

MCCLATCHY CO  
Form 10-Q  
August 10, 2007

---

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

---

**FORM 10-Q**

---

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended:** July 1, 2007

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 1-9824

\_\_\_\_\_  
(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**52-2080478**

(I.R.S. Employer Identification No.)

**2100 "Q" Street, Sacramento, CA**  
(Address of principal executive offices)  
**916-321-1846**

**95816**  
(Zip Code)

Registrant's telephone number, including area code  
\_\_\_\_\_

Indicate by check mark whether the registrant has (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days (check one):  Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (check one): Large accelerated filer  Accelerated filer  Non-accelerated filer

Edgar Filing: MCCLATCHY CO - Form 10-Q

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12-b of the Exchange Act). [   
 ] Yes [X] No

As of August 8, 2007, the registrant had shares of common stock as listed below outstanding:

Class A Common Stock	56,985,873
Class B Common Stock	25,112,430

---

---

Table of Contents

**THE McCLATCHY COMPANY**

**INDEX TO FORM 10-Q**

<b>Part I - FINANCIAL INFORMATION</b>	Page
Item 1 - Financial Statements (unaudited):	
Consolidated Balance Sheet– July 1, 2007 and December 31, 2006	1
Consolidated Statement of Income for the three and six months ended July 1, 2007 and June 25, 2006	3
Consolidated Statement of Cash Flows for the six months ended July 1, 2007 and June 25, 2006	4
Consolidated Statement of Stockholders' Equity for the period December 31, 2006 to July 1, 2007	5
Notes to Consolidated Financial Statements	6
Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations	19
Item 3 - Quantitative and Qualitative Disclosures About Market Risk	31
Item 4 - Controls and Procedures	31
<b>Part II - OTHER INFORMATION</b>	
Item 1A - Risk Factors	32
Item 4 - Submission Of Matters To A Vote Of Security Holders	33
Item 6 - Exhibits	33
Signatures	34
Index of Exhibits	35

---

**PART I - FINANCIAL INFORMATION****Item 1 - FINANCIAL STATEMENTS**

**THE MCCLATCHY COMPANY**  
**CONSOLIDATED BALANCE SHEET (UNAUDITED)**  
(In thousands)

	July 1, 2007	December 31, 2006
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 25,271	\$ 19,581
Trade receivables (less allowance of \$11,682 in 2007 and \$12,732 in 2006)	271,332	311,785
Other receivables	24,083	36,477
Newsprint, ink and other inventories	40,813	52,097
Deferred income taxes	47,055	248,753
Prepaid income taxes	92,640	88,836
Land and other assets held for sale	25,669	231,029
Other current assets	20,128	23,192
Newspaper assets held for sale	-	563,589
	546,991	1,575,339
<b>PROPERTY, PLANT AND EQUIPMENT:</b>		
Land	205,042	204,692
Building and improvements	391,883	382,206
Equipment	833,947	811,173
Construction in progress	21,895	36,401
	1,452,767	1,434,472
Less accumulated depreciation	(497,530)	(458,496)
	955,237	975,976
<b>INTANGIBLE ASSETS:</b>		
Identifiable intangibles -net	1,339,135	1,369,046
Goodwill-net	3,586,969	3,559,828
	4,926,104	4,928,874
<b>INVESTMENTS AND OTHER ASSETS:</b>		
Investments in unconsolidated companies	499,458	520,213
Income tax refund	200,998	-
Land held for sale	186,365	-
Prepaid pension assets	29,332	32,457
Other	20,296	21,851
	936,449	574,521
<b>TOTAL ASSETS</b>	<b>\$ 7,364,781</b>	<b>\$ 8,054,710</b>

*See notes to consolidated financial statements.*

**THE MCCLATCHY COMPANY**  
**CONSOLIDATED BALANCE SHEET (UNAUDITED)**  
(In thousands, except share amounts)

	July 1, 2007	December 31, 2006
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Current portion of bank debt	\$ -	\$ 530,000
Accounts payable	101,766	139,501
Accrued compensation	108,060	135,363
Income taxes	-	47,330
Unearned revenue	87,282	82,524
Accrued interest	33,677	33,697
Accrued dividends	14,769	14,727
Other accrued liabilities	39,944	45,166
Newspaper liabilities held for sale	-	83,806
	385,498	1,112,114
<b>NON-CURRENT LIABILITIES:</b>		
Long-term debt	2,677,338	2,746,669
Deferred income taxes	708,314	706,893
Pension and postretirement obligations	313,363	311,127
Other long-term obligations	106,450	74,283
	3,805,465	3,838,972
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>STOCKHOLDERS' EQUITY:</b>		
Common stock \$.01 par value:		
Class A - authorized 200,000,000 shares, issued 56,907,576 in 2007 and 55,795,162 in 2006	569	557
Class B - authorized 60,000,000 shares, issued 25,191,397 in 2007 and 26,116,397 in 2006	252	261
Additional paid-in capital	2,193,132	2,182,544
Retained earnings	1,028,546	1,016,023
Treasury stock, 3,029 shares at cost	(122)	-
Accumulated other comprehensive loss	(48,559)	(95,761)
	3,173,818	3,103,624
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 7,364,781</b>	<b>\$ 8,054,710</b>

*See notes to consolidated financial statements.*

**THE McCLATCHY COMPANY**  
**CONSOLIDATED STATEMENT OF INCOME (UNAUDITED)**  
(In thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	July 1, 2007	June 25, 2006	July 1, 2007	June 25, 2006
<b>REVENUES - NET:</b>				
Advertising	\$ 488,277	\$ 183,683	\$ 965,300	\$ 350,017
Circulation	69,707	23,504	141,587	47,268
Other	22,043	4,813	39,698	9,178
	580,027	212,000	1,146,585	406,463
<b>OPERATING EXPENSES:</b>				
Compensation	228,959	84,103	465,283	169,842
Newsprint and supplements	72,186	27,267	147,603	53,531
Depreciation and amortization	38,357	9,973	76,190	19,860
Other operating expenses	123,144	38,396	252,740	75,690
	462,646	159,739	941,816	318,923
<b>OPERATING INCOME</b>	<b>117,381</b>	<b>52,261</b>	<b>204,769</b>	<b>87,540</b>
<b>NON-OPERATING (EXPENSES) INCOME:</b>				
Interest expense	(49,556)	-	(103,341)	-
Interest income	42	15	106	28
Equity income (losses) in unconsolidated companies, net	(11,198)	496	(20,947)	892
Other - net	791	(38)	743	(45)
	(59,921)	473	(123,439)	875
<b>INCOME FROM CONTINUING OPERATIONS</b>				
<b>BEFORE INCOME TAX PROVISION</b>	<b>57,460</b>	<b>52,734</b>	<b>81,330</b>	<b>88,415</b>
<b>INCOME TAX PROVISION</b>	<b>22,929</b>	<b>20,545</b>	<b>32,286</b>	<b>34,445</b>
<b>INCOME FROM CONTINUING OPERATIONS</b>	<b>34,531</b>	<b>32,189</b>	<b>49,044</b>	<b>53,970</b>
<b>INCOME (LOSS) FROM DISCONTINUED OPERATIONS - NET OF INCOME TAXES</b>				
	705	11,947	(4,778)	17,893
<b>NET INCOME</b>	<b>\$ 35,236</b>	<b>\$ 44,136</b>	<b>\$ 44,266</b>	<b>\$ 71,863</b>
<b>NET INCOME PER COMMON SHARE:</b>				
<b>Basic:</b>				
Income from continuing operations	\$ 0.42	\$ 0.69	\$ 0.60	\$ 1.15
Income (loss) from discontinued operation	0.01	0.25	(0.06)	0.39
Net income per share	\$ 0.43	\$ 0.94	\$ 0.54	\$ 1.54
<b>Diluted:</b>				
Income from continuing operations	\$ 0.42	\$ 0.69	\$ 0.60	\$ 1.15
Income (loss) from discontinued operation	0.01	0.25	(0.06)	0.38
Net income per share	\$ 0.43	\$ 0.94	\$ 0.54	\$ 1.53
<b>WEIGHTED AVERAGE NUMBER OF COMMON SHARES:</b>				

Edgar Filing: MCCLATCHY CO - Form 10-Q

Basic	81,976	46,771	81,931	46,753
Diluted	82,037	46,985	82,010	47,028

*See notes to consolidated financial statements.*

3

---

**THE McCLATCHY COMPANY**  
**CONSOLIDATED STATEMENT OF CASH FLOWS (UNAUDITED)**  
(In thousands)

	Six Months Ended	
	July 1, 2007	June 25, 2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Income from continuing operations	\$ 49,044	\$ 53,970
Reconciliation to net cash provided by continuing operations:		
Depreciation and amortization	76,190	19,860
Contribution to pension plans	-	(31,545)
Employee benefit expense	16,956	8,710
Stock compensation expense	4,292	3,621
Deferred income taxes	-	(2,718)
Equity loss (income) in unconsolidated companies	20,947	(892)
Other	2,735	115
Changes in certain assets and liabilities:		
Trade receivables	40,453	2,254
Inventories	11,279	(158)
Other assets	7,537	(8,930)
Accounts payable	(31,340)	(11,711)
Accrued compensation	(26,573)	(1,714)
Income taxes	(44,580)	24,817
Other liabilities	(8,810)	1,701
Net cash provided by operating activities of continuing operations	118,130	57,380
Net cash provided by operating activities of discontinued operations	3,340	28,530
Net cash provided by operating activities	121,470	85,910
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property, plant and equipment	(28,340)	(18,955)
Proceeds from sale of equipment	19,356	-
Equity investments and other - net	(806)	206
Net cash used by investing activities of continuing operations	(9,790)	(18,749)
Proceeds from sale of newspaper	522,922	-
Other	(4,837)	(5,103)
Net cash provided (used) by investing activities of discontinued operations	518,085	(5,103)
Net cash provided (used) by investing activities	508,295	(23,852)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repayments of term bank debt	(350,000)	-
Net borrowings (repayments) from revolving bank debt	(250,508)	109,000
Net repayments from commercial paper	-	(154,200)
Payment of cash dividends	(29,495)	(16,842)
Other - principally stock issuances	5,928	2,831
Net cash used by financing activities	(624,075)	(59,211)
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>5,690</b>	<b>2,847</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b>19,581</b>	<b>3,052</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ 25,271</b>	<b>\$ 5,899</b>



OTHER CASH FLOW INFORMATION:

Cash paid during the period for:

Income taxes (net of refunds)	\$ 82,033	\$ 18,120
Interest (net of capitalized interest)	\$ 98,319	\$ 2,719

*See notes to consolidated financial statements*

4

---

**THE McCLATCHY COMPANY**  
**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (UNAUDITED)**  
(In thousands, except share amounts)

	Par Value		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Treasury		Total
	Class A	Class B			Loss	Stock	
<b>BALANCES, DECEMBER 31, 2006</b>	\$ 557	\$ 261	\$ 2,182,544	\$ 1,016,023	\$ (95,761)	\$ -	\$ 3,103,624
Adoption of FIN 48				(2,218)			(2,218)
<b>ADJUSTED BALANCES, JANUARY 1, 2007</b>	557	261	2,182,544	1,013,805	(95,761)	-	3,101,406
Net income				44,266			44,266
Pension amortization from other comprehensive income					2,132		2,132
Total comprehensive income							46,398
Adjustment to eliminate minimum pension liability related to Star Tribune					45,070		45,070
Dividends declared (\$.36 share)				(29,525)			(29,525)
Conversion of 925,000 Class B shares to Class A shares	9	(9)					-
Issuance of 228,109 Class A shares under stock plans	3		5,747				5,750
Stock compensation expense			4,541				4,541
Tax benefit from stock plans			300				300
Purchase of treasury stock						(122)	(122)
<b>BALANCES, JULY 1, 2007</b>	\$ 569	\$ 252	\$ 2,193,132	\$ 1,028,546	\$ (48,559)	\$ (122)	\$ 3,173,818

**THE McCLATCHY COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**NOTE 1. SIGNIFICANT ACCOUNTING POLICIES**

The McClatchy Company (the "Company") is the third largest newspaper company in the United States, with 31 daily newspapers and approximately 50 non-dailies. Twenty of its daily newspapers were acquired on June 27, 2006 in the Knight Ridder acquisition (the "Acquisition") – see Note 2. McClatchy also operates leading local websites and direct marketing operations in each of its markets which complement its newspapers and extend its audience reach in each market. McClatchy-owned newspapers include *The Miami Herald*, *The Sacramento Bee*, the (Fort Worth) *Star-Telegram*, *The Kansas City Star*, *The Charlotte Observer*, and *The (Raleigh) News & Observer*.

McClatchy also has a portfolio of premium digital assets. Its leading local websites offer users information, comprehensive news, advertising, e-commerce and other services. The Company owns and operates McClatchy Interactive, an interactive operation that provides websites with content, publishing tools and software development. McClatchy operates Real Cities, the largest national advertising network of local news websites and owns 14.4% of CareerBuilder, the nation's largest online job site. McClatchy also owns 25.6% of Classified Ventures, a newspaper industry partnership that offers classified websites such as the nation's number two online auto website, cars.com, and the number one rental site, apartments.com.

The consolidated financial statements include the Company and its subsidiaries. Significant intercompany items and transactions are eliminated. In preparing the financial statements, management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments necessary (consisting of normal recurring items, except as discussed in Note 2 and an adjustment to record the settlement of litigation by a company in which the Company is an investor as discussed in Note 3) to present fairly the Company's financial position, results of operations, and cash flows for the interim periods presented. The financial statements contained in this report are not necessarily indicative of the results to be expected for the full year.

**Discontinued operations** - On March 5, 2007, the Company sold the (Minneapolis) *Star Tribune* newspaper and other publications and websites related to the newspaper to an entity affiliated with Avista Capital Partners for \$530.0 million. In addition, the Company expects a cash income tax refund equal to approximately \$201 million related to the sale in 2008. The results of *Star Tribune's* operations, including interest expense directly attributable to the *Star Tribune*, have been recorded as discontinued operations in all periods presented.

**Revenue recognition** - The Company recognizes revenues from advertising placed in a newspaper and/or on a website over the advertising contract period or as services are delivered, as appropriate, and recognizes circulation revenues as newspapers are delivered over the applicable subscription term. Circulation revenues are recorded net of direct delivery costs. Other revenue is recognized when the related product or service has been delivered. Revenues are recorded net of estimated incentive offerings including special pricing agreements, promotions and other volume-based incentives. Revisions to these estimates are charged to income in the period in which the facts that give rise to the revision become known.

**Cash equivalents** are highly liquid debt investments with original maturities of three months or less.

**Concentrations of credit risk** - Financial instruments, which potentially subject the Company to concentrations of credit risk, are principally cash and cash equivalents and trade accounts receivables. Cash and cash equivalents are placed with major financial institutions. The Company routinely assesses the financial strength of significant customers and this assessment, combined with the large number and geographic diversity of its customers, limits the Company's concentration of risk with respect to trade accounts receivable.

**Inventories** are stated at the lower of cost (based principally on the first-in, first-out method) or current market value.

**Property, plant and equipment** is stated at cost. Major improvements, as well as interest incurred during construction, are capitalized. Expenditures for maintenance and repairs are charged to expense as incurred.

**Depreciation** is computed generally on a straight-line basis over estimated useful lives of:

5 to 60 years for buildings and improvements

9 to 25 years for presses

2 to 15 years for other equipment

**Goodwill and Intangible Impairment** - The Company accounts for goodwill in accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*. As required by SFAS No. 142, the Company tests for goodwill annually or whenever events occur or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The required two-step approach uses accounting judgments and estimates of future operating results. Changes in estimates or the application of alternative assumptions and definitions could produce significantly different results. The factors that most significantly affect the fair value calculation are private and public market trading multiples and estimates of future cash flows. The Company periodically analyzes its intangible assets with indefinite lives for impairment.

**Stock-based compensation** - All share-based payments to employees, including grants of employee stock options, stock appreciation rights, restricted stock and purchases under the employee stock purchase plan ("ESPP"), are recognized in the financial statements based on their fair values. At July 1, 2007, the Company had six stock-based compensation plans. Total stock-based compensation expense from continuing operations was \$2.2 million and \$4.3 million for the three months and six months ended July 1, 2007, respectively and was \$1.6 million and \$3.6 million for the three months and six months ended June 25, 2006, respectively.

The Company has issued a total of 65,000 shares of restricted Class A Common Stock to its Chief Executive Officer: (1) 40,000 shares on January 25, 2005, valued at the Company's closing stock price on that date of \$70.55, which vest on January 25, 2009, subject to certain performance criteria and (2) 25,000 shares on January 24, 2006, valued at the Company's closing stock price on that date of \$58.05, which vest over four annual installments, subject to certain performance criteria, beginning on January 24, 2007. On January 24, 2007, 6,250 shares vested. At this time, the Company expects such performance criteria to be met and is expensing the related stock-based compensation over the respective four-year periods based on the grant date fair values.

**Deferred income taxes** result from temporary differences between amounts of assets and liabilities reported for financial and income tax reporting purposes. Determination of deferred income taxes related to the Acquisition is subject to further adjustments based upon completion of deferred income tax assets and liabilities (see Note 2).

**Comprehensive income (loss)** - The Company records changes in its net assets from non-owner sources in its statement of stockholders' equity. These changes arise primarily from minimum pension liability adjustments.

The following table summarizes the composition of total comprehensive income (in thousands):

	For the three months ended		For the six months ended	
	July 1, 2007	June 25, 2006	July 1, 2007	June 25, 2006
Net income	\$ 35,236	\$ 44,136	\$ 44,266	\$ 71,863
Pension amortization from other comprehensive income, net of tax	2,132	-	2,132	-
<b>Total comprehensive income</b>	<b>\$ 37,368</b>	<b>\$ 44,136</b>	<b>\$ 46,398</b>	<b>\$ 71,863</b>

**Treasury stock** - The Company accounts for treasury stock under the cost method.

**Segment reporting** - The Company's primary business is the publication of newspapers. The Company aggregates its newspapers into a single reportable segment because each has similar economic characteristics, products, customers and distribution methods.

**Earnings per share ("EPS")** - Basic EPS excludes dilution from common stock equivalents and reflects income divided by the weighted average number of common shares outstanding for the period. Diluted EPS is based upon the weighted average number of outstanding shares of common stock and dilutive common stock equivalents in the period. Common stock equivalents arise from dilutive stock options and are computed using the treasury stock method. The anti-dilutive stock options that could potentially dilute basic EPS in the future, but were not included in the weighted average share calculation for the three months and six months ended July 1, 2007 were 3,830,396 and 3,778,007, respectively and were 2,511,418 and 2,112,561 for the three months and six months ended June 25, 2006, respectively.

**Reclassifications**- Certain prior period amounts have been reclassified to conform to the 2007 presentation and relate primarily to accounting for the (Minneapolis) *Star Tribune* as a discontinued operation.

**Income Taxes** - On July 13, 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109* ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes* and prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Under FIN 48, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant

taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Additionally, FIN 48 provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006.

The Company adopted the provisions of FIN 48 on January 1, 2007. The total amount of unrecognized tax benefits as of the date of adoption was \$66.7 million. Of the \$66.7 million of unrecognized tax benefits at January 1, 2007, \$8.5 million are tax benefits that, if recognized, would favorably affect the effective income tax rate in future periods. The other \$58.2 million of unrecognized tax benefits would, if recognized, result in a decrease to goodwill previously recorded related to acquisitions. There were no material changes to these amounts through July 1, 2007.

With few exceptions, the Company is no longer subject to examination by U.S. federal, state, or foreign tax authorities for years before 2002.

## **NOTE 2. ACQUISITION AND DIVESTITURES**

### *Acquisition Transaction:*

On June 27, 2006 (the second day of the Company's third fiscal quarter), the Company completed the purchase of Knight-Ridder, Inc. ("Knight Ridder") pursuant to a definitive merger agreement entered into on March 12, 2006, under which the Company paid Knight Ridder shareholders a per share price consisting of \$40.00 in cash and .5118 of a Class A McClatchy common share (the "Acquisition"). The Company issued approximately 35 million Class A common shares in connection with the Acquisition. The total purchase price was approximately \$4.6 billion. In addition, the Company assumed \$1.9 billion in Knight Ridder long-term debt at closing.

Prior to the Acquisition, Knight Ridder published 32 daily newspapers in 29 U.S. markets, operated websites in all of its markets and owned a variety of internet and other investments which consisted of: 33.3% of each of CareerBuilder LLC ("CareerBuilder") and ShopLocal LLC ("ShopLocal"), 25.0% of Topix.net ("Topix"), 21.5% of Classified Ventures LLC ("Classified Ventures"), 33.3% interest in SP Newsprint Company ("SP"), 13.5% interest in the Ponderay Newsprint Company ("Ponderay") and 49.5% of The Seattle Times Company which owns *The Seattle Times* newspaper and weekly newspapers in the Puget Sound area, and daily newspapers located in Walla Walla and Yakima, Washington and in Portland, Maine and various other smaller investments. Knight Ridder was the founder and operator of Real Cities, the largest national advertising network of local news websites.

To consummate the Acquisition, the Company borrowed \$3.076 billion under a new bank debt facility (see Note 5) and used the proceeds from the sales of four Knight Ridder newspapers in order to pay Knight Ridder shareholders (\$2.7 billion) and refinance its and Knight Ridder's bank debt (\$498.0 million). The after-tax proceeds from the sales of the eight Knight Ridder newspapers sold after the Acquisition closed were used to reduce debt.

### *Acquisition Accounting:*

Pursuant to Emerging Issues Task Force No. 99-12, *Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination*, the McClatchy common stock issued on June 27, 2006 was valued based upon the average closing price of McClatchy common stock from March 8, 2006 through March 14, 2006 (two business days before and after the terms of the Acquisition were agreed to and announced), or \$52.06 per share. As a result, the fair value of the 35.0 million shares of McClatchy common stock issued in the Acquisition was recorded at \$1.821 billion, which was included in the total Acquisition purchase price of approximately \$4.6 billion. The fair value of such shares declined to approximately \$1.398 billion as of the Acquisition closing date (June 27, 2006), however the decline of \$423.0 million in valuation had no effect on the total Acquisition purchase price recorded. The difference is included in goodwill in the allocation of the purchase price

below.

