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Buying or Building a Broadcast Station:

Everything You Want — and Need — to Know, But Didn't Know Who to Ask

Second Edition

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by

Erwin G. Krasnow,
J. Geoffrey Bentley,
and Robin B. Martin

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National Association of Broadcasters
1771 N Street N.W.
Washington, D.C. 20036
(202) 429-5376

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PREFACE: A GUIDE TO USING THIS BOOK

This edition of ***Buying or Building a Broadcast Station*** is more than a revision. There are entirely new sections and what remains from the earlier edition has been extensively revised and updated. The book has been enriched by the collaboration of a third author (Robin B. Martin) who has owned and operated a dozen broadcast stations.

This book provides a step-by-step guide to becoming an owner of a radio or television station. It describes the process involved both in applying for a new broadcast station and in acquiring an existing facility. It also provides practical pointers on all aspects of the process.

Section I describes the unique characteristics of broadcasting as a business venture and explains why broadcasting may be an attractive investment. This section also deals with the myths and misconceptions involved in acquiring a broadcast station.

Section II begins by providing pointers on how to assemble an acquisition team. There is a detailed discussion of the various types of acquisition consultants, including a 16-step guide to selecting the right lawyer and a checklist of questions to ask prior to and during the interview. This section also contains an extensive guide to valuing a station and establishing a price for the station. Basic issues such as determining the optimal business organization for an acquisition and taking advantage of changes in the tax laws are dealt with next. (The tax discussion was enriched by the contributions of two tax attorneys, Karl L. Kellar of Jones, Day, Reavis & Pogue, Washington, D.C., and Jana DeSirgh, Cadwalader, Wickersham & Taft, Washington, D.C.)

Section II provides an A-to-Z guide to financing the purchase of a broadcast station, including preparing a business plan, selecting potential lenders, combining sources of financing, convincing the lender, and negotiating the terms of a loan. The remainder of Section II deals with the legal and regulatory aspects of acquiring a station, ranging from entering into a contract to obtaining from the Federal Communications Commission approval for the proposed transaction.

Section III covers how to make the choice between buying a station and entering the business by applying for permission to build a new station. For those interested in applying for a construction permit for a new broadcast facility, the initial challenge involves securing authorization from the Federal Communications Commission to construct the station. This section describes what is involved in preparing an application. It shows how to find a frequency, select a transmitter site, obtain financing and prosecute an application. It also describes the process used by the FCC to choose the "winning" application from a number of competing applicants.

The appendices provide a "gold mine" of useful practical information and illustrative examples. Most readers regard appendices as "after-thoughts." However, the appendices in this book are an integral part of the text and should be explored and used extensively.

Appendix A is a glossary of financial terms used throughout the book.

Appendix B, "Evaluating and Financing the Broadcast Acquisition," was prepared by Richard L. Geismar. It contains a pragmatic description of the philosophical, operational and financial aspects of acquiring broadcast properties. This description is followed by a discussion of actual situations, including the rationale that went behind the decisions of both the seller and the buyer and the practical aspects of the activities of each. The actual situations include an FM station and an AM-

FM combination in a medium market, three top-rated facilities in major markets, a new start-up FM facility, a turn-around AM facility in a major market, and network-affiliated and independent VHF and UHF television stations.

Appendix C consists of station and market review checklists for the prospective purchaser.

Appendix D provides a point-by-point discussion of the ingredients of a model financing proposal. The discussion of a model financing proposal is followed by a hypothetical proposal for the acquisition of a radio station by a first-time buyer which closely tracks the model proposal and therefore illustrates the type of information appropriate to a proposal and a workable style of presentation.

Appendix E, prepared by David E. Schutz, Managing Director, ComCapital Group, contains a detailed discussion of the use of leveraged buyouts to acquire a broadcast station. A leveraged buyout is an increasingly popular method of financing the acquisition of a station wherein borrowed money is used to finance the majority, if not all, of the purchase price. The station's operating profits are then used to repay the loan. Appendix E includes as examples the leveraged buyout of both a radio and a television station.

Appendix F, a Financial Resource Index, is based on information contained in the *1987 Directory Of Lenders And Investors To The Broadcast Industry*, a booklet compiled and published by Frazier Gross & Kadlec, Inc. It is a guide to potential sources of capital and lists institutions which have participated in one or more broadcast acquisitions. Appendix F is divided into two main sections—Lenders and Investors—with subsections under Investors that include investment banks, venture capital firms, insurance companies and other investors.

Appendix G contains an outline of typical provisions contained in an asset purchase agreement for an acquisition of a broadcast station.

In summary, this book contains everything you want—and need to know—about buying or building a broadcast station. As you read it, we caution you to keep in mind that the many rules, regulations, bank policies, economic conditions and market trends cited in this text are ever-changing realities. And, while this book presents a "snapshot" of these interactive elements at the time we go to press, the reader should carefully check the status of these elements as they bear on your decision to buy or build a broadcast station.

ACKNOWLEDGEMENTS

Countless people have influenced this book, including virtually everyone we have dealt with in the broadcast acquisition process. However, we wish to single out the following individuals for their special willingness to provide their insights and expertise: Professor Michael Botein, New York Law School; Tom Kