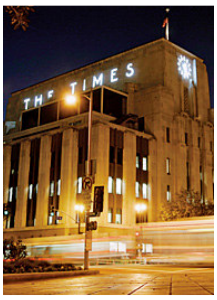
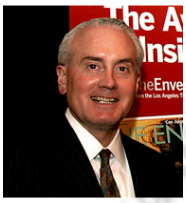
The 'Grave Dancer' takes a tumble
Emily Thornton, Michael Arndt, Ronald Grover

Zell, at his office in Chicago, expected only single-digit revenue declines Len Irish



The Los Angeles Times building, which is for sale Reed Saxon/AP Photo

Lipinski, the Chicago Tribune's editor, left during the latest round of job cuts E. Jason Wambsgans/Chicago Tribune/MCT



Hiller, the paper's publisher, left during the latest round of job cuts

"It's the deal from hell," says Sam Zell, never one to mince words. "And it will continue to be the deal from hell until we turn it around." Zell is talking, of course, about his $8.5 billion purchase of Tribune Co. in December 2007, a transaction that's shaping up to be one of the most disastrous the media world has ever seen. Zell is a real estate tycoon, and his plush office reflects his decades of success: Giant even by CEO standards, it brims with paintings and statues and looks out on a private garden above the Chicago River. One item that stands out among the clutter is an upside-down map of the world, a prop presumably intended to convince visitors that they're in the presence of an iconoclast. Zell, 66 and fiercely devoted to blue jeans, has burnished that image carefully over the years.

Were it not for the Tribune debacle, there would be no reason to question Zell's brilliance as a businessman. He describes himself, immodestly, as a "grave dancer" who buys properties at fire-sale prices and resells them for a profit. His biggest coup came in late 2006, when he orchestrated a bidding war for his real estate trust, Equity Office Properties. EOP eventually went to Blackstone Group (BX) for $39 billion, in what was then the biggest leveraged buyout in history. Weeks later he thumbed his nose at the dealmaking world with a satirical song, posted on the Web, that predicted the credit crunch soon to sweep the globe. It seemed he could do no wrong.

Then Zell bought Tribune and stumbled into a calamity of plunging sales and rising costs. He had expected only single-digit declines in newspaper ad revenue. Turns out he was off by a factor of two or three. "If current trends in advertising are permanent," he says, "we have a really serious problem."

He should have seen it coming. Tribune comprises eight newspapers, including the Chicago Tribune, Los Angeles Times, and Baltimore Sun, which together generate 76% of the company's revenues; more than 50 Web sites; 25 television stations, including superstation WGN America; a 31% share of the Food Network; the Chicago Cubs baseball team; and real estate and other holdings. Tribune had been slumping for years, courting buyers for more than 18 months before Zell ambled onto the scene in early 2007. Against that bleak backdrop, he loaded the already strapped company with more than $8 billion in fresh debt to pay for the deal, leveraging Tribune to within an inch of its life.

The payments, $1.4 billion by June 2009 alone, have proven crippling. Tribune's junk-level credit rating has fallen since Zell took over, and some of its bonds are fetching 35¢ on the dollar. Zell has been forced to cut costs far more than he anticipated. It may not be enough to avoid a default. "The colossal debt Zell piled on is forcing Tribune to take more and more desperate actions," says media consultant Alan D. Mutter.

On paper, Zell's plan looked great. He would quickly sell the Chicago Cubs, Wrigley Field, and a 25% stake in Comcast SportsNet Chicago to pay off debt, and focus on making Tribune's newspapers zippier and more ad-friendly. The strategy was based on an innovative financing scheme that used Tribune's tax-exempt employee stock ownership plan as the vehicle through which to fund the transaction. That would allow Tribune to save big on taxes: It paid $245 million annually on average over the past three years. Zell's financing arrangement required the billionaire to pony up just $315 million of his own cash to wrest control of the company, with a warrant to buy 40% more for as little as $500 million. What's more, Zell turned Tribune into a so-called S corporation, a designation usually reserved for small businesses. That could allow Tribune to sell assets in 10 years without having to pay capital-gains taxes.

Zell doesn't need Tribune to thrive; merely keeping it alive could earn him an astronomical return when it comes time to sell. That has always been the goal. "When we first undertook this project, we viewed Tribune as 60 ways to get lucky," Zell says. But amid the credit crunch, the quick asset sales haven't panned out. With the newspaper business deteriorating, his seemingly clever strategy has thrown the whole Tribune enterprise into jeopardy.

The question for the company's 18,500 employees is whether Sam Zell is the guy to save it. Although he owned a radio company called Jacor Communications that was acquired by Clear

Channel Communications (CCU) in 1999 and spends his weekends in Malibu, Zell is no media mogul and hasn't mixed well in that world thus far. Early on, he told Tribune executives he would "cut off their ties" if he caught them looking so formal at future meetings. Prone to off-color jokes and profanity, he's more like "that guy you see on the Mexican beer commercial," says Jeff Peterson, owner of Geoffrey's Malibu, a restaurant frequented by Zell and his wife, Helen. "He just seems like a down-to-earth guy's guy."

Many staffers are alarmed by Zell's open disdain for the newspaper business. "The industry has lost its credibility" because of biased, boring, and self-indulgent articles, says Zell. For that matter, he doesn't much care for baseball, either, says Chicago White Sox majority owner and longtime friend Jerry Reinsdorf: "He actually dislikes it." Most dealmakers, by contrast, lionize the companies they own to pump up sale prices. "If you have a lemonade stand, you don't try to sell the lemonade by saying it's terrible," says Myron Levin, a reporter for 23 years at the Los Angeles Times who took a buyout in March.

Adding to the uncertainty, Zell has tapped some quirky characters with no newspaper experience to run key elements of the Tribune empire. Randy Michaels, the chief operating officer, is a former Clear Channel executive and onetime "shock jock" who worked for Zell at Jacor. Michaels has installed jukeboxes, pinball machines, and a sculpture of a six-legged man running in circles called "The Bureaucratic Shuffle" in the Tribune Tower in Chicago. Marc Chase, president of Tribune Interactive, is another Clear Channel alum and former DJ. Robert J. Gremillion, Tribune's executive vice-president and interim publisher of the Chicago Tribune, hails from the broadcasting division. Gerald Spector, the chief administrative officer who's overseeing the Los Angeles Times, is a Zell acolyte from the real estate business with a penchant for sweaters emblazoned with cartoon characters.

Tribune's new chief innovation officer, Lee Abrams, a former XM Satellite Radio Holdings (XMSR) programmer, has raised eyebrows, too. In March he began firing off 5,000-word e-mails suggesting employees peruse his 108 blog posts on what's wrong with the media. "While my background is steeped in rock 'n' roll," he wrote in his first e-mail, "I strongly believe that News and Information is the NEW rock 'n' roll…The NEW rock 'n' roll isn't about Elvis or James Dean, but it IS about re-inventing media with the exact same moxie that the fathers of rock 'n' roll had. The Tribune has the choice of doing to News/Information/Entertainment what rock 'n' roll did to music."

Empty Promises

With the newspaper industry in free fall, Zell's new survival plan is to build out Tribune's broadcasting and Internet groups, which represent 24% of revenues, and slash costs in the newspaper group. "It's a smart move," says Hale Holden, a debt analyst at Barclays Capital (BCS) who follows Tribune. Broadcast companies are commanding valuations double what newspaper companies enjoy. "We think it's one of the few options he has available," Holden says.

That grim assessment stands in stark contrast to the jubilation that greeted Zell last Dec. 20, his first day as CEO, as he strode triumphantly into the Chicago Tribune offices, smiled broadly at his new comrades, and announced: "You own this company now!" He promised no cuts.

Even then, most observers knew the industry was being buffeted by falling revenues. "We started out saying, 'big Christmas, slow January,'" Zell says of the typically booming fourth quarter and anemic first quarter for ad sales. "Then we started seeing trends we didn't expect." Companies were abandoning newspaper ads at an accelerating pace because of a souring economy and cheaper alternatives online. "It's going to get worse, and it's going to go on a lot longer," says New York Daily News owner Mortimer Zuckerman, who has known Zell for 15 years and considers him a "business genius."

As ad sales nosedived, Zell rushed to enact a turnaround plan originally scheduled for 2010. It called for cost cuts and an immediate redesign of Tribune's six smallest dailies to make them

leaner and more attractive to advertisers. Zell told employees, whom he addressed as "fellow investors," that they had to start acting like owners. The new mantra was "AFDI," an abbreviation for a crude slogan that was later sanitized to mean "Actually Frigging Doing It."

The first round of cuts came in the form of buyouts intended to slice 2% of Tribune's workforce. Zell suggested in a Feb. 13 memo that the moves reflected "the reality of our significant debt levels" and other problems. Tribune publishers sent memos hinting that future packages wouldn't be as lucrative. Profits were falling so fast that Tribune looked likely to violate loan agreements requiring it to keep new debt no higher than nine times operating earnings. (The ratio now stands at 8.1.) In March, Standard & Poor's (which, like BusinessWeek, is a unit of The McGraw-Hill Companies (MHP)) cut Tribune's credit rating to B-, from B. Says analyst Emile Courtney, who wrote the report: "That reflects the concern that Tribune might violate [loan agreements] in the near term…as early as December."

Operating chief Michaels conferred with publishers to find out how many pages Tribune could afford to print without breaking its debt provisions. In June he ordered that the ratio of ads to news shift to 50-50 instead of the usual 60% reserved for articles—meaning the so-called news hole had to shrink by 17%. The Baltimore Sun killed its stand-alone daily business section. The Orlando Sentinel ditched its stock tables. The Los Angeles Times announced it was merging sections devoted to books, opinion, real estate, autos, and a weekend calendar.

To Michaels, the moves are a matter of survival. "An animal with his leg caught in a trap will chew it off," he explains. "At the moment, we're doing some leg-chewing." Zell, meanwhile, has no patience for what he views as the pomposity of journalists casting their profession as some kind of sacred trust. "If you want to tell people what they should want, become a professor," he says. "But if you're in the newspaper business—and I emphasize the word business—then you have to respond to what your customer wants."

Zell and Michaels also shook up the sales side. They started placing calls to big advertisers, paying sales reps on commission only, and arming them with new types of ads, including ones in the middle of stories. "We want to incent them like hell to be greedy," says EVP Gremillion. Even if advertisers didn't want to be in the paper, Zell suggested, they could buy space on delivery trucks and printing plants.

As newspaper bosses were cutting jobs and pages, Zell's lieutenants sought to crank up broadcast profits, which had fallen 10% in 2007 because 13 Tribune stations were affiliated with the struggling CW Network. Michaels pressured CW to lower the estimated $72 million a year Tribune pays for its programs. He also complained about its core audience of young women, saying they tend not to watch local news. Local newscasts are the most lucrative programs because 100% of the ad revenue flows to the station, without network or syndicator middlemen.

The More Urgent Problem

Internally, Michaels unleashed radical changes designed to double the number of hours of local news on Tribune's stations. In Fort Lauderdale, Tribune is building a local TV news station inside the newsroom of the South Florida Sun-Sentinel to feed hours of content to Miami's WSFL-TV station. It also plans to launch a four-hour local morning show in January. In Chicago the company is planning a 24-hour breaking news center in the Tribune's newsroom to provide content for television, radio, cell phones, and newspapers. "What we're doing could really change the business not only for television but also for print," says Ed Wilson, Tribune's head of broadcasting. One top executive at a major network has doubts: "Michaels doesn't know this business and hasn't taken the time to learn it. He's still a radio guy playing a TV executive."

None of the moves address the more urgent problem: Tribune's need for cash. It raised $630 million on July 29 by selling New York's Newsday, one of its most profitable newspapers, to Cablevision Systems (CVC) (Zell smartly kept a 3% stake to avoid taxes.) The price was less than what analysts estimate Zell paid for it last year, but it covered a big chunk of debt. In

June, Zell put Tribune's headquarters and the Los Angeles Times' property on the market. On July 3, Tribune signed a $300 million asset-backed commercial paper deal with Barclays, in essence borrowing against money it expects to collect in the future.

And so the layoffs will keep coming. Tribune has axed 1,100 people thus far, with newspapers bearing the brunt. On July 2 the Los Angeles Times scrambled to cut 150 people, or 17% of its staff. It happened so fast that one editor said he didn't know whether to nod sadly or smile to his own staff members in the hallway because he couldn't recall who was on the list.

One wonders what might have happened had someone else bought Tribune. Zell and his team have limited flexibility, but a different buyer might not have taken on so much debt. Zell says the casualties will be "significantly greater" by yearend, and he's unapologetic about that. "I knew that I needed to act as both the grenade thrower and the bomb deflector if we were going to get from here to there," he says. Getting "there," of course, would mean a big payday for Sam Zell.

Fonte: Business Week, p. 34-39, August 11. 2008.