9

---

The Acquisition was accounted for as a purchase. Pursuant to SFAS 141, *Business Combinations*, the purchase price was allocated to the assets acquired and liabilities assumed based upon their estimated fair values as of June 27, 2006, the date of the Acquisition. The purchase price allocation, while substantially complete, is subject to further adjustments based upon completion of analyses of deferred income tax assets and liabilities. See Note 4 for adjustments made in the first six months of fiscal 2007.

The following table summarizes, on an unaudited pro forma basis, the combined results of continuing operations of the Company for the three and six months ended June 25, 2006 as though the Acquisition had taken place on the first day of the fiscal quarter (in thousands):

	Three Months Ended June 25, 2006	Six Months Ended June 25, 2006
Revenues	\$ 632,433	\$ 1,228,728
Income from continuing operations	\$ 37,047(1)	\$ 55,927(1)
Income from continuing operations per diluted share	\$ 0.45	\$ 0.68

(1) Excludes \$18.1 million of income tax benefits related to the Company's recalculation of its deferred tax liabilities and assets.

#### *Disposition Transactions:*

In conjunction with the Acquisition, the Company divested 12 Knight Ridder newspapers for strategic and antitrust reasons. The divested newspapers were the *Philadelphia Inquirer*; *Philadelphia Daily News*; *San Jose Mercury News*; *St. Paul Pioneer Press*; *Akron Beacon Journal* (OH); *Wilkes Barre Times Leader* (PA); *Aberdeen American News* (SD); *Grand Forks Herald* (ND); *Ft. Wayne News-Sentinel* (IN); *Contra Costa Times* (CA); *Monterey Herald* (CA); and *Duluth News Tribune* (MN). The Company received cash proceeds of approximately \$2.0 billion (net of transaction costs) from these divestitures. In addition, the buyers assumed approximately \$77 million of Knight Ridder retirement obligations related to certain newspapers. Four of the 12 newspapers were sold concurrently with the closing of the Acquisition. The remaining eight newspapers were owned for periods ranging from two days to 36 days following the closing of the Acquisition. The operating results of these eight divested newspapers for the periods they were owned by the Company, including interest expense and debt issuance costs related to bank debt incurred until their respective sales, are included in discontinued operations in the Company's consolidated statement of income for the period from June 27, 2006 to December 31, 2006. No accounting gain or loss was recognized on the sale of the 12 newspapers.



In July 2006, the Company sold 18.3% of its interest in each of CareerBuilder and ShopLocal, and 13.8% of its interest in Topix for an aggregate of \$309.7 million in cash and used the after-tax proceeds to reduce debt. No accounting gain or loss was recognized on the sale of these investments. The Company retained a 15.0% interest in each of CareerBuilder and ShopLocal, and an 11.3% interest in Topix. Effective May 11, 2007, the Company's interest in CareerBuilder declined to 14.4%.

On March 5, 2007, the Company sold the (Minneapolis) *Star Tribune* newspaper and other publications and websites related to the newspaper to an entity affiliated with Avista Capital Partners for \$530.0 million. The Company expects to receive an income tax refund of approximately \$201 million related to the sale in 2008. This amount has been recorded as a long-term receivable on the consolidated balance sheet.

The results of *Star Tribune's* operations, including interest on debt incurred to purchase it, have been recorded as discontinued operations in all periods presented. The Company used the proceeds from the sale of the *Star Tribune* to reduce debt.

Revenues and loss from discontinued operations, net of income taxes, for the three months and six months ended July 1, 2007 and June 25, 2006 were as follows (in thousands):

	Three Months Ended		Six Months Ended	
	July 1, 2007	June 25, 2006	July 1, 2007	June 25, 2006
Revenues	\$ 91	\$ 92,234	\$ 52,994	\$ 179,775
Income (loss) from discontinued operations before income taxes (1)	\$ 146	\$ 20,373	\$ (4,637)	\$ 30,630
Income tax expense (benefit)	(559)	8,426	141	12,737
Income (loss) from discontinued operations	\$ 705	\$ 11,947	\$ (4,778)	\$ 17,893

(1) Includes interest expense allocated to discontinued operations of \$0 and \$1.2 million for the three months and six months ended July 1, 2007, respectively and \$1.6 million and \$3.7 million for the three months and six months ended June 25, 2006, respectively.

### NOTE 3. INVESTMENTS IN UNCONSOLIDATED COMPANIES

The following is the Company's ownership interest and carrying value of investments in unconsolidated companies and joint ventures (dollars in thousands):

Company	% Ownership Interest	July 1, 2007	December 31, 2006
CareerBuilder	14.4	\$ 225,992	\$ 230,506
Seattle Times Company	49.5	89,910	102,228
Classified Ventures	25.6	98,476	98,259
SP Newsprint	33.3	38,543	40,666
Ponderay Newsprint	27.0	24,068	26,162
ShopLocal	15.0	11,147	10,993
Topix	11.3	9,442	9,956
McClatchy Tribune Information Services	50.0	1,102	773
Other	Various	778	670

\$ 499,458 \$ 520,213

The Company primarily uses the equity method of accounting for these investments.

During the second fiscal quarter of 2007, The Seattle Times Company (“STC”) entered into an agreement to settle certain outstanding legal issues and amend their Joint Operating Agreement relating to STC and The Hearst Corporation (“Hearst”) Seattle newspaper. As a result, STC is expected to pay approximately \$24 million to Hearst in the third fiscal quarter of 2007. The Company has expensed \$7.8 million as its share of this payment as part of its equity loss in the second fiscal quarter of 2007.

#### NOTE 4. INTANGIBLE ASSETS AND GOODWILL

Intangible assets and goodwill, along with their weighted-average amortization periods consisted of the following (in thousands):

July 1, 2007				
	Gross Amount	Accumulated Amortization	Net Amount	Weighted Average Amortization Period
Intangible assets subject to amortization:				
Advertiser and subscriber lists	\$ 817,701	\$ (177,203)	\$ 640,498	14 years
Other	26,261	(10,624)	15,637	8 years
Total	\$ 843,962	\$ (187,827)	656,135	
Other intangible assets not subject to amortization:				
Newspaper mastheads			683,000	
Total			1,339,135	
Goodwill - net			3,586,969	
Total intangible assets and goodwill			\$ 4,926,104	
December 31, 2006				
	Gross Amount	Accumulated Amortization	Net Amount	Weighted Average Amortization Period
Intangible assets subject to amortization:				
Advertiser and subscriber lists	\$ 817,701	\$ (148,427)	\$ 669,274	14 years
Other	26,161	(9,389)	16,772	8 years
Total	\$ 843,862	\$ (157,816)	686,046	
Other intangible assets not subject to amortization:				
Newspaper mastheads			683,000	
Total			1,369,046	
Goodwill - net			3,559,828	
Total intangible assets and goodwill			\$ 4,928,874	



The following is a summary of the changes in the identifiable intangible assets and goodwill from December 31, 2006 to July 1, 2007 (in thousands):

	December 31, 2006	Additions	Disposals/ Adjustments	Amortization Expense	July 1, 2007
Intangible assets subject to amortization	\$ 843,862	\$ 25	\$ 75	\$ -	\$ 843,962
Accumulated amortization	(157,816)		(9)	(30,002)	(187,827)
	686,046	25	66	(30,002)	656,135
Mastheads and other	683,000				683,000
Goodwill - net	3,559,828	27,141			3,586,969
Total	\$ 4,928,874	\$ 27,166	\$ 66	\$ (30,002)	\$ 4,926,104

(1) Relates primarily to revised estimates of acquired income tax reserves.

Amortization expense for continuing operations was \$15.0 million and \$1.2 million in the second fiscal quarters of 2007 and 2006, respectively and was \$30.0 million and \$2.4 million for the first six months of fiscal 2007 and 2006, respectively.

The estimated amortization expense for the remainder of fiscal 2007 and the five succeeding fiscal years is as follows (in thousands):

Year	Amortization Expense
2007	\$ 29,948
2008	59,941
2009	59,910
2010	59,232
2011	57,837
2012	57,368

**NOTE 5. LONG-TERM DEBT**

As of July 1, 2007 and December 31, 2006, long-term debt consisted of the following (in thousands):

	July 1, 2007	December 31, 2006
Term A bank debt, weighted average interest of 6.11% at July 1, 2007 and 6.12% at December 31, 2006	\$ 750,000	\$ 1,100,000
Revolving bank debt, interest of 6.10% at July 1, 2007 and 6.10% at December 31, 2006	415,287	665,795
Publicly-traded notes:		
\$100 million 6.625% debentures due in 2007	100,011	100,025
\$200 million 9.875% debentures due in 2009	210,139	212,950
\$300 million 7.125% debentures due in 2011	304,005	304,512
\$200 million 4.625% debentures due in 2014	174,443	172,705
\$400 million 5.750% debentures due in 2017	361,724	359,848
\$100 million 7.150% debentures due in 2027	90,940	90,717
\$300 million 6.875% debentures due in 2029	270,789	270,117
Total debt	2,677,338	3,276,669
Less current portion	-	530,000
Long term debt	\$ 2,677,338	\$ 2,746,669

The publicly-traded notes are stated net of unamortized discounts and premiums resulting from recording such assumed liabilities at fair value as of the June 27, 2006 Acquisition date. The notes due in 2007 are expected to be refinanced on a long-term basis by drawing on the Company's revolving credit facility and accordingly, are included in long-term debt.

Through June 27, 2006, the Company used its senior unsecured revolving credit facility, which provided borrowings of up to \$500 million. This credit facility was refinanced with a new \$3.2 billion senior unsecured credit facility ("Credit Agreement") entered into in connection with the Acquisition. At the closing of the Acquisition, the Company's new Credit Agreement consisted of a \$1 billion five-year revolving credit facility and \$2.2 billion five-year Term A loan. Both the Term A loan and the revolving credit facility are due on June 27, 2011.

The Company has repaid \$600.5 million of bank debt in the first six months of fiscal 2007 from the sale of the *Star Tribune* newspaper, sales of other assets and cash generated from operations. A total of \$529.1 million of funds were available under the revolving credit facility at July 1, 2007.

Debt under the Credit Agreement bears interest at the London Interbank Offered Rate ("LIBOR") plus a spread ranging from 37.5 basis points to 125.0 basis points. Applicable rates are based upon the Company's ratings on its long-term debt from Moody's Investor Services ("Moody's") and Standard & Poor's. A commitment fee for the unused revolving credit ranges from 10.0 basis points to 20.0 basis points depending on the Company's ratings. Standard & Poor's has rated the facility "BB+" and Moody's has rated the facility "Baa3". According to the Credit Agreement, the Company will pay interest at LIBOR plus 75.0 basis points on outstanding debt and its commitment fees are currently at 15.0 basis points.

The Credit Agreement contains financial covenants including a minimum interest coverage ratio (as defined in the Credit Agreement) of 3.00 to 1.00 through July 1, 2007; 2.75 to 1.00 from September 30, 2007 through September 28, 2008 and 3.00 to 1.00 from December 28, 2008 and thereafter; and a maximum leverage ratio (as defined in the Credit Agreement) of 4.75 to 1.00 through July 1, 2007; 5.00 to 1.00 from September 30, 2007 through March 30, 2008; 4.75 to 1.00 from June 29, 2008 through September 28, 2008; 4.25 to 1.00 from December 28, 2008 to September 27, 2009; and declining to 4.00 to 1.00 on December 27, 2009 and thereafter. At July 1, 2007, the Company was in compliance with all debt covenants.

In addition, the Company's Material Subsidiaries (as defined in the Credit Agreement) have guaranteed the Company's obligations under the Credit Agreement. These guarantees were effected on May 4, 2007, and continue in effect upon the earlier of the termination of the Credit Agreement or the date which is one year after the date both ratings agencies have rated the Company's bank debt as investment grade.

At July 1, 2007, the Company had outstanding letters of credit totaling \$55.6 million securing estimated obligations stemming from workers' compensation claims and other contingent claims.

The following table presents the approximate annual maturities of debt, based upon the Company's required payments (adjusted for management's expectations regarding the notes due in fiscal 2007 as discussed above), for the next five years and thereafter (in thousands):

Year	Payments
2008	\$ -
2009	200,000
2010	-
2011	1,565,287
2012	-
Thereafter	1,000,000
	2,765,287
Less net discount	(87,949)
Total debt	\$ 2,677,338

#### NOTE 6. EMPLOYEE BENEFITS

The Company sponsors defined benefit pension plans ("retirement plans"), which cover a majority of its employees. Benefits are based on years of service and compensation. Contributions to the retirement plans are made by the Company in amounts deemed necessary to provide the required benefits. The Company made \$40.0 million in voluntary contributions to its retirement plans in early fiscal 2006 (including \$8.5 million to *Star Tribune* plans). No contributions to the Company's retirement plans are currently planned for fiscal 2007.

The Company also has a limited number of supplemental retirement plans to provide key employees with additional retirement benefits. The terms of the plans are generally the same as those of the retirement plans, except that the supplemental retirement plans are limited to key employees and provide an enhanced pension benefit. These plans are funded on a pay-as-you-go basis and the accrued pension obligation is largely included in other long-term obligations.

The elements of pension costs for continuing operations are as follows (in thousands):

	Three Months Ended		Six Months Ended	
	July 1, 2007	June 25, 2006	July 1, 2007	June 25, 2006
Service cost	\$ 10,872	\$ 4,235	\$ 18,810	\$ 8,028
Interest cost	22,772	6,462	46,988	12,258
Expected return on plan assets	(26,024)	(8,517)	(54,250)	(16,268)
Prior service cost amortization	24	50	105	94
(Gain)/loss amortization	(556)	2,372	3,453	4,491
Net pension expense	\$ 7,088	\$ 4,602	\$ 15,106	\$ 8,603

No material contributions were made to the Company's multi-employer plans for continuing operations for the three months and six months ended July 1, 2007 and June 25, 2006.

The Company also provides for or subsidizes post-retirement healthcare and certain life insurance benefits for employees. The elements of post-retirement benefits for continuing operations are as follows (in thousands):

	Three Months Ended		Six Months Ended	
	July 1, 2007	June 25, 2006	July 1, 2007	June 25, 2006
Service cost	\$ 200	\$ 1	\$ 422	\$ 1
Interest cost	426	97	1,434	106
(Gain)/loss amortization	(6)	-	(6)	-
Net post-retirement expense	\$ 620	\$ 98	\$ 1,850	\$ 107

## NOTE 7. COMMON STOCK AND STOCK PLANS

On June 27, 2006, in connection with the Acquisition, the Company increased the authorized number of its Class A Common shares from 100,000,000 to 200,000,000 shares and issued 34,988,009 new Class A Common shares in connection with the Acquisition (see Note 2).

The Company's Class A and Class B Common Stock participate equally in dividends. Holders of Class B are entitled to one vote per share and to elect as a class 75% of the Board of Directors, rounded down to the nearest whole number. Holders of Class A Common Stock are entitled to one-tenth of a vote per share and to elect as a class 25% of the Board of Directors, rounded up to the nearest whole number. Class B Common Stock is convertible at the option of the holder into Class A Common Stock on a share-for-share basis.

The holders of shares of Class B Common Stock are parties to an agreement, the intent of which is to preserve control of the Company by the McClatchy family. Under the terms of the agreement, the Class B shareholders have agreed to restrict the transfer of any shares of Class B Common Stock to one or more "Permitted Transferees," subject to certain exceptions. A "Permitted Transferee" is any current holder of shares of Class B Common Stock of the Company; any lineal descendant of Charles K. McClatchy (1858 to 1936); or a trust for the exclusive benefit of, or in which all of the remainder beneficial interests are owned by, one or more lineal descendants of Charles K. McClatchy.



Generally, Class B shares can be converted into shares of Class A Common Stock and then transferred freely (unless, following conversion, the outstanding shares of Class B Common Stock would constitute less than 25% of the total number of all outstanding shares of common stock of the Company). In the event that a Class B shareholder attempts to transfer any shares of Class B Common Stock in violation of the agreement, or upon the happening of certain other events enumerated in the agreement as "Option Events," each of the remaining Class B shareholders has an option to purchase a percentage of the total number of shares of Class B Common Stock proposed to be transferred equal to such remaining Class B shareholder's ownership percentage of the total number of outstanding shares of Class B Common Stock. If all the shares proposed to be transferred are not purchased by the remaining Class B shareholders, the Company has the option of purchasing the remaining shares. The agreement can be terminated by the vote of the holders of 80% of the outstanding shares of Class B Common Stock who are subject to the agreement. The agreement will terminate on September 17, 2047, unless terminated earlier in accordance with its terms.

At July 1, 2007, the Company had six stock-based compensation plans. The Company applied APB Opinion 25 and related interpretations in accounting for its plans in fiscal 2005 and prior years. The Company has adopted SFAS No. 123R for its stock plans effective December 26, 2005, the first day of fiscal 2006.

Beginning in fiscal 2005, the Company awarded stock-settled stock appreciation rights ("SARs") in lieu of stock options to its employees. The SARs were granted at fair market value, have a ten-year term and vest in four equal annual installments beginning on March 1 following the year for which the award was made.

Outstanding options and SARs are summarized as follows:

	Options/ SARs	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)
Outstanding December 31, 2006	4,064,075	\$ 52.78	\$ 4,857
Granted	37,250	39.45	
Exercised	(69,625)	26.55	
Forfeited	(94,250)	63.74	
Expired	(227,000)	56.57	
Outstanding July 1, 2007	3,710,450	52.63	nil
Options and SARs exercisable:			
July 1, 2007	2,130,825	\$ 53.42	

As of July 1, 2007, there were \$11.4 million of unrecognized compensation costs related to non-vested stock-based compensation arrangements granted under the Company's plans. The cost is expected to be recognized over a weighted average period of 1.9 years.

The following tables summarize information about stock options and SARs outstanding in the stock plans at July 1, 2007:

Range of Exercise Prices	Options/SARs Outstanding	Average Remaining Contractual Life	Weighted Average Exercise Price	Options/SARs Exercisable	Weighted Average Exercise Price
\$ 26.19 - \$42.50	1,486,625	6.79	\$ 40.81	590,625	\$ 38.44
\$ 45.98 - \$59.09	1,253,200	6.34	\$ 54.37	892,825	\$ 52.86
\$ 59.58 - \$73.36	970,625	6.82	\$ 68.49	647,375	\$ 67.86
\$ 26.19 - \$73.36	3,710,450	6.65	\$ 52.63	2,130,825	\$ 53.42

The weighted average remaining contractual life on options exercisable at July 1, 2007 was 5.1 years. The fair value of the stock options and SARs granted was estimated on the date of grant using a Black-Scholes option valuation model that uses the assumptions noted in the following table. The expected life of the options represents the period of time that options granted are expected to be outstanding using the historical exercise behavior of employees. Expected volatility was based on historical volatility for a period equal to the stock option's expected life for shares granted in the second fiscal quarters of 2007 and 2006, and for a one-year look back period for shares granted prior to fiscal 2006. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	Six Months Ended	
	July 1, 2007	June 25, 2006
Dividend yield	1.96	1.57
Expected life in years	5.41	5.27
Volatility	.19	.19
Risk-free interest rate	4.74%	5.00%
Weighted average fair value of options/SARs granted	\$ 8.40	\$ 11.01

The Company also offers eligible employees the option to purchase common stock under its ESPP. The expense associated with the plan is computed using a Black-Scholes option valuation model with similar assumptions to those described for stock options, except that volatility is computed using a one-year look back given the short-term nature of this option. Expense associated with the ESPP is included in the stock-related compensation discussed in Note 1.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Overview

The McClatchy Company (the "Company") is the third largest newspaper company in the United States, with 31 daily newspapers and approximately 50 non-dailies. Twenty of its daily newspapers were acquired on June 27, 2006 in the Knight Ridder acquisition (the "Acquisition") – see Note 2 to the consolidated financial statements. McClatchy also operates leading local websites and direct marketing operations in each of its markets which complement its newspapers and extend its audience reach in each market. McClatchy-owned newspapers include *The Miami Herald*, *The Sacramento Bee*, the (Fort Worth) *Star-Telegram*, *The Kansas City Star*, *The Charlotte Observer*, and *The (Raleigh) News & Observer*.

McClatchy also has a portfolio of premium digital assets. Its leading local websites offer users information, comprehensive news, advertising, e-commerce and other services. The Company owns and operates McClatchy Interactive, an interactive operation that provides websites with content, publishing tools and software development. McClatchy operates Real Cities, the largest national advertising network of local news websites and owns 14.4% of CareerBuilder, the nation's largest online job site. McClatchy also owns 25.6% of Classified Ventures, a newspaper industry partnership that offers classified websites such as the nation's number two online auto website, cars.com, and the number one rental site, apartments.com.

The Company's primary source of revenue is advertising, which accounts for roughly 84% of the Company's revenue. While percentages vary from year to year and from newspaper to newspaper, retail advertising carried as a part of newspapers ("run-of-press" or "ROP" advertising) or in advertising inserts placed in newspapers (preprint advertising) generally contributes roughly 37% of advertising revenues at the Company's newspapers. Recent trends have been for certain national or regional retailers to use greater preprint and online advertising and less ROP advertising, although that trend shifts from time to time. Nonetheless, ROP advertising still makes up the majority of retail advertising. Classified advertising (including online classified advertising), primarily in automotive, employment and real estate categories, generally contributes about 33% of advertising revenue and national advertising generally contributes about 8% of total advertising revenue. Direct marketing and other advertising make up the remainder of the Company's advertising revenues. Circulation revenues contribute roughly 12% of the Company's newspaper revenues. Most newspapers are delivered by independent contractors. Circulation revenues are recorded net of direct delivery costs.

See the following "Results of Operations" for a discussion of the Company's revenue performance and contribution by category for the three months and six months ended July 1, 2007 and June 25, 2006.

### Critical Accounting Policies

Critical accounting policies are those accounting policies that management believes are important to the portrayal of the Company's financial condition and results and require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. The Company's 2006 Annual Report on Form 10-K includes a description of certain critical accounting policies, including those with respect to revenue recognition, allowance for uncollectible accounts, acquisition accounting, goodwill and intangible impairment, discontinued operations, pension and post-retirement benefits, income taxes, insurance and stock-based employee compensation.



*Income Tax Contingencies:*

The Company is subject to periodic audits by the Internal Revenue Service and other state and local taxing authorities. These audits may challenge certain aspects of the Company's tax positions such as the timing and amount of deductions and allocation of taxable income to the various tax jurisdictions. Income tax contingencies are accounted for in accordance with FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"), and may require significant management judgment in estimating final outcomes. Actual results could materially differ from these estimates and could significantly affect the effective tax rate and cash flows in future periods.

Recent Events and Trends

*Acquisition Transaction:*

On June 27, 2006 (the second day of the Company's third fiscal quarter), the Company completed the purchase of Knight-Ridder, Inc. ("Knight Ridder") pursuant to a definitive merger agreement entered into on March 12, 2006, under which the Company paid Knight Ridder shareholders a per share price consisting of \$40.00 in cash and .5118 of a Class A McClatchy common share (the "Acquisition"). The Company issued approximately 35 million Class A common shares in connection with the Acquisition. The total purchase price was approximately \$4.6 billion. In addition, the Company assumed \$1.9 billion of Knight Ridder's long-term debt at the closing of the Acquisition.

Prior to the Acquisition, Knight Ridder published 32 daily newspapers in 29 U.S. markets, operated websites in all of its markets and owned a variety of internet and other investments which consisted of: 33.3% of each of CareerBuilder LLC ("CareerBuilder") and ShopLocal LLC ("ShopLocal"), 25.0% of Topix.net ("Topix"), 21.5% of Classified Ventures LLC ("Classified Ventures"), 33.3% interest in SP Newsprint Company ("SP"), 13.5% interest in the Ponderay Newsprint Company ("Ponderay") and 49.5% of The Seattle Times Company which owns *The Seattle Times* newspaper and weekly newspapers in the Puget Sound area, and daily newspapers located in Walla Walla and Yakima, Washington and in Portland, Maine and various other smaller investments. Knight Ridder was the founder and operator of Real Cities, the largest national advertising network of local news websites.

To consummate the Acquisition, the Company borrowed \$3.076 billion under a new bank debt facility (see Note 5 to the consolidated financial statements) and used the proceeds from the sales of four Knight Ridder newspapers (see Disposition Transactions below) in order to pay Knight Ridder shareholders (\$2.7 billion) and refinance its and Knight Ridder's bank debt (\$498.0 million). The after-tax proceeds from the sales of the eight Knight Ridder newspapers sold after the Acquisition closed were used to reduce debt.

The Acquisition was accounted for as a purchase. The purchase price was allocated to the assets acquired and liabilities assumed based upon their estimated fair values as of the June 27, 2006 Acquisition date. The purchase price allocation was primarily based upon an independent valuation. The purchase price allocation, while substantially completed, is subject to further adjustments based upon completion of analyses of deferred income tax assets and liabilities.

*Disposition Transactions:*

In conjunction with the Acquisition, the Company divested 12 Knight Ridder newspapers for strategic and antitrust reasons. The divested newspapers were the *Philadelphia Inquirer*; *Philadelphia Daily News*; *San Jose Mercury News*; *St. Paul Pioneer Press*; *Akron Beacon Journal* (OH); *Wilkes Barre Times Leader* (PA); *Aberdeen American News* (SD); *Grand Forks Herald* (ND); *Ft. Wayne News-Sentinel* (IN); *Contra Costa Times* (CA); *Monterey Herald* (CA); and *Duluth News Tribune* (MN). The Company received cash proceeds of approximately \$2.0 billion (net of transaction costs) from these divestitures. In addition, the buyers assumed approximately \$77 million of Knight Ridder retirement obligations related to certain newspapers. Four of the 12 newspapers were sold concurrently with the closing of the Acquisition. The remaining eight newspapers were owned for periods ranging from two days to 36 days following the closing of the Acquisition. The operating results of these eight divested newspapers for the periods they were owned by the Company, including interest expense and debt issuance costs related to bank debt incurred until their respective sales, are included in discontinued operations in the Company's consolidated statement of income for 2006. No accounting gain or loss was recognized on the sale of the 12 newspapers.

In July 2006, the Company sold 18.3% of its interest in each of CareerBuilder and ShopLocal, and 13.8% of its interest in Topix for an aggregate of \$309.7 million in cash and used the after-tax proceeds to reduce debt. No accounting gain or loss was recognized on the sale of these investments. The Company retained a 15.0% interest in each of CareerBuilder and ShopLocal and an 11.3% interest in Topix. Effective May 11, 2007, the Company's interest in CareerBuilder declined to 14.4%.

On March 5, 2007, the Company sold the (Minneapolis) *Star Tribune* and other publications and websites related to the newspaper to an entity affiliated with Avista Capital Partners for \$530.0 million. The Company expects to receive an income tax refund of approximately \$201 million related to the sale in 2008. This amount has been recorded as a long-term receivable on the consolidated balance sheet.

The results of *Star Tribune*'s operations, including interest on debt incurred to purchase it, have been recorded as discontinued operations in all periods presented. The Company used the proceeds from the sale of the *Star Tribune* to reduce debt.

*Advertising Revenues:*

Classified advertising revenues have continued to decline since the third fiscal quarter of 2006 and advertising results declined across the board in the second fiscal quarter of 2007, but particularly in real estate advertising. Real estate advertising began to weaken in the fourth fiscal quarter of 2006 and has declined substantially since then. The Company has seen significant declines in California and Florida, where real estate values and thus advertising were strong in the second fiscal quarter of 2006 (see discussion below). The decline in automotive classified advertising reflected an industry-wide decline that began in 2004, while employment advertising has been in decline in most markets since the third fiscal quarter of 2006. National advertising also declined in the second fiscal quarter of 2007 reflecting a slowdown in a number of segments including telecommunications, national automotive and financial advertising, an industry-wide trend.

A total of 68.5% of the Company's advertising declines in the second fiscal quarter of 2007 came from California and Florida, two regions that benefited strongly from the real estate boom, and are likewise being hurt in the subsequent real estate slowdown. Advertising revenues were down 17.8% in the second fiscal quarter of 2007. The housing sector is an important component of these states' economies. Hence, California and Florida also account for a majority of the decline in auto and employment advertising, as the real estate downturn is having an impact on these categories as well. These states have experienced similar advertising downturn and recovery cycles in the past, and were recently the Company's best performing regions. Management believes a significant portion of the current advertising downturn reflects these cyclical forces and expects declines to continue in 2007 because of the difficult trends in these states.

See the revenue discussions in management's review of "Results of Operations".

21

---

*Newsprint:*

Newsprint prices continued to decline in the second fiscal quarter of 2007 after a sustained period of increasing prices from 2002 through early 2006. Through the first six months of fiscal 2007, newsprint expense was 13.8% lower than pro forma newsprint expense (which includes the 20 Knight Ridder Newspapers) in the first six months of 2006, primarily reflecting lower newsprint usage and, to a lesser degree, lower newsprint prices. Newsprint pricing is dependent on global demand and supply for newsprint. Significant changes in newsprint prices can increase or decrease the Company's operating expenses. However, because the Company has ownership interests in newsprint producers (Ponderay and SP), the recent trend of falling newsprint prices, while favorably affecting operating expenses, is contributing to equity losses from these investments. Ponderay and SP are also currently impacted by the higher cost of energy and fiber used in the papermaking process. The impact of newsprint price increases on the Company's financial results is discussed under "Results of Operations".

As a result of the recently announced strategic alternative review at SP, the Company and its partners are seeking to sell SP. The ultimate outcome of the strategic review cannot be determined and the timing of a transaction, if any, which the Company and its partners may undertake has not been determined.

## **RESULTS OF OPERATIONS**

The Company noted the following items related to the Acquisition and other matters that impacted second fiscal quarter of 2007 and year-to-date fiscal 2007 results:

- On June 26, 2006, the Company issued approximately 35 million Class A shares in connection with the Acquisition. As a result, the weighted average diluted shares used to calculate earnings per share in the second fiscal quarter of 2007 increased to approximately 82 million shares compared to approximately 47 million shares in second fiscal quarter of 2006.
- The purchase price for the Acquisition has been allocated to the assets acquired and liabilities assumed based upon their estimated fair values as of June 27, 2006, the date of the Acquisition. The purchase price allocation, while substantially complete, is subject to further adjustments based upon completion of analyses of deferred income tax assets and liabilities.
- On March 5, 2007, the Company sold the (Minneapolis) *Star Tribune* newspaper for \$530.0 million in proceeds and is expected to receive a tax refund of approximately \$201 million related to the sale in 2008. The results of *Star Tribune's* operations have been recorded as discontinued operations in all periods presented.
- During the second fiscal quarter of 2007, STC and Hearst entered into an agreement to settle certain outstanding legal issues and amend their Joint Operating Agreement relating to STC and Hearst's Seattle newspaper. As a result, STC is expected to pay approximately \$24 million to Hearst in the third fiscal quarter of 2007. The Company has expensed \$7.8 million as its share of this payment as part of its equity loss in the second fiscal quarter of 2007.



The Company's results from continuing operations since the close of the Acquisition (and all pro forma amounts for prior periods discussed) include the operations of the 20 retained former Knight Ridder newspapers and all of the Company's previously owned newspaper operations except for the (Minneapolis) *Star Tribune* newspaper.

The growth in revenues and expenses in the second fiscal quarter of 2007 compared to the same period in 2006 resulted from the Acquisition. To facilitate an analysis of operating results, the comparative analysis between the three months and six months ended July 1, 2007 and June 25, 2006 discussed below is supplemented by a comparison to 2006 pro forma results from continuing operations. Pro forma amounts reflect the results of continuing operations of the Company as defined in the preceding paragraph. The financial results for Knight Ridder and the 20 newspapers retained by the Company included in the pro forma information were derived from the historical unaudited financial statements of Knight Ridder. The Company believes that the use of pro forma reporting of operating results enhances measurement of performance by permitting comparisons with prior historical data. Such supplemental pro forma data is not necessarily indicative of the operating results that would have occurred if the Acquisition had been completed as of the beginning of fiscal 2006.

### **Second Fiscal Quarter of 2007 Compared to Second Fiscal Quarter of 2006**

The Company reported income from continuing operations of \$34.5 million or \$0.42 per share in the second fiscal quarter of 2007, compared to \$32.2 million or \$0.69 per share in the second fiscal quarter of 2006. The Company recorded income from discontinued operations of \$0.7 million or \$0.01 per share relating to the results of the (Minneapolis) *Star Tribune*. The Company's total net income was \$35.2 million or \$0.43 per share including discontinued operations in the second fiscal quarter of 2007, compared to net income of \$44.1 million or \$0.94 per share in the second fiscal quarter of 2006.

#### *Revenues:*

Revenues in the second fiscal quarter of 2007 were \$580.0 million, up \$368.0 million or 173.6% from the second fiscal quarter of 2006 revenues of \$212.0 million, due to the addition of the 20 former Knight Ridder newspapers and the sale of the (Minneapolis) *Star Tribune*. Advertising revenues totaled \$488.3 million and circulation revenues were \$69.7 million. On a pro forma basis, revenues decreased \$52.4 million or 8.3% from the second fiscal quarter of 2006 with advertising revenues decreasing \$53.1 million or 9.8% and circulation revenues decreasing \$3.4 million or 4.6% from the second fiscal quarter of 2006.

As discussed in Recent Events and Trends above, 68.5% of the Company's advertising declines in the second fiscal quarter of 2007 came from California and Florida, two regions that benefited strongly from the real estate boom, and are likewise being hurt in the subsequent real estate slowdown. Advertising revenues were down 17.8% in these two regions in the second fiscal quarter. The housing sector is an important component of these states' economies. Hence, California and Florida also account for a majority of the decline in auto and employment advertising, as the real estate downturn is having an impact on these categories as well.

The following summarizes the Company's revenue by category on a pro forma basis, which compares second fiscal quarter of 2007 with second fiscal quarter of 2006 (dollars in thousands):

	July 1, 2007	As Reported June 25, 2006	% Change	Pro Forma June 25, 2006	% Change
<b>Advertising:</b>					
Retail	\$ 213,203	\$ 74,971	184.4	\$ 227,220	(6.2)
National	46,064	15,394	199.2	50,821	(9.4)
<b>Classified:</b>					
Auto	43,760	18,085	142.0	51,729	(15.4)
Employment	66,236	25,954	155.2	78,363	(15.5)
Real estate	54,687	28,916	89.1	67,492	(19.0)
Other	23,120	6,480	256.8	23,085	0.2
Total classified	187,803	79,435	136.4	220,669	(14.9)
<b>Direct marketing and other</b>					
	41,207	13,883	196.8	42,658	(3.4)
Total advertising	488,277	183,683	165.8	541,368	(9.8)
Circulation	69,707	23,504	196.6	73,087	(4.6)
Other	22,043	4,813	358.0	17,978	22.6
Total revenues	\$ 580,027	\$ 212,000	173.6	\$ 632,433	(8.3)

Retail advertising increased \$138.2 million or 184.4% from the second fiscal quarter of 2006 reflecting the Acquisition. On a pro forma basis, retail advertising decreased \$14.0 million or 6.2% from the second fiscal quarter of 2006. On a pro forma basis, online retail advertising increased \$2.4 million or 59.8% from the second fiscal quarter of 2006, while print ROP advertising decreased \$14.5 million or 10.3% from the second fiscal quarter of 2006. On a pro forma basis, preprint advertising decreased \$1.9 million or 2.3% from the second fiscal quarter of 2006.

National advertising increased \$30.7 million or 199.2% from the second fiscal quarter of 2006 reflecting the Acquisition. On a pro forma basis, national advertising decreased \$4.8 million or 9.4% from the second fiscal quarter of 2006. The declines in total national advertising were primarily in the telecommunications, national automotive and financial advertising categories, reflecting an industry-wide trend. Online national advertising increased \$1.7 million from the second fiscal quarter of 2006 and decreased \$0.6 million on a pro forma basis.

Classified advertising increased \$108.4 million or 136.4% from the second fiscal quarter of 2006 reflecting the Acquisition. On a pro forma basis, classified advertising decreased \$32.9 million or 14.9% from the second fiscal quarter of 2006. Online classified advertising increased \$25.1 million or 267.0% from the second fiscal quarter of 2006. On a pro forma basis, online classified advertising decreased \$2.8 million or 7.6% from the second fiscal quarter of 2006.

- Real estate advertising was up \$25.8 million or 89.1% from the second fiscal quarter of 2006. On a pro forma basis, real estate advertising decreased \$12.8 million or 19.0% from the second fiscal quarter of 2006. The Company has seen dramatic declines in California and Florida, where real estate values, and thus advertising, were exceptionally strong in 2006. The Company expects declines in this revenue category to continue because of the difficult trends in these states.
- Automotive advertising increased \$25.7 million or 142.0% from the second fiscal quarter of 2006. On a pro forma basis, automotive advertising declined \$8.0 million or 15.4% from the second fiscal quarter of 2006, reflecting an industry-wide trend. Print advertising declined 18.7%, while online advertising grew 12.9% reflecting the strength of the Company's cars.com online products.
- Employment advertising increased \$40.3 million or 155.2% from the second fiscal quarter of 2006. On a pro forma basis, employment advertising decreased \$12.1 million or 15.5% from the second fiscal quarter of 2006. Print employment advertising declined 17.0% while online employment advertising declined 12.4%. Online employment advertising was affected by the current affiliate agreement with CareerBuilder, the Company's online employment advertising partner. This agreement is helping to grow online employment revenues at the legacy McClatchy newspapers. However, under the current affiliate agreement selected products are no longer available to be sold by the 20 acquired Knight Ridder newspapers, which are reducing their internet revenues.

Online advertising, which is included in each of the advertising categories discussed above, totaled \$42.8 million in the second fiscal quarter of 2007, an increase of \$31.2 million or 269.4% over the second fiscal quarter of 2006. On a pro forma basis, online advertising decreased \$1.0 million or 2.2% from the second fiscal quarter of 2006 and was held down by the current CareerBuilder affiliate agreement's impact on employment advertising as discussed above.

Direct marketing revenues increased \$27.1 million or 202.0% from the second fiscal quarter of 2006 reflecting the Acquisition. On a pro forma basis, direct marketing revenues decreased \$1.7 million or 3.9% from the second fiscal quarter of 2006 reflecting the overall slow advertising environment. The Company extends its newspaper franchises by supplementing the mass reach of the newspaper with direct marketing and direct mail products so that advertisers can both achieve broad appeal and capture targeted audiences with one-stop shopping.

Circulation revenues increased \$46.2 million or 196.6% from the second fiscal quarter of 2006 reflecting the Acquisition. On a pro forma basis, consolidated circulation revenues decreased \$3.4 million or 4.6% from the second fiscal quarter of 2006, primarily reflecting lower circulation volumes. The Company continues to reduce third-party and outlying circulation that is not highly valued by its newspaper advertisers, and expects circulation volumes to remain lower in fiscal 2007 compared to fiscal 2006.

#### *Operating Expenses:*

Operating expenses increased \$302.9 million or 189.6% in the second fiscal quarter of 2007 related to expenses added by the Acquisition. On a pro forma basis, operating expenses were down \$57.5 million or 11.1% from the second fiscal quarter of 2006, as the Company continued to reduce costs and realized synergies from the Acquisition. On a

pro forma basis, compensation costs were down 12.5%, with payroll down 12.4%, and a 6.9% reduction in staffing. On a pro forma basis, fringe benefits were down 13.2%. On a pro forma basis, newsprint and supplement expense was down 17.0% with newsprint expense down 17.4% and supplement expense down 14.3%. On a pro forma basis, other operating costs were down 8.5%, reflecting lower bad debt and professional services. Professional services in the second fiscal quarter of 2006 included \$4.7 million of strategic alternative review services incurred and recorded by Knight Ridder. On a pro forma basis, depreciation and amortization expense increased by 4.3% due primarily to the purchase price accounting related to the Acquisition.

25

---

*Interest:*

Interest expense for continuing operations was \$49.6 million for the second fiscal quarter of 2007 primarily reflecting the service costs on debt incurred to finance the Acquisition. Interest expense also included \$1.7 million related to accrued interest on the liability for unrecognized tax benefits. The Company's effective interest rate in the second fiscal quarter of 2007 was approximately 6.4%.

*Equity Income (Loss):*

Loss from unconsolidated companies resulted primarily from operating results of the Company's newsprint investments and STC (see Note 3 to the consolidated financial statements).

*Income Taxes:*

The income tax rate from continuing operations in the second fiscal quarter of 2007 was 39.9%, compared to 39.0% in the second fiscal quarter of 2006. The effective tax rate for the current fiscal year is expected to be in the 39.5% to 40.0% range, but the tax rate is preliminary and may change when the purchase price allocation and related deferred taxes are finalized.

*Discontinued Operations:*

Income from discontinued operations, (related to the (Minneapolis) *Star Tribune* newspaper -- see Note 2 to the consolidated financial statements) in the second fiscal quarter of 2007 was \$0.7 million or \$0.01 per share. Income from discontinued operations was \$11.9 million or \$0.25 per share in the second fiscal quarter of 2006. Additionally, \$2.1 million in interest incurred on the debt used to finance the purchase of the *Star Tribune* was recorded in discontinued operations in the second fiscal quarter of 2006.

**First Six Months of Fiscal 2007 Compared to First Six Months of Fiscal 2006**

The Company reported income from continuing operations of \$49.0 million or \$0.60 per share in the first six months of fiscal 2007, compared to \$54.0 million or \$1.15 per share in the first six months of fiscal 2006. The Company recorded a loss from discontinued operations in the first six months of fiscal 2007 of \$4.8 million or \$0.06 per share relating to the results of the (Minneapolis) *Star Tribune* newspaper. The Company's net income was \$44.3 million or \$0.54 per share including discontinued operations in the first six months of fiscal 2007 compared to \$71.9 million or \$1.53 per share in the first six months of fiscal 2006. Revenues and expenses in the six-month period were generally affected by the trends discussed in the quarterly comparison above, with exceptions noted below.

*Revenues:*

Revenues from continuing operations in the first six months of fiscal 2007 were \$1.147 billion, up \$740.1 million or 182.1% from the first six months of fiscal 2006 revenues from continuing operations of \$406.5 million, due to the 20 former Knight Ridder newspapers and the sale of the (Minneapolis) *Star Tribune*. Advertising revenues were \$965.3 million and circulation revenues were \$141.6 million in the first six months of fiscal 2007. On a pro forma basis, revenues decreased \$82.1 million or 6.7% from the first six months of fiscal 2006 with advertising revenues decreasing \$79.8 million or 7.6% and circulation revenues decreasing \$6.1 million or 4.1% from the first six months of fiscal 2006.



A total of 72.1% of the Company's advertising declines in the first six months of fiscal 2007 came from California and Florida, two regions that benefited strongly from the real estate boom, and are likewise being hurt in the subsequent real estate slowdown. Advertising revenues were down 14.4% in these two regions in the first six months of fiscal 2007. The housing sector is an important component of these states' economies. Hence, California and Florida also account for a majority of the decline in auto and employment advertising, as the real estate downturn is having an impact on these categories as well.

The following table summarizes the Company's revenues by category on a pro forma basis, which compares the first six months of fiscal 2007 with the first six months of fiscal 2006 (dollars in thousands):

	As Reported Year to Date			Pro Forma Year to Date	
	July 1, 2007	June 25, 2006	% Change	June 25, 2006	% Change
<b>Advertising:</b>					
Retail	\$ 419,231	\$ 139,659	200.2	\$ 431,565	(2.9)
National	91,214	29,152	212.9	101,220	(9.9)
<b>Classified:</b>					
Auto	85,895	36,585	134.8	101,950	(15.7)
Employment	135,882	51,082	166.0	154,076	(11.8)
Real estate	109,837	55,379	98.3	131,706	(16.6)
Other	44,725	12,672	252.9	44,613	0.3
Total classified	376,339	155,718	141.7	432,345	(13.0)
Direct marketing and other	78,516	25,488	208.1	80,011	(1.9)
Total advertising	965,300	350,017	175.8	1,045,141	(7.6)
Circulation	141,587	47,268	199.5	147,672	(4.1)
Other	39,698	9,178	332.5	35,915	10.5
Total revenues	\$ 1,146,585	\$ 406,463	182.1	\$ 1,228,728	(6.7)

Retail advertising increased \$279.6 million or 200.2% from the first six months of fiscal 2007 from the first six months of fiscal 2006 reflecting the Acquisition. On a pro forma basis, retail advertising decreased \$12.3 million or 2.9% from the first six months of fiscal 2006. On a pro forma basis, online retail advertising increased \$5.2 million or 70.9% from the first six months of fiscal 2006, while ROP advertising decreased \$17.6 million or 6.7% from the first six months of fiscal 2006. On a pro forma basis, preprint advertising increased \$0.1 million or 0.1% from the first six months of fiscal 2006.

National advertising increased \$62.1 million or 212.9% from the first six months of fiscal 2006 reflecting the Acquisition. On a pro forma basis, national advertising decreased \$10.0 million or 9.9% from the first six months of fiscal 2006. The declines reflect the same conditions discussed in the quarterly results. Online national advertising increased \$3.1 million from the first six months of fiscal 2006 and decreased \$1.4 million on a pro forma basis.

Classified advertising increased \$220.6 million or 141.7% from the first six months of fiscal 2006 reflecting the Acquisition. On a pro forma basis, classified advertising decreased \$56.0 million or 13.0% from the first six months of fiscal 2006. Print classified advertising declined 14.8% on a pro forma basis, while online classified advertising was down 3.6% on a pro forma basis in the first six months of fiscal 2007.

- Real estate advertising was up \$54.5 million or 98.3% from the first six months of fiscal 2006. On a pro forma basis, real estate advertising decreased \$21.9 million or 16.6% from the first six months of fiscal 2006 as discussed in the quarterly review above.
- Automotive advertising increased \$49.3 million or 134.8% from the first six months of fiscal 2006. On a pro forma basis, automotive advertising declined \$16.1 million or 15.7% from the first six months of fiscal 2006, reflecting an industry-wide trend. As in the quarterly discussion above, growth in online automotive advertising revenue was offset by declines in print advertising.
- Employment advertising increased \$84.8 million or 166.0% from the first six months of fiscal 2006. On a pro forma basis, employment advertising decreased \$18.2 million or 11.8% from the first six months of fiscal 2006, partially reflecting the effect of the current CareerBuilder affiliate agreement discussed above.

Online advertising, which is included in each of the advertising categories discussed above, totaled \$84.0 million in the first six months of fiscal 2007, an increase of \$61.9 million or 280.3% over the first six months of fiscal 2006 reflecting the Acquisition. On a pro forma basis, online advertising increased \$1.1 million or 1.4% from the first six months of fiscal 2006, reflecting growth in retail and automotive advertising, which was partially offset by employment advertising and to a lesser degree, real estate declines.

Direct marketing revenues increased \$53.0 million or 216.1% from the first six months of fiscal 2006 reflecting the Acquisition. On a pro forma basis, direct marketing revenues decreased \$1.6 million or 2.0% from the first six months of fiscal 2006. The Company extends its newspaper franchises by supplementing the mass reach of the newspaper with direct marketing and direct mail products so that advertisers can both achieve broad appeal and capture targeted audiences with one-stop shopping.

Circulation revenues increased \$94.3 million or 199.5% from the first six months of fiscal 2006 reflecting the Acquisition. On a pro forma basis, circulation revenues decreased \$6.1 million or 4.1% from the first six months of fiscal 2006.

#### *Operating Expenses:*

Operating expenses increased \$622.9 million or 195.3% in the six months of fiscal 2007 related to expenses added by the Acquisition. On a pro forma basis, operating expenses were down \$86.6 million or 8.4% from the first six months of fiscal 2006, as the Company continued to reduce costs and realized synergies from the Acquisition. On a pro forma basis, compensation costs were down 10.6%, with payroll down 10.6%, and a 6.2% reduction in staffing. On a pro forma basis, fringe benefits were down 10.8%. On a pro forma basis, newsprint and supplement expense was down 13.8% with newsprint expense down 12.8% and supplement expense down 19.2%. On a pro forma basis, other operating costs were down 3.7%, reflecting lower professional services. Professional services in the first half of fiscal 2006 include \$8.5 million of alternative strategic review services incurred and recorded by Knight Ridder. On a pro forma basis, depreciation and amortization expense increased by 3.0% due primarily to the purchase price accounting related to the Acquisition.



*Interest:*

Interest expense for continuing operations was \$103.3 million for the first six months of fiscal 2007 primarily reflecting the service costs on debt incurred to finance the Acquisition. While the Company used the proceeds of the (Minneapolis) *Star Tribune* newspaper sale to reduce debt, it carried interest on this debt for the first two months of the year, which equated to about \$5.7 million in interest expense included in continuing operations. Interest expense also included \$3.0 million related to accrued interest on the liability for unrecognized tax benefits. Excluding these two items, the Company's interest expense was \$94.6 million. The Company's effective interest rate in the first six months of fiscal 2007 was approximately 6.4%. In the first six months of fiscal 2007, a total of \$1.2 million of interest expense was allocated to discontinued operations related to debt used to acquire the (Minneapolis) *Star Tribune* newspaper, which was sold on March 5, 2007.

*Equity Income (Loss):*

Loss from unconsolidated companies resulted primarily from the operating results of the Company's newsprint investments and to a lesser extent from the Company's investment in internet-related companies and STC (see Note 3 to the consolidated financial statements).

*Income Taxes:*

The income tax rate from continuing operations in the first six months of fiscal 2007 was 39.7%, compared to 39.0% in the first six months of fiscal 2006. The effective tax rate for the current fiscal year is expected to be in the 39.5% to 40.0% range, but the tax rate is preliminary and may change when the purchase price allocation and related deferred taxes are finalized.

*Discontinued Operations:*

Loss from discontinued operations, (related to the (Minneapolis) *Star Tribune* newspaper, see Note 2 to the consolidated financial statements) in the first six months of fiscal 2007 was \$4.8 million or \$0.06 per share. Income from discontinued operations was \$17.9 million or \$0.38 per share in the first six months of fiscal 2006. Additionally, \$1.2 million and \$3.7 million in interest incurred on the debt used to finance the purchase of the *Star Tribune* was recorded in discontinued operations in the first six months of fiscal 2007 and fiscal 2006, respectively.

## **LIQUIDITY AND CAPITAL RESOURCES**

*Sources and Uses of Liquidity and Capital Resources:*

The Company's cash and cash equivalents were \$25.3 million as of July 1, 2007. The Company generated \$121.5 million of cash from operating activities in the first six months of fiscal 2007. The increase in cash from operating activities in the first six months of fiscal 2007 resulted primarily from the Acquisition.

The Company generated \$508.3 million of cash from investing activities largely from the \$522.9 million proceeds (net of expenses) from the sale of the (Minneapolis) *Star Tribune* newspaper (see Note 2 to the consolidated financial statements) in the first six months of fiscal 2007 and the sale of equipment totaling \$19.4 million. These sources of funds were offset by \$28.3 million purchases of property, plant and equipment.

The Company used \$624.1 million of cash from financing sources in the first six months of 2007, primarily for repayment of bank debt. Of the \$624.1 million, the Company repaid \$600.5 million of debt in the first six months of fiscal 2007. The Company paid \$29.5 million in dividends in the first six months of fiscal 2007 and also received \$5.7 million in proceeds from issuing Class A stock under employee stock plans in the first six months of fiscal 2007.

At July 1, 2007, the Company had \$212.0 million of land and other assets held for sale. The Company expects to sell its Miami land in 2008 (included in long-term assets) and its San Jose land in the third fiscal quarter of 2007 (included in current assets). Gross proceeds (before transaction costs) from those sales are expected to be \$190.0 million and \$25.0 million, respectively. At July 1, 2007, the Company also had an income tax receivable of \$201.0 million which it expects to receive in fiscal 2008 related to the sale of the *Star Tribune* (see Note 2 to the consolidated financial statements).

As a result of the recently announced strategic alternative review at SP, the Company and its partners are seeking to sell SP. The ultimate outcome of the strategic review cannot be determined and the timing of a transaction, if any, which the Company and its partners may undertake has not been determined.

#### *Debt and Related Matters:*

Through June 27, 2006, the Company used its senior unsecured revolving credit facility, which provided borrowings of up to \$500 million. This credit agreement was refinanced with a new \$3.2 billion senior unsecured credit facility ("Credit Agreement") entered into in connection with the Acquisition. At closing, the Company's new Credit Agreement consisted of a \$1 billion five-year revolving credit facility and \$2.2 billion five-year Term A loan. Both the Term A loan and the revolver are due on June 27, 2011.

On June 27, 2006, McClatchy borrowed \$2.2 billion under the Term A loan and \$876.0 million under the revolving credit facility. The Company has subsequently repaid \$1.45 billion of the Term A loan and \$460.7 million of the revolving credit facility, primarily from proceeds received in the sale of the eight former Knight Ridder newspapers, net of income taxes paid on the tax gain on the sale (see Note 2 to the consolidated financial statements), proceeds generated from asset sales and cash generated by operations in fiscal 2007 as discussed above. A total of \$529.1 million of funds were available under the revolving credit facility at July 1, 2007.

Debt under the Credit Agreement bears interest at the London Interbank Offered Rate ("LIBOR") plus a spread ranging from 37.5 basis points to 125.0 basis points. Applicable rates are based upon the Company's ratings on its long-term debt from Moody's Investor Services ("Moody's") and Standard & Poor's. A commitment fee for the unused revolving credit ranges from 10.0 basis points to 20.0 basis points depending on the Company's ratings. Standard & Poor's has rated the facility "BB+" and Moody's has rated the facility "Baa3". According to the Credit Agreement, the Company will pay interest at LIBOR plus 75.0 basis points on outstanding debt and its commitment fees are currently at 15.0 basis points.

The Credit Agreement contains financial covenants including a minimum interest coverage ratio (as defined in the Credit Agreement) of 3.00 to 1.00 through July 1, 2007; 2.75 to 1.00 from September 30, 2007 through September 28, 2008 and 3.00 to 1.00 from December 28, 2008 and thereafter; and a maximum leverage ratio (as defined in the Credit Agreement) of 4.75 to 1.00 through July 1, 2007; 5.00 to 1.00 from September 30, 2007 through March 30, 2008; 4.75 to 1.00 from June 29, 2008 through September 28, 2008; 4.25 to 1.00 from December 28, 2008 to September 27, 2009; and declining to 4.00 to 1.00 on December 27, 2009 and thereafter. At July 1, 2007, the Company was in compliance with all debt covenants.

In addition, the Company's Material Subsidiaries (as defined in the Credit Agreement) have guaranteed the Company's obligations under the Credit Agreement. These guarantees were effected on May 4, 2007, and continue in effect upon the earlier of the termination of the Credit Agreement or the date which is one year after the date both ratings agencies have rated the Company's bank debt as investment grade.

At July 1, 2007, the Company had outstanding letters of credit totaling \$55.6 million securing estimated obligations stemming from workers' compensation claims and other contingent claims.

*Contractual Obligations:*

As of July 1, 2007, the Company has purchase obligations primarily related to capital expenditures for property, plant and equipment expiring at various dates through 2008, totaling approximately \$16.4 million.

Significant changes in the Company's contractual obligations since year-end 2006 include the reduction of current-portion of long-term debt of \$530.0 million (see Note 2 to the consolidated financial statements) and an increase of \$25.7 million in income tax reserves through July 1, 2007, of which \$25.2 million related to the adoption of FIN 48 (see Note 1 to the consolidated financial statements).

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Debt under the Credit Agreement bears interest at the LIBOR plus a spread ranging from 37.5 basis points to 125.0 basis points. Applicable rates are based upon the Company's ratings on its long-term debt from Moody's and Standard & Poor's. A hypothetical 25 basis point change in LIBOR for a fiscal year would increase or decrease in the annual net income by \$2.0 million to \$2.5 million based on the current amounts outstanding under the Credit Agreement.

