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INSIDE

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By Kathryn M. Welling and Frank K. Martin

Calling Mr. Smulyan's Bluff

Emmis Bid Tests Institutional Holders' Will To Buck Imperial CEO

Jeffrey H. Smulyan, Chairman and CEO of Indianapolis-based **Emmis Communications Corp.** (EMMS) was one of two prominent and very public losers this spring in the hotly contested battle to win Baseball Commish Bud Selig's blessings to buy the struggling Washington Nationals. Selig's May 3 decision to award the franchise to D.C.-based rival bidders not only dashed Smulyan's stated hopes of rejoining the ranks of major league owners (despite a star-crossed 1989-1992 stint as the out-of-town owner of the Seattle Mariners that won him few fans in the Pacific Northwest or elsewhere in baseballdom), but also forced the media group he founded to write off roughly \$1.1 million in third-party acquisition-related costs. So it's not terribly surprising, perhaps, that the 58-year-old Smulyan not only came out swinging for the fences with his latest takeover proposal, but also loudly proclaimed that, *this time*, the takeover game is to be played under rules befitting a sandlot bully: His way, or else he'll take his bat, ball and gloves home, and no one will get to play.

More precisely, according to the letter Smulyan's wholly owned merger vehicle, ECC Acquisition, delivered to Emmis' board on May 7, "Mr. Smulyan

will not agree to any other transaction involving Emmis or his shares of Emmis." Any other, that is, but his own non-binding proposal to acquire the outstanding publicly held shares of the media group with

Very Important Disclosure!

Frank Martin, the co-author of this story is very much an interested person in Emmis. Frank is the managing partner of **Martin Capital Management**, a registered investment adviser that has filed a **13D** [available on w@w's website] indicating beneficial ownership of 7.2% of the Emmis' total outstanding shares. Martin Capital is a long-term investor and its average cost for Emmis shares is in close proximity to the proposed offering price. Mr. Martin is also the author of a recently published book, *Speculative Contagion: An Antidote for Speculative Epidemics*.

its top-drawer radio assets in New York, Chicago and Los Angeles for a miserly \$15.25 a share in cash (all of a 13.6% premium to the previous day's close).

This prospective intransigence on Jeff Smulyan's part is no trifling matter. Emmis' board over the years has

lavished not merely ordinary shares and options on the Emmis founder and CEO, but Class B *super-voting* shares and options. Super-voting shares that, under most circumstances, give Jeff Smulyan 10 votes for every one that can be cast by Emmis' ordinary shareholders—95% of which are presumptively sophisticated institutional investors. (See table on page 3.) The upshot is that in most instances,

Emmis Shareholders Looking For More



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Jeff Smulyan, whose economic stake in the company (calculated in the way most generous to his interests) amounts to just under 17%, controls 66.7% of Emmis shareholder votes. Seemingly, then, more than enough to easily block unwanted rival bids. (This calculation assumes that he exercises options on 1.5 million shares which are exercisable currently or within 60 days—even though those options have average strike prices in the mid- to high-20s.

Assuming he doesn't commit that economic folly, Smulyan's economic and voting interests in Emmis are actually 13.7% and 60.4%, respectively.)

Yet, as is the case with most schoolyard oppressors, there is rather less behind Jeff Smulyan's bravado than first meets the eye. While most commentary, in news reports and from Wall Street analysts alike, has assumed that his assertion of nearly two-thirds voting control effectively grants the Emmis CEO *carte blanche* to complete his going private proposal, *his way*, a close reading of his 13D filing, and of Emmis' press release disclosing the bid, reveals otherwise.

Specifically, there's a very crucially significant exception to Mr. Smulyan's super-voting rights: To quote his 13D: "The proposed merger would be a "going private" transaction (as such term is defined in the Charter) involving the Issuer and a purchaser affiliated with the Reporting Person. Therefore, a holder of Class B Common Stock is entitled to vote on the transaction on an "as converted" to Class A Common Stock basis, *with one vote per share for each class of Common Stock.*" (Emphasis added.)

In short, if Jeff Smulyan's proposal to take Emmis private is eventually put before the company's shareholders for a vote, his super-voting shares' electoral power will shrivel like Superman exposed to Kryptonite, and he'll be able to vote no more than 17% of the company's equity (presumably) for his own bid. What's more, while his informal powers of "(im)moral suasion" with Emmis' board are no doubt extensive, as a board member, he has but one

vote among eight.

So where does this leave Emmis' outside, Class A, shareholders—most of whom, given their largely institutional character and the stock's dismal performance in recent years are likely either incorrigible value types or indexers of the closet or straight variety? It might initially appear, should a formal offer be forthcoming, that they'll all find themselves the

hapless victims of a classic "Catch-22." If they vote against Jeff Smulyan's offer because they believe that the highest and best price for all shareholders—based on relative economic interest—is well above \$15.25 a share, and they prevail, nothing changes at Emmis. In effect, Emmis' largely institutional shareholders would remain hostage to a CEO whose loyalty to Class A shareholders clearly takes a backseat to his own interests and whose dual-class voting power gives him almost absolute control. If, by contrast, they vote for an offer they deem unfair to long-term holders, their only rationale, sadly, would likely be "at least I'll know the extent of my loss."

Such an unhappy stalemate is not yet, however, ordained by the fates. No shareholder vote has been scheduled at Emmis; Indeed, no formal bid has even been made, no timetable announced.

Emmis' board has merely kicked the CEO's proposition over to a special committee of independent directors, who have busied themselves hiring their own financial and legal advisors. (For whom *all* the company's shareholders will doubtless foot the bill.) No word yet on when or even whether a recommen-

If Jeff Smulyan's proposal to take Emmis private is eventually put before the company's shareholders for a vote, his super-voting shares' electoral power will shrivel like Superman exposed to Kryptonite, and he'll be able to vote no more than 17% of the company's equity for (presumably) his own bid.

Easy Access

To Background Documents

There have been 8 SEC Documents filed concerning Emmis in the past Filings since its April 10Q. That document, plus 3 13 Ds, 3 8 Ks and two versions of its 10K are assembled for easy reference under this link on w@w's web site.

dation from the independent committee to the full board will be forthcoming or, obviously, on whether the board will approve any deal, sending it to a shareholder vote in which, as noted, every share, no matter its class, would have but one vote—despite Mr. Smulyan’s well-publicized control of Emmis’ “super-voting” Class B shares.

So the ball, for now, is squarely in Emmis’ board’s court, and—even more immediately—in the court of that special committee of its independent directors. Emmis has not said precisely who is on that committee, but 5 of the 8 directors it lists in a 10K amendment filed June 28 are not Emmis employees: attorney

Susan B. Bayh, **Frank V. Sica**, (a former senior advisor to Soros Capital and now president of Menemsha Capital Partners, a private investment firm), **Richard A. Leventhal** (president and majority owner of LMCS, LLC, an investment, management and consulting company), **Peter A. Lund**, (a private investor, media consultant and former CEO of CBS Inc.), and **Lawrence B. Sorrel**, (managing partner and co-CEO of Tailwind Capital Partners).

What’s fascinating about the position in which Emmis’ independent board members now find themselves is that it’s not beyond the realm of possibility that Mr. Smulyan’s recent maneuverings—instead of bullying holders of Emmis’ “inferior” class of stock into selling out to him at a rock-bottom price—may have served only to push Emmis’ independent directors into a corner from which they may not be able to escape without acute embarrassment or worse. In large part, because the resolution of this brewing conflict over the company’s value could have implications far beyond the bottom lines of Emmis’ beleaguered public shareholders.

For the Emmis story brings into sharp relief some critical issues in corporate governance—particularly the abuse and breakdown, all-too-common these days, of what should be the bedrock “agency/principal” relationship between managements and shareholders. Not to mention that, should the going private battle turn nasty, CEO Smulyan’s flagrant attempt to pick Emmis’ Class A shareholders’ pockets could conceivably become an issue in the next Presidential election campaign cycle.



No, Jeff Smulyan isn’t eying the White House. For himself.

But **Indiana Senator Evan Bayh** is. And the acquisition-minded Indianapolis corporate chieftain has long been one of the rising young Democrat’s most consistent and generous supporters. According to campaign finance reports compiled by **The Center For Responsive Government** at www.OpenSecret.org, Jeff Smulyan and his wife, **Heather**, have personally donated over \$12,000 directly to various Evan Bayh campaigns since 1997—at the same time making more than \$297,000 in personal contributions to various other (almost entirely) Democratic candidates, causes and political action committees. [A listing can be found on w@w’s website.] Generous contributions by any standard, but particularly so when it’s considered that Smulyan has more than \$1 million in loans outstanding from Emmis Communications. The media company itself, meanwhile, has reported more than \$110,000 of so-called “soft money” contributions—overwhelmingly to Democratic campaigns for the Senate, since 1999.

Thus, the reader may not be surprised to learn that the aforementioned Susan B. Bayh, who has sat on Emmis’ board ever since 1994, happens to be Evan Bayh’s wife. The attorney, a native Californian, was elected to the Emmis post in the midst of her husband’s second term as governor of the Hoosier state. That board position now places her, however uncomfortably, squarely in the middle of the developing tug-of-war between Emmis’ management and its outside shareholders over the valuation of the media group.

Fiduciary Duties

Directors owe duties of “care” and “loyalty” to the corporation and its shareholders. These duties require the board of directors to act in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances, and in a manner he or she reasonably believes to be in the best interest of the corporation and its shareholders.

Duty of Care

The duty of care is both subjective and objective. The duty of care is subjective, because it recognizes that the duty varies based on the director’s qualifications and the nature of the company. However, the duty is also objective, because it requires of the director, honesty, diligence, common sense, informed judgments and reasonable actions.

Duty of Loyalty

The duty of loyalty requires directors to exercise their powers, as directors, in the corporation’s interests and not in their own interests or in the interests of any other person or organization.

The graduate of the University of Southern California Law Center is both a career political wife and a career board member. Currently designated as Emmis’ “lead director,” as well as chair of its corporate governance committee and a member of its three-person compensation committee, Susan Bayh is presumably also one of the Emmis independent directors appointed by the board to the special committee charged with rendering an independent opinion on Jeff Smulyan’s going private proposal.

The company’s most recent proxy had this to say about Mrs. Bayh’s responsibilities: “Our independent directors have appointed Susan B. Bayh as the “Lead Director.” In that role, Mrs. Bayh is responsible for coordinating and leading the independent directors, presiding over executive sessions of the independent directors and acting as a liaison between the independent directors and the rest of the board of directors and Emmis management.” None of those responsibilities is likely to have become *less* burdensome since Jeff Smulyan launched his bid.

By all accounts a tireless campaigner and undeniable asset on the hustings, Mrs. Bayh, a poli sci major in college, boasts bona fides, as a political wife, beyond question. Evan Bayh was elected Indiana Secretary of State in 1986, just a year after their wedding. Two years later, at ages 28 for her and 33 for him, the young couple moved into the governor’s mansion for what turned out to be two terms, which were quickly followed by the first of her husband’s two (so far) successful runs for the U.S. Senate. Susan and Evan are parents of photogenic 10-year-old twin sons and, in between campaigns, she has worked for quintessentially correct educational and environmental causes. (Susan Bayh is credited with founding the Indiana Literacy Foundation in 1992 and until 2001 served as one of three U.S. delegates to a U.S.-Canada International Joint Commission over-

seeing air and water quality in the Great Lakes Region.)

Alas, Susan Bayh’s credentials in such matters as the valuation of corporate assets and the fiduciary duties owed by Emmis’ board to all of its shareholders, regardless of class, are substantially less obvious.

Not that she doesn’t sit on an impressive array of corporate boards—and neatly supplement her husband’s Senate salary in the process. Emmis’ latest proxy indicates, for instance, that her total compensation from the company last year was in the range of \$75,500-\$89,000, not counting unexercised options. While the most recent financial disclosure statement available for the Senator (for 2004) lists between \$100,000 and \$250,000 in Emmis stock among the couple’s largest financial assets. In fact, it’s their only significant stake in an individual equity. (The others are assorted fund holdings). As it happens, that same document indicates that an Emmis subsidiary also made a \$3,800 payment to the Senator that year—or, rather, given the niceties occasionally observed in the nation’s capital, to a charity in lieu of royalties due him for a book. (Presumably, the volume involved was Bayh’s slim encomium to his father and fatherhood, “*From Father to Son: A Private Life in the Public Eye.*” It sank pretty much without a trace after being published by Emmis Books in 2003 and is currently ranked No. 742,603 on Amazon.)

As noted, Emmis is not, by any means, the only corporation on whose board Mrs. Bayh serves. SEC filings indicate she currently is also a director of **Wellpoint, Inc.** (WLP), a Blue Cross/Blue Shield company; (Cash compensation: \$82,352 in 2005, plus shares), of **Cubist Pharmaceuticals, Inc.** (CBST), a biopharmaceutical company; of **Curis, Inc.**, a therapeutic drug development company; of **Dendreon Corp.** (DNDN), a biotechnology company; of **Dyax Corp.** (DYAX), a biopharmaceutical company; and of **Novavax, Inc.** (NVAX), a biopharmaceutical company.

What’s germane about all this to the issue of the control premium (or lack thereof) in Emmis shares is that however eloquently Susan Bayh’s professional resume bespeaks influence, it’s awfully thin on experience. Especially where the rubber of corporate governance theory meets the road in battles for corporate control. The only other S&P 500 company on whose board she sits, Wellpoint, is the nation’s largest health insurer and has completed a raft of transactions since she joined the board of predecessor Anthem Inc. in 1998. But the big issues it has faced have not (so far as publicly known) involved the pitting of management’s personal interests against those of the shareholders.

Nor does anything in her curriculum vitae indicate earlier exposure to such nitty-gritty issues. Fresh out of law school, she worked for less than a year for

Gibson, Dunn & Crutcher in Washington before marrying Evan Bayh and moving to Indianapolis. Mrs. Bayh then put in four years as a litigation associate at one of the bastions of the Indiana bar, **Barnes & Thornburg**, before moving—about the time her husband was elected governor—into the capacious corporate folds of another pillar of Indy’s business community, pharmaceutical giant **Eli Lilly & Co. (LLY)**. She toiled as an attorney for Lilly from 1989 to 1994. Then, during her husband’s second term as governor, Indiana’s First Lady took a chair as a Distinguished Visiting Professor at the Butler University’s Indianapolis business college, a post she held through 2003. Since then, regulatory filings indicate, it’s been boards and more boards for Mrs. Bayh.

In sum, there’s little in her background to indicate which way Susan Bayh will now lead Emmis’ independent directors as they examine its CEO’s bid. But if, falling back on her legal training, she turns for guidance to legal theory and precedent, she should find the basics of fiduciary duty (see box), though “defined” only in common law, relatively straightforward.

More intriguingly, should she dig far enough, she’ll discover that there’s recent precedent in the Delaware courts for holding certain, “expert” independent directors liable for voting for a transaction that they know, or have reason to believe, is unfair to public shareholders. The court found, in other words, in *In re Emerging Communications, Inc. Shareholder Litigation, Del. Ch. Civ. A. No. 16415 (May 3, 2004)*, that an expert director can’t rely on the fig leaf of a fairness opinion from a special committee regarding a negotiated merger price. The court ruled that the expert director knew or should have known the price in question was unfair and so had a duty to vote against the transaction and to urge the board to do likewise. The director held liable in that case was deemed an expert because of substantial specialized experience in the industry in question, a description that, based on Emmis’ SEC filings, would seem to fit, if not Mrs. Bayh, at least 3 of the company’s 5 independent directors. Although that decision was handed down by a lower court—and the case settled, forestalling higher review—legal observers have taken a special note of the opinion, not only because it raised the bar for expert directors but also because the jurist who authored the opinion has since been elevated to the Delaware Supreme Court.

Then again, if Mrs. Bayh turns to academia for insight into the ins and outs of corporate governance with super-voting shares, she is likely to discover that the mechanism, which favors one group of shareholders disproportionately to its economic interest in a company (in direct contravention of the “one person, one vote” principle that governs her husband’s political career), has grown alarmingly in popularity and in economic influence over the last decade.

According to the latest published research on the topic, *“Incentives vs. Control: An Analysis of U.S. Dual-Class Companies,”* published in December 2003 (with data through 2001), by Paul A. Gompers, Harvard Business School, Harvard University and NBER, et al., there were 215 U.S. companies with both “superior” and “inferior” classes of stock that year, more than double the 100 such firms counted just five years earlier. These were not penny ante companies, either, with total assets in excess of \$1 trillion.

Prof. Gompers and his fellows began their research with the classic supposition that managerial equity ownership helps to align the interests of the manager (agent) and the shareholders (principals). Successful small businesses, where owners and managers are one and the same, prove the validity of the incentive argument in thousands of locales across the country everyday—and are obviously untroubled by agent/principal conflicts. But when small businesses grow to need outside equity capital, the potential arises for friction between the interests of principals and of their agents. To one extent or another, all publicly traded companies must cope with this dynamic tension. But as nearly daily headlines demonstrate all too well today, and as the researchers observed, the separation of ownership and management grew into such an enormous divide in the 1990s that a germ of original truth mutated into a pandemic of stock-option abuses, throwing the agent/principal relationship into a cocked hat. The incentive mechanisms employed—mainly options but also super-voting shares—gave rise to egregious programs of self-enrichment for the agents at the expense of the principals.

The Harvard academics further observed that super voting shares associated with equity ownership can “create entrenchment, and an entrenched management may be immune to career concerns, the discipline of the product market, monitoring by large shareholders, and value-enhancing takeovers.” What’s more, “the more control that the insiders have, the more they can pursue strategies that are at the expense of outside shareholders ... In this situation, managers may expropriate minority shareholders and extract what have been called ‘the

Emmis’ Biggest Institutional Shareholders

Value	Institution Name
\$42,868,074.70	Martin Capital Mgmt. LLP
\$39,381,898.38	Westport Asset Mgmt., Inc.
\$36,107,698.00	Noonday Asset Mgmt. LP
\$34,323,721.08	Barclays Global Investors NA (CA)
\$31,743,457.24	Neuberger Berman LLC
\$31,264,740.76	Eubel Brady & Suttman Asset Mgmt.
\$28,929,616.76	Reed, Conner & Birdwell LLC
\$26,198,678.00	TCS Capital Mgmt. LLC
\$22,941,710.00	RR Partners LP
\$18,708,213.70	Vanguard Group, Inc.
\$17,084,628.00	Daruma Asset Mgmt., Inc.
\$14,905,318.12	Babson Capital Mgmt., LLC
\$14,385,504.10	Dimensional Fund Advisors, Inc.
\$13,666,417.60	T. Rowe Price Associates, Inc. (MD)
\$13,641,877.92	Deutsche Bank Investment Mgmt., INC.
\$11,561,096.14	State Street Global Advisors
\$10,954,429.64	Broadview Advisors LLC
\$10,603,727.42	Kitzinger Lautmann Capital Mgmt., Inc.
\$9,467,370.00	Wells Capital Mgmt., Inc.
\$9,147,278.14	Hocky Mgmt. Co. LLC

Source: Bigdough.com, reported holdings as of 6/20/06.

private benefits of control.”

If, after reading research like that, Susan Bayh is uncertain whether Emmis’ management is entrenched, she should consider:

- The board cannot fire Emmis’ CEO.
- A 2000 amendment to Emmis’ articles of incorporation specifies an 80% vote of shareholders to remove directors.
- The compensation committee granted one million options to the CEO in 1999 to purchase Class B shares, with 200,000 shares vesting each March 1 from 2000 through 2004, when “certain performance targets are met.” But the grant included a default proviso that should disabuse shareholders of any notion that a pay-for-performance policy governs CEO compensation at Emmis: “*Any options that have not been previously vested will vest on March 1, 2006.*”
- And, finally, Jeff Smulyan’s stated refusal to entertain any bids for Emmis but his own.

What’s more, if Mrs. Bayh is wondering whether her husband’s political patron is immune to career concerns, she might note:

- The \$1.1 million write off Emmis just took for expenses related to its CEO’s quixotic quest to buy the Washington Nationals, and the team’s who-knows-how-many-future skyboxes.
- Emmis Book’s re-publication this year of one of its titles from 2004 that can’t be found on any best-sellers list: “*Baby It’s You: What You Can Do To Find True Love,*” ranked No. 843,718 on Amazon. While the source of demand for the volume is unclear, author Heather Hill is Jeff Smulyan’s wife.

Finally, if Mrs. Bayh is wondering whether the Emmis CEO is attempting to expropriate the interests of its Class A shareholders “to extract the

private benefits of control,” she might contemplate the explanation of his going private transaction provided in Jeff Smulyan’s SEC filing: “*We believe that our offer is fair to and in the best interest of Emmis and its various constituencies, including its public shareholders. This offer represents a 13.6% premium over the closing price of Emmis’ Class A shares on May 5, 2006.*” It’s a most peculiar assertion, on a couple of levels:

- First, Emmis is not somehow an entity onto itself with sundry constituencies, but a company owned by all its shareholders.
- Second, the valuation claim utterly disregards various alternative methods of surfacing the highest value of the company for the benefit of all its shareholders—albeit alternatives seemingly foreclosed by Jeff Smulyan’s *ex ante* refusal to consider any bid but his own.

Should Mrs. Bayh continue to soldier on, perusing the available research, she will likely note that market value consequences of the entrenchment of managements have been documented. The academics have found (surprise!) that the more control insiders have (as in Emmis) the more they can pursue strategies at the expense of outside shareholders. Moreover, the Harvard researchers’ observed, in other words, that many of the traditional mechanisms that separate control from cash flow rights, such as dual-class shares, can lead to significant *agency costs* of “an order of magnitude larger than those existing in firms in which insiders own a majority of the shares.” The “agency costs,” the professors referred to were problems like so-called moral hazard—the increased risk of questionable or unethical behavior by the CEO who may not suffer the full consequences of problems caused by his actions, or who may actually benefit, because of the inherent asymmetry of information flow between manage-

Emmis Communications'

SOFT MONEY DONATIONS

Contributor	Occupation	Date	Amount	Recipient
Emmis Comm. Corp.		9/21/00	\$5,000	Democratic Senatorial Campaign Cmte
Emmis Comm. Corp.		7/20/00	\$2,500	Democratic Congressional Campaign Cmte
Emmis Comm. Corp.		7/20/00	\$12,500	Democratic Congressional Campaign Cmte
SMULYAN, JEFF		6/30/00	\$5,000	Democratic Senatorial Campaign Cmte
Emmis Comm. Corp.		6/22/2000	\$5,000	Democratic Senatorial Campaign Cmte
Emmis Comm. Corp.		5/15/00	\$10,000	Democratic National Cmte
Emmis Broadcasting Corp.		6/29/99	\$10,000	DSCC/Non-Federal Corporate
Emmis Comm. Corp.		6/29/99	\$15,000	DCCC/Non-Federal Account 1
Emmis Comm. Corp.		3/22/99	\$5,000	DNC/Non-Federal Corporate
SMULYAN, JEFFERY M	EMIS Broadcasting	5/12/2000	\$10,000	Democratic National Cmte
Emmis Comm. Corp.		6/29/1999	\$10,000	Democratic Senatorial Campaign Cmte
Emmis Comm. Corp.		6/29/1999	\$15,000	Democratic Congressional Campaign Cmte
Emmis Comm. Corp.		3/22/1999	\$5,000	Democratic National Cmte
			\$110,000	

Source: The Center For Responsive Government; www.OpenSecrets.org

NOTE: The donations listed may be made by individuals associated with the organization as well as by the organization itself.

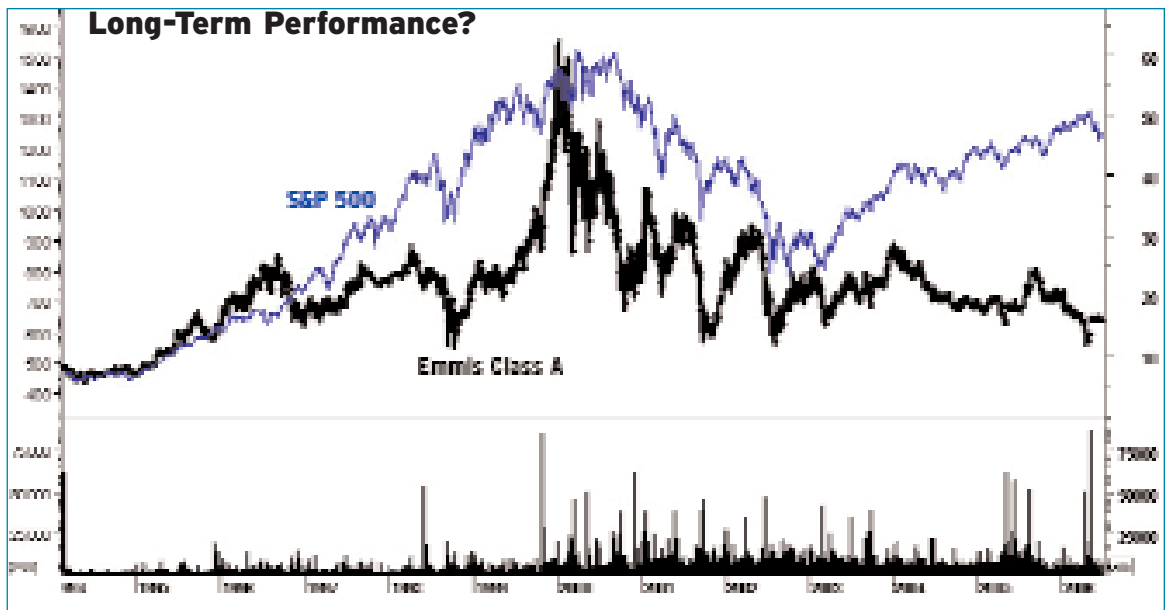
ments and shareholders.

Indeed, it might even occur to Susan Bayh if she reads the Harvard paper that Jeff Smulyan's proposal to take Emmis private at \$15.25 a share could well be a case of the CEO benefiting from his mismanagement of the corporation. After all, since bringing EMMS public in 1994 at \$7.75 (adjusted for 2000's 2-for-1 stock split), the CEO has enjoyed absolute power to direct the affairs of the company, and yet the stock's long-term performance has been, to put it politely, underwhelming. [See nearby chart.]

As Benjamin Graham famously said, "In the short run the stock market is a voting booth, in the long run, it is a weighing machine," so let's look at Emmis over the long haul. Somewhat arbitrarily indexing Emmis, a group of broadcasting industry stocks, and the S&P 500 at a value of \$100 in May of 1996, 10 years later the index value of the broadcasters and of the S&P stood around 200—while Emmis languished near an index value of 50 this spring—until it upticked slightly when Emmis was officially cut from the "Nats" roster of bidders, and then was levitated modestly again only four days later by Smulyan's "winner-take-all" offer. [See chart on page 1.]

Whether 10 years is long enough for value to trump popularity on the scales of time can be argued, but the Emmis case certainly suggests that a firmly entrenched CEO, ultimately accountable to no one but himself, can be hazardous to the wealth of outside shareholders.

That is not to imply, by any stretch, that Emmis is utterly without value, or that Jeff Smulyan's management hasn't bolstered that value. In fact, the company has sold 27.2 million shares in four secondary offerings since 1998, raking in total proceeds of \$713 million at a weighted average price of \$26.23. Indeed, the combined value of those secondaries comfortably exceeds the \$567 million value that the CEO's proposed offer implies for all the company's outstanding equity. Thus, if Jeff Smulyan eventually proves as adroit in picking an opportunistic price at which to buy back outsiders' shares (to his singular benefit, if he is successful in taking the company private) as he was in selling them in the first place, he might consider starting a hedge fund



on the strength of that long-term record. Even more to the point perhaps, the market itself has been suggesting that Emmis is worth more than its CEO's proposed offer, with the shares consistently trading at a premium, albeit a modest one, ever since it was announced.

What higher valuation than Jeff Smulyan's \$15.25 a share, might Susan Bayh and the rest of Emmis' board find equitable, if they poked around a bit in the company attic? Right off the bat, they'd likely discover that it's all-too-easy these days for Wall Street analysts to dump on Emmis' prospects. *Everyone* knows that the internet is stealing ad dollars from traditional media, Emmis' radio stations included, the litany begins. Its audience is being fragmented by the growing popularity of satellite radio and mp3 players; finally, the company's dominance in its major markets is no sure thing, requiring additional "investment" (read: reduced broadcast cash flows in the immediate future).

But the independent directors wouldn't have to dig very far beyond that conventional wisdom to find that, as recently as April 18 when Emmis reported that decline in its fourth quarter revenues, Jeff Smulyan himself was having none of the negativism about Emmis's outlook. Emmis held its fourth quarter conference call that day. And the *CallStreet* transcript of the event is revealing of the attitude of the man who it must be conceded knows the value of Emmis' remaining properties better than anyone else—the mogul who's spent the last quarter century buying and selling the media outlets in the group, Jeff Smulyan:

"I'm remarkably upbeat—and upbeat in spite of the market, which clearly doesn't look very good... I'm upbeat because I think this industry is now getting ready to turn the corner and, more important for us, Emmis is turning the corner and

"...the reality is what we are seeing is mid-teens valuations for really good asset holdings. —[and]everybody agrees we [have] the best assets in the business."

we're making some steps that we think will position us for the future. ... We've decided this year that we are going to invest in our business, and we're going to take a longer-term view... "

He then added, in reply to a question about private market values for radio stations, "...the reality is what we are seeing is mid-teens valuations for really good asset holdings. —[and]everybody agrees we [have] the best assets in the business."

Now granted, investors, on the evidence of the stock's reaction to Emmis' fourth quarter results, were not immediately convinced, because the shares swooned from \$15 to \$12 that day. But then came the fast-paced corporate events that have lifted Emmis shares out of the cellar. They first ticked up just a tad as outside investors, if not Jeff Smulyan, reacted positively to the May 3 news that Emmis wouldn't be investing in the Washington Nationals. (See chart on page 1.) They then gapped up above the projected offering price four days later, on the announcement of Smulyan's low-ball going private proposal. Which —no matter what else you say about it—demonstrates in a very real way that Emmis's founder sees the company as a bargain at only slightly below current prices. He's putting his money—or, at least, the banks' who've said they're highly confident of bankrolling his bid—where his "remarkably upbeat" mouth was during Emmis' April conference call.

And there's no need for analytical backflips to see why. Just use the same "mid-teens" valuation metrics the CEO applied during that conference call, which took place a scant three weeks before he made his going private proposal, and you can easily come up with an enterprise value for Emmis closer to \$1.9 billion than to the \$1.4 billion value implied by the terms of Mr. Smulyan's letter to the board.

Emmis' adjusted trailing broadcast cash flow (including a minor contribution from publishing assets) approximates \$125 million. If the CEO's own "mid-teens" multiple is assumed to be 15 times, applying that to the company's trailing cash flow yields an enterprise value close to \$1.9 billion, or half a billion dollars higher than Jeff Smulyan's proposal.

The upshot is that, after reducing that estimated enterprise value by Emmis' remaining debt (net of cash and of an estimate of the value of discontinued assets held for sale) and by preferred stock outstanding, the equity value of Emmis to an outside buyer would be closer to \$30 a share than to its CEO's \$15.25 bid. And that, majority shareholders argue, is a difference worth fussing about.

In the end, all serious investors are "value" oriented,

in the sense that they commit in the present at \$X price and expect to sell in the future at some multiple of \$X that is greater than one. Yet in the case of Emmis, the current public market value, depressed for the many reasons cited above, is well below the current private market value, according to words from the mouth of the CEO himself. Still, any value investor [like **Martin Capital Management**], who knowingly paid \$.50 over time for \$1.00 worth of value in Emmis, is now watching helplessly as that very same CEO tries to use his super-voting shares to block access to the exchange window—and grab that value all for himself.

Sadly, if Emmis' independent directors don't step up to the plate, call his bluff and perform their fiduciary duties for all of the company's shareholders, outside investors will be forever denied the opportunity to engage in a free-market value-for-value exchange. And a dollar's worth of Emmis will forever fetch only \$.50.

That is enterprise, but it ain't free.

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