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To: PN Employees

From: Brian Tierney

Yesterday I met with the Council of Unions, Guild leadership and, later in the day, approximately 140 independent managers, to update them on the serious business issues we are facing. Today, I'd like to share directly with you what I shared with them.

We are in a very difficult position. As you may have read, newspapers across the country are experiencing a dramatic drop-off in advertising revenue. This drop-off has been greatest in larger markets, including Philadelphia. Let me explain how this impacts us and what we must do to solve the problem.

Our July and August advertising revenue numbers were down from last year and September's revenue fell even further, down 10.2% from last year. We expect October and November to be significantly worse than September. Since October/November are traditionally our two strongest revenue months, our actual dollar misses in those two months will likely be the largest two month revenue drop in our history.

Unfortunately, this is a problem for newspapers across the country. For example, the investment company Lehman Brothers recently cut its newspaper industry revenue forecast for 2006 to a decline of 1.7%, and adjusted its 2007 forecast to a 3.5% revenue loss. According to yesterday's Wall Street Journal, the Boston Globe is on track to lose money this year. The New York Times Company yesterday reported a 3rd quarter advertising revenue decline of 12.4% for its New England Group (including the Globe) and a 4.1% decline for The New York Times Group compared to a year ago. Newspaper publishers and owners across the country are saying that this has been the worst 90 day stretch that they have ever seen in the business. They also universally believe that this reduced revenue picture will be a permanent part of the future of newspapers.

This downturn's impact on our ability to grow the business is dramatic. To put it in perspective, in 2004 PNI produced over $100 million in cash flow for Knight Ridder. In 2005 that number fell to about $76 million. This year, we are projected to have approximately $50 million in cash flow. However, when we deduct the annualized payment of principal and interest on our bank loans, we will have approximately $10 million to market and invest in the business, including for capital at SPP.

Simply put, this dramatic revenue decline will prevent us from meeting our bank obligations if we don't take absolutely critical actions on the cost side of our business. Those loans require us to pay the banks' interest quarterly, and to improve our performance annually to a level that assures the banks that we will be able to pay back the principal on our loans. Based on our current 2006 projections, we will meet our interest obligations for 2006, but will fall short of the performance expectation. Without immediate and dramatic changes to the business, in 2007 we will not only miss our performance requirement, but we will also not have enough cash to make our interest payments.

Many of you may be asking – did you and the PMH investors see this coming? The answer is yes and no. While our forecasts did expect reduced revenue due to the loss of big Philadelphia retailers like Strawbridges and continued reductions in our classified business, we didn't foresee the speed and extent of the decline, and didn't anticipate the huge falloff in the National advertising category. Again, even the largest publicly traded newspaper companies didn't see the speed or depth of this decline. Like us, they too are rapidly planning their responses to this dramatic revenue erosion.

If we are going to survive and grow, we need to significantly restructure our labor contracts and our workforce. We have been working with our labor unions to reach a deal by October 31. We have reached agreements and made significant headway with some unions, but are very far apart with some others. We need to reach agreements that allow us to achieve the savings to meet our loan obligations, and to reinvest in and to grow our business. However, even with those savings, some layoffs are unavoidable. We must reduce our workforce so that it is in line with our reduced revenue. To the extent we don't get the savings, those layoffs will be larger.

This is not the message I thought I would be sending you when we bought these two great newspapers almost four months ago. It isn't the message I want to send. But it is our reality, and I have an obligation to all of you to make sure you know what we are facing, and what we must do to move things in the right direction. If we can get these changes behind us, I truly believe that we will be positioned to grow this business and our newspapers. These changes will give us the time to do just that.

I want to end on a hopeful note. We have been working tirelessly over the past months to build our local retail advertising base. That is the area of advertising we think holds the greatest promise for long term growth. While our overall advertising revenue is down, we recently closed significant retail advertising deals, including deals with Comcast, Macy's and Boscov's. These agreements confirm my belief that with increased marketing and sales pressure we can grow this business. I remain optimistic about our business if we do what common sense tells us we need to do.

I will continue to update you on the steps we are taking to move this organization in a positive direction and to build a viable news organization for the long term.