See the discussion at "Recent Events and Trends - Operating Expenses" in Management's Discussion and Analysis of Financial Condition and Results of Operations for the impact of market changes on the Company's newsprint and pension costs.

### **ITEM 4. CONTROLS AND PROCEDURES**

*Evaluation of disclosure controls and procedures.* Our management evaluated, with the participation of our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a - 15(e) or 15d - 15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, the Company's management, including the CEO and CFO, concluded that the Company's disclosure controls and procedures were effective at that time to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure and that such information is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission Rules and Forms.

*Changes in internal control over financial reporting.* There was no change in our internal control over financial reporting that occurred during the second quarter of fiscal 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II - OTHER INFORMATION

### Item 1A. Risk Factors

#### **Forward-Looking Information:**

This quarterly report on Form 10-Q contains forward-looking statements regarding the Company's actual and expected financial performance and operations. These statements are based upon our current expectations and knowledge of factors impacting our business, including, without limitation, statements about litigation, the ability to consummate contemplated sales transactions for its assets or investments which may enable debt reduction on anticipated terms or at all, tax and other benefits from the sale of the (Minneapolis) *Star Tribune* newspaper, advertising revenues, return on pension plan assets and assumed salary increases, newsprint costs, amortization expense, stock option expenses, prepayment of debt, capital expenditures, sufficiency of capital resources and possible acquisitions and investments. Such statements are subject to risks, trends and uncertainties. Forward-looking statements are generally preceded by, followed by or are a part of sentences that include the words "believes," "expects," "anticipates," "estimates," or similar expressions. For all of those statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. You should understand that the following important factors, in addition to those discussed elsewhere in this document and in the documents which we incorporate by reference, could affect the future results of McClatchy and could cause those future results to differ materially from those expressed in our forward-looking statements: general economic, market or business conditions, especially in any of the markets where we operate newspapers; impact of any litigation or any potential litigation; geo-political uncertainties including the risk of war; changes in newsprint prices and/or printing and distribution costs from anticipated levels; changes in interest rates; changes in pension assets and liabilities; increased competition from newspapers, internet sites or other forms of media reaching the markets we serve; increased consolidation among major retailers in our markets or other events depressing the level of advertising; changes in our ability to negotiate and obtain favorable terms under collective bargaining agreements with unions; competitive action by other companies; difficulties in servicing our debt obligations; other occurrences leading to decreased circulation and diminished revenues from retail, classified and national advertising; and other factors, many of which are beyond our control.

See McClatchy's 2007 Form 10-K filed with the Securities and Exchange Commission on March 1, 2007 for further discussion of risk factors that could affect operating results.

## Item 4. Submission Of Matters To A Vote Of Security Holders:

The Company held its annual shareholders' meeting on May 16, 2007 to vote on two proposals. Shareholders approved all of the proposals by voting as follows:

## 1. Election of Directors of the Board

	VOTES	
	FOR	WITHHELD
Class A Common Stock		
Elizabeth Ballantine	46,813,690	2,495,780
Kathleen Foley Feldstein	46,750,814	2,558,656
P. Anthony Ridder	46,546,767	2,762,703
Maggie Wilderotter	46,743,074	2,566,396
Class B Common Stock		
Leroy Barnes, Jr.	23,786,457	-0-
William K. Coblenz	23,786,457	-0-
Molly Maloney Evangelisti	23,786,457	-0-
Larry Jinks	23,786,457	-0-
Joan F. Lane	23,786,457	-0-
Brown McClatchy Maloney	23,786,457	-0-
William B. McClatchy	23,786,457	-0-
Kevin S. McClatchy	23,786,457	-0-
Theodore Mitchell	23,786,457	-0-
S. Donley Ritchey	23,786,457	-0-
Gary B. Pruitt	23,786,457	-0-
Frederick R. Ruiz	23,786,457	-0-

	FOR	AGAINST	ABSTAIN	BROKER NON-VOTES
2. Ratification of Deloitte & Touche LLP as independent auditors for 2007	28,686,832	22,282	8,290	-0-

## Item 6. Exhibits

Exhibits filed as part of this Report as listed in the Index of Exhibits, on page 35 hereof.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

The McClatchy Company  
Registrant

August 10, 2007  
Date

By: /s/ Gary B. Pruitt  
Gary B. Pruitt  
Chief Executive Officer

August 10, 2007  
Date

By: /s/ Patrick J. Talamantes  
Patrick J. Talamantes  
Chief Financial Officer

## INDEX OF EXHIBITS

<b>Exhibit</b>	<b>Description</b>
2.1*	Agreement and Plan of Merger, dated March 12, 2006, between the Company and Knight-Ridder, Inc., included as Exhibit 2.1 in the Company's Current Report on Form 8-K filed March 12, 2007.
3.1*	The Company's Restated Certificate of Incorporation dated June 26, 2006, included as Exhibit 3.1 in the Company's Quarterly Report on Form 10-Q for the quarter ended June 25, 2006.
3.2*	The Company's By-laws as amended as of June 22, 2006, included as Exhibit 3.2 in the Company's Current Report on Form 8-K filed June 28, 2006.
4.1*	Form of Physical Note for Commercial Paper Program included as Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 27, 2004.
10.1*	Credit Agreement dated June 27, 2006 by and among the Company, lenders party thereto, Bank of America, N.A., as Administrative Agent, Swing Line Lender and Letter of Credit Issuer, JPMorgan Chase Bank as Syndication Agent and Banc of America Securities LLC and JPMorgan Securities Inc. as Joint Lead Arrangers and Joint Book Managers, included as Exhibit 10.2 in the Company's Current Report on Form 10-Q filed for the quarter ending on June 25, 2006.
10.2*	Amendment 1 to Credit Agreement dated March 28, 2007 by and between The McClatchy Company and Bank of America, N.A., as Administrative Agent, included as Exhibit 99.1 in the Company's Current Report on Form 8-K filed April 2, 2007.
10.3*	Amendment 2 to Credit Agreement dated July 30, 2007 by and between The McClatchy Company and Bank of America, N.A., as Administrative Agent, included as Exhibit 10.1 in the Company's Current Report on Form 8-K filed July 31, 2007.
10.4*	General Continuing Guaranty dated May 4, 2007 by each Material Subsidiary in favor of the Lenders party to the Credit Agreement dated June 27, 2006 by and between The McClatchy Company, the Lenders and Bank of America, N.A., as Administrative Agent, included as Exhibit 10.3 in the Company's Current Report on Form 10-Q for the quarter ending on April 1, 2007.
10.5*	Second Supplemental Indenture dated June 27, 2006, between the Company and Knight-Ridder, Inc. included as Exhibit 10.3 in the Company's Current Report on Form 10-Q filed for the quarter ending on June 25, 2006.
10.6*	Fourth Supplemental Indenture dated June 27, 2006, between the Company and Knight-Ridder, Inc. included as Exhibit 10.4 in the Company's Current Report on Form 10-Q filed for the quarter ending on June 25, 2006.
**10.7*	The McClatchy Company Management by Objective Plan Description included as Exhibit 10.4 in the Company's Report filed on Form 10-K for the Year ending December 31, 2000.
**10.8*	



Edgar Filing: MCCLATCHY CO - Form 10-Q

The Company's Amended and Restated Long-Term Incentive Plan included as Exhibit 99.1 to the Company's Report on Form 8-K filed May 23, 2005.

\*\*10.9\* Amended and Restated Supplemental Executive Retirement Plan included as Exhibit 10.4 to the Company's 2001 Form 10-K.

\*\*10.10\* The Company's Amended and Restated 1990 Directors' Stock Option Plan dated February 1, 1998 included as Exhibit 10.12 to the Company's 1997 Form 10-K.

\*\*10.11\* Amended and Restated 1994 Stock Option Plan included as Exhibit 10.15 to the Company's Report on Form 10-Q filed for the Quarter Ending on July 1, 2001.

Edgar Filing: MCCLATCHY CO - Form 10-Q

- \*\*10.12\* Form of 2004 Stock Incentive Plan Nonqualified Stock Option Agreement included as Exhibit 99.1 to the Company's Current Report on Form 8-K filed December 16, 2004.
- \*\*10.13\* Amendment 1 to The McClatchy Company 2004 Stock Incentive Plan dated January 23, 2007, included as Exhibit 10.10 to the Company's 2006 Report on Form 10-K.
- \*\*10.14\* Form of Restricted Stock Agreement related to the Company's 2004 Stock Incentive Plan, included as Exhibit 99.1 to the Company's Current Report on Form 8-K dated January 28, 2005.
- \*\*10.15\* The Company's Amended and Restated Chief Executive Bonus Plan, included as Exhibit 10.12 to the Company's Report on Form 10-Q for the Quarter Ending June 29, 2003.
- \*\*10.16\* Amended and Restated Employment Agreement between the Company and Gary B. Pruitt dated October 22, 2003, included as Exhibit 10.10 to the Company's 2003 Form 10-K.
- 10.17\* Form of Indemnification Agreement between the Company and each of its officers and directors, included as Exhibit 99.1 to the Company's Current Report on Form 8-K filed on May 23, 2005.
- \*\*10.18\* Amended and Restated 1997 Stock Option Plan included as Exhibit 10.7 to the Company's 2002 Report on Form 10-K.
- \*\*10.19\* Amendment 1 to The McClatchy Company 1997 Stock Option Plan dated January 23, 2007, included as Exhibit 10.16 to the Company's 2006 Report on Form 10-K.
- \*\*10.20\* The Company's Amended and Restated 2001 Director Stock Option Plan, included as Exhibit 10.13 to the Company's 2004 Report on Form 10-K.
- \*\*10.21\* Amendment 1 to The McClatchy Company 2001 Director Option Plan dated January 23, 2007, included as Exhibit 10.18 to the Company's 2006 Report on Form 10-K.
- 10.22\* Stock Purchase Agreement by and between The McClatchy Company and Snowboard Acquisition Corporation, dated December 26, 2006, included as Exhibit 2.1 to the Company's Report on Form 8-K filed December 26, 2006.
- 10.23 Contract for Purchase and Sale of Real Property by and between The Miami Herald Publishing Company and Richmond, Inc. and Knight Ridder, Inc. and Citisquare Group, LLC, dated March 3, 2005.
- 10.24 First amendment to Contract for Purchase and Sale of Real Property by and between The Miami Herald Publishing Company and Richmond, Inc. and Knight Ridder, Inc. and Citisquare Group, LLC, dated March 3, 2005.
- 21\* Subsidiaries of the Company.
- 31.1 Certification of the Chief Executive Officer of The McClatchy Company pursuant to Rule 13a-14(a) under the Exchange Act.
- 31.2 Certification of the Chief Financial Officer of The McClatchy Company pursuant to Rule 13a-14(a) under the Exchange Act.

Edgar Filing: MCCLATCHY CO - Form 10-Q

32.1 Certification of the Chief Executive Officer of The McClatchy Company pursuant to 18 U.S.C. Section 1350.

32.2 Certification of the Chief Financial Officer of The McClatchy Company pursuant to 18 U.S.C. Section 1350.

\* Incorporated by reference

\*\* Compensation plans or arrangements for the Company's executive officers and directors