

May 22, 2006

Publication: Indianapolis Business Journal (IN)

Section: INSIDE

Page: 4

BEHIND THE NEWS

Smulyan's bid exposes firm's **governance flaws**

GREG ANDREWS gandrews@ibj.com

One reason Jeff Smulyan's bid to take **Emmis** Communications Corp. private is so fascinating is that the Indianapolis-based radio company remains in the dark ages as far as good corporate **governance** is concerned. **Emmis' governance** practices are better than only 2 percent of the companies in the S&P 400 and 36 percent of media companies, according to an analysis released last fall by Institutional Shareholder Services, a Maryland firm that advises big investors.

What's not to like? Here's a sampling:

The company doles out two classes of stock. One-the kind everyday folks like you and me can own-has one vote per share. Only Smulyan, the CEO and chairman, can own the Class B shares, which are worth 10 votes apiece.

He's continued to receive plump pay packages, despite the 80-percent decline in **Emmis'** stock price over the past six years. **Emmis** hasn't yet disclosed his total pay for the fiscal year that ended in February, but his base compensation alone was \$830,000.

In addition, according to filings with the Securities and Exchange Commission, the eight-person board granted him options to purchase 200,000 shares of Class B stock two months ago and already has committed to award him options to buy another 100,000 shares in March 2007.

"In light of the company's sustained poor performance, ISS questions why the compensation committee has guaranteed future equity awards to the CEO without linking them to performance, as well as perpetuated the unequal voting structure of the company," ISS said in a report last year.

Separate and unequal

That voting structure has emerged as a sore point among **Emmis** investors scoffing at Smulyan's offer to buy the 83 percent of the company he doesn't already own for \$15.25 a share, or a total of \$471 million.

Through one prism, the offer Smulyan unveiled May 8 looks substantial. The per-share price represents a 13.6-percent premium to the closing price the previous business day.

But it's a 32-percent discount to the stock's 52-week high reached eight months ago.

As IBJ Daily reported May 18, two major **Emmis** investors that collectively own 17 percent of the company's shares-Elkhart-based Martin Capital Management and North Carolina-based Noonday Asset Management-already have decided to vote against Smulyan's offer if it passes muster with the independent board committee reviewing it.

Martin Capital Management Managing Partner Frank Martin told Smulyan in a May 17 letter that, through the extra voting power of his Class B shares, "you have effectively negated a system that depends on checks and balances."

Smulyan owns about the same amount of shares as those two firms combined. But because of the Class B shares, his voting power is 67 percent. He can wield that power on any vote, except on his own bid to take the company private.

That means outside shareholders have the firepower to shoot down Smulyan's offer, but not to approve any alternative that might emerge, even a more lucrative one.

The 59-year-old executive is doing everything he can to discourage potential suitors from even contemplating an offer. In the May 8 press release announcing Smulyan's offer, the company said Smulyan had informed the board he "will not agree to any other transaction involving **Emmis** or his shares of **Emmis**."

So where does that leave Smulyan's current bid, which analysts nearly universally say isn't good enough?

"The end result of this set of circumstances is that some increase in the bid will likely be necessary" to win shareholder approval, Barrington Research analyst James Goss said in a report.

"However, there would also appear to be an effective upper limit on the amount to which the bid would need to be raised, since an alternative bid would not likely be supported by Mr. Smulyan."

Sweet timing for Smulyan

A year ago, Smulyan would have had little hope of taking the company private on his own. He probably would have needed a big financial backer that, no doubt, would have wanted a say in operations in return for its investment.

That's because the company back then had a lot more shares outstanding and a lot more debt. It cleaned up its balance sheet by divesting its TV stations for nearly \$1 billion. And, thinking that the company's shares were undervalued, the board bought back 20.2 million shares for \$395 million, or \$19.50 apiece.

That buyback helped Smulyan in another big way. If all those shares were outstanding today, Smulyan wouldn't have such a big hand in **Emmis'** fate. His shares, even with their extra clout, wouldn't represent enough votes to spurn unwanted suitors.

Reprinted with permission of Indianapolis Business Journal (www.ibj.com), IBJ Corp., copyright 2006.