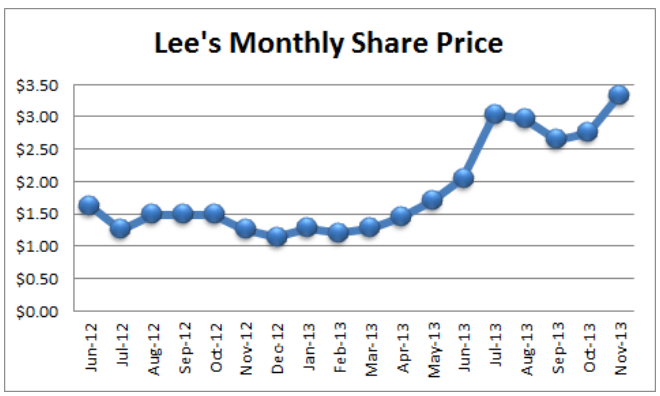
LEE Continues to Deleverage its Balance Sheet

Accumulate

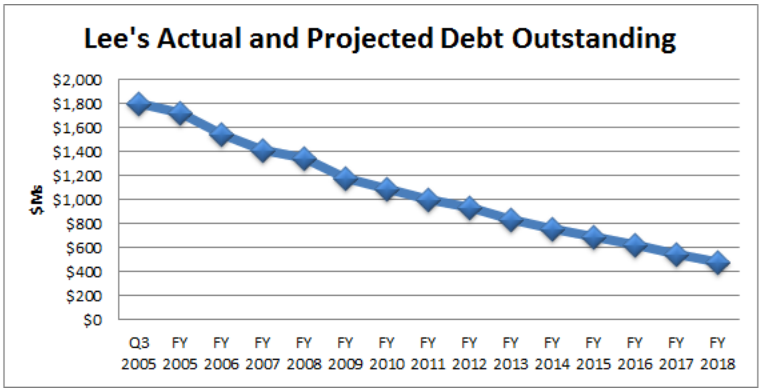
We were initially skeptical of the merits of Berkshire Hathaway's (BRK.B) (BRK.A) investments in the beleaguered newspaper sector, especially Lee Enterprises (LEE). However, we took a second look at Lee and we liked that Lee had a free cash flow yield of 90% when we released our initial report in June 2012 and that Lee survived a bankruptcy filing with only 13% stockholder dilution. Although Lee's share price history was rather rocky from June 2012 to May 2013, it has taken off since the end of May as it has benefited from Berkshire Hathaway doubling down on its ownership of Lee's debt. Berkshire initially became a capital stakeholder in Lee by buying $85M of its Second Lien Term loans and received 3.2M shares associated with this term loan. We were surprised that Berkshire sold off 3.1M of its shares but refinanced Lee's $94M worth of debt associated with its Pulitzer Inc subsidiary. We also think that Cannell Capital may be regretting its Q4 2012 sale of Lee Enterprises shares and CALPERS is regretting selling most of its Lee Enterprises position in Q1 2013.



Source: Morningstar Direct

RECENT QUARTER

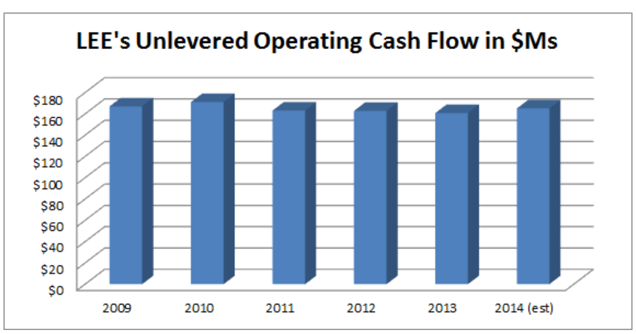
Lee's most recent quarterly results are continuing to show that the company is narrowing its revenue declines and stabilizing its free cash flows. Lee generated free cash flows of $27.4M in the Q4 2013 period ($82.1M in FY 2013). This was an increase from the $11.75M in Q4 2012 ($49 M in FY 2012). Lee's FY 2013 free cash flows benefitted from the absence of the huge reorganization costs incurred in the prior year, though higher cash interest expenses partially offset that benefit. At least Lee's cash interest expense has peaked in FY 2013. Lee used its free cash flows to pay down $26M in its debt during the quarter. We do not expect Lee to incur additional debt financing and reorganization expenses in order to survive as an organization because of its steady record of debt retirement.



Source: Morningstar Direct and Our Estimates

SUMMARY OF OBSERVATIONS

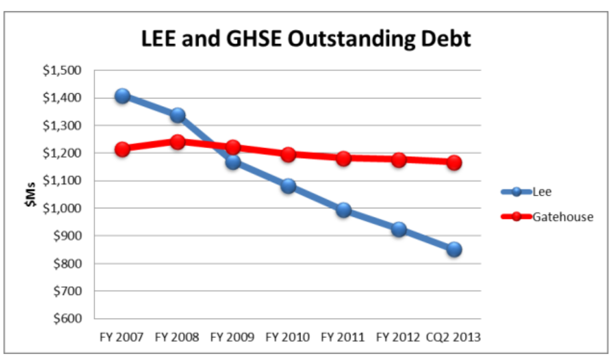
We were happy that Lee's adjusted free cash flows of $18.2M in Q4 2013 exceeded our conservative estimate of $16M. We expect Lee to generate $32M in free cash flows for Q1 2014 and $17M in free cash flows for the Q2 2014 to Q4 2014 periods primarily due to the absence of additional mandatory debt financing and reorganization costs that were incurred in the comparable periods in 2012. This will result in Lee generating $83M in FY 2014 and enable Lee to reduce the face value of its outstanding debt below $780M at the end of FY 2014. We were pleasantly surprised that Lee's capital expenditures increased year-over-year in FY 2013 versus FY 2012. Although the 24% growth was rather high, we can acknowledge that at least Lee and its creditors are comfortable with it making proactive investments in its business. We have seen instances in business and government where the leadership skimps on maintenance, repairs, renovations and upgrades and it results in drastic expenses to replace capital assets.



Source: Lee's 2013 Deutsche Bank Leveraged Finance Presentation and Our Estimates

Lee's adjusted revenue declined by 2.8% in Q4 2013 versus Q4 2012 and we attribute this to declines in its adjusted advertising revenues due to the weak economy. Operating cash flow increased by 4.1% as a 4% reduction in cash operating expenses offset the revenue declines. Lee incurred a $171M impairment of intangibles and other assets but at least it reduced its amortization expenses by 42.5%. Lee's management projected that its adjusted cash operating expenses to decline by 3.5%-4.5% in FY 2013 and met that target by reducing its adjusted cash operating expenses by 3.7%. Interest Expense decreased by $4.5M year-over-year in Q4 2013 due to reduced debt outstanding and the refinancing of its Pulitzer Notes. Compensation expenses decreased 9.3% due to an 8.4% reduction in the average number of full-time equivalent employees of 8.2%. Newsprint and ink expense decreased 22.3% due to a reduction in newsprint volume of 19.4%. Other operating expenses decreased 7.6%.

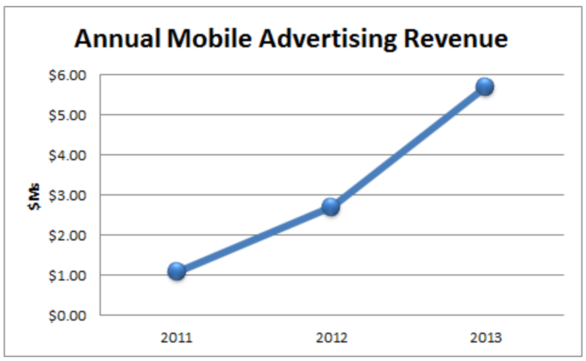
We are expecting Lee's EPS to have bottomed out as its interest expense rate is not likely to increase further and Lee is steadily paying off its outstanding debt. Gatehouse Media (GHSE.PK) is the community newspaper leader serving the New England region. Although Lee and Gatehouse engaged in debt-funded deals-from-hell around the 2005-2007 buyout boom and bust, Lee is at least making progress in reducing its debt unlike Gatehouse. Fortress Investment Group (FIG) owns 40% of Gatehouse and FIG's externally managed and advised affiliate Newcastle Investment Corporation (NCT) recently acquired Dow Jones' Local Media Group. Gatehouse Media declared bankruptcy in September and plans to settle its outstanding debt for 40 cents on the dollar in cash or stock in New Media Investment Group Inc., a new holding company that will own GateHouse and the legacy Dow Jones Local Media Group.



Source: Morningstar Direct

Lee is making steady, incremental progress in monetizing its digital properties. Lee's adjusted circulation and subscription revenue increased by 4% due to gains from paid content initiatives and a $.50 price increase on its flagship *St. Louis Post-Dispatch* newspaper publication that took place in Q1 2013. Lee's digital revenue in Q4 2013 was $19.9M and grew by 9.5% year-over-year (6.8% in FY 2013). The key driver of Lee's digital revenue performance continues to be its mobile advertising revenue, which reached $1.5M in Q4 2013 and increased by 65% versus Q4 2012 (111% FY 2013 versus FY 2012).

Lee achieved its spectacular mobile advertising growth in Q4 2013 after achieving 150% increase in mobile advertising revenues in FY 2012 and 127% in the first nine months of 2013. Lee's combined print and digital advertising revenue decreased 5.7% to $113.6M, with retail advertising down 4.2%, classified down 8.4% and national down 14.9%. Combined print and digital classified employment revenue decreased 11.1%, while automotive decreased 11.8%; real estate decreased 2.5% and other classified decreased 6.2%. Print advertising revenue on a stand-alone basis decreased 6.7%.



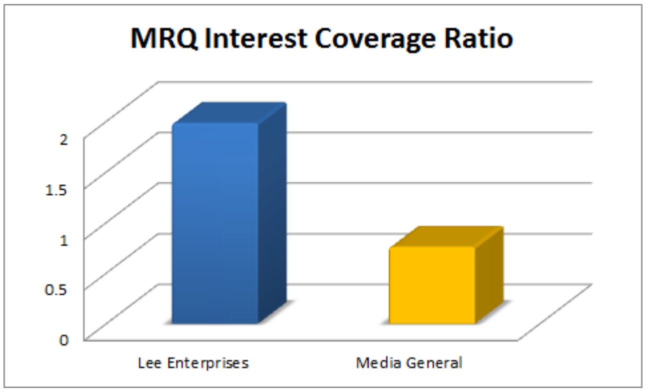
We previously discussed how Berkshire Hathaway stepped up to refinance Lee Enterprises' Pulitzer Notes. Lee had $94M outstanding on its Pulitzer Notes as of Q2 2013; Lee paid off $14M in Q3 2013 and $17M in Q4 2013 and now has $63M remaining on its Pulitzer notes. When Lee pays off its remaining Pulitzer Notes debt, Lee's Second Lien lenders have a springing First Lien on the assets of Lee's Pulitzer operations. We believe that Lee should be able to refinance its First Lien and Second Lien term loans in order to reduce its interest rate (and potentially extend the final maturity date) for four reasons:

- Lee's Second Lien Term Loan holders have a springing lien on the assets of Lee's Pulitzer operations and we expect this will take effect next year once Lee retires its remaining Pulitzer Notes debt.
- Media General (MEG) struck a deal to refinance its debt once it completes its merger with Young Broadcasting and completed its merger with Young recently. Lee should be

able to refinance its debt since it had a better interest coverage ratio than Media General as of its most recent quarter.

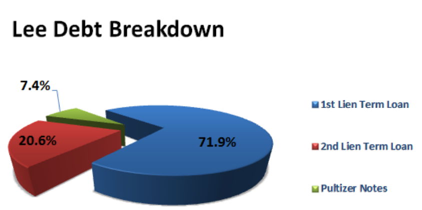
- Lee is two years ahead of schedule for paying down its debt and we believe that it could reduce the outstanding face value of its debt to below $500M by the end of FY 2018.

- Lee's actual principal debt repayments are significantly higher than its mandatory debt repayments, which shows that Lee is serious about retiring its debt rather than resorting to extend and pretend refinancing



Source: MRQ Reports for [Lee Enterprises] and [Media General]

We are content that Lee has sold off two of its less profitable newspapers and received 17X TTM FCFs (*North County Times)* and 20 TTM FCFs (*The Garden Island)* for these papers. Lee's stabilizing free cash flows will enable it to ensure that it does not need to sell its newspaper properties at fire-sale prices. With the recent sale of *The Boston Globe* and *The Washington Post*, we are hoping that Lee would be able to engage in proactive strategic discussions to gauge bidder interest for any of its publications and to see if potential bidders are willing to pay a fair price for any of Lee's publications.



Source: Lee's 2013 Deutsche Bank Leveraged Finance Presentation

CONCLUSION

In conclusion, we are pleased to see Lee's share price and operating income stabilizing. Lee is most certainly not a blue-chip company and the glory days of the newspaper publishing business are most certainly over. However, we also believe that the worst for Lee is over and we do not expect it to buy any other newspaper chains at 25X TTM FCFs using debt as it did with Pulitzer in 2005. Lee has been able to keep its EBITDA from declining significantly since it bottomed out in 2009. Although Lee's revenue has been steadily sagging since 2006, it has been able to offset these headwinds with lower operating costs. Lee has also mitigated its print revenue declines with its revenue from its digital advertising and circulation programs. Lee is now approximately ahead of schedule concerning reducing debt as the face value of Lee's outstanding debt ($847.5M) is comparable with the amount projected in Lee's reorganization plan for September 2015. Finally, we were pleased that Lee's mobile advertising revenue increased by 111% year-over-year in FY 2013 and its $5.7M in mobile advertising revenue was comparable to the $5.8M that we projected earlier in the year.

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Disclosure: Analyst(s) covering this company owns common shares in LEE.

RECOMMENDATION SCALE

INVESTMENT RATING	DEFINITION
STRONG BUY	Stocks expected to be 20% underpriced relative to its intrinsic value and whose total return is expected to significantly exceed the market index benchmarks.
ACCUMULATE	Stocks expected to be at least 10% underpriced relative to its intrinsic value and whose total return is expect to exceed the market index benchmarks.
NEUTRAL	Stocks expected to be fairly priced relative to its intrinsic value and whose total return is expected to closely track the market index benchmarks.
AVOID	Stocks expected to be slightly overpriced and to either potentially see a small, incremental decline in its price to converge with its intrinsic value or expected to appreciate at a slower pace relative to the market index benchmarks.
STRONG SELL	Stocks expected to be strongly overpriced and to potentially see a rapid decline in price to converge with its intrinsic value or expected to significantly underperform relative to the market index benchmarks.

Relevant benchmarks: In North America, the relevant benchmark is the S&P 500 Index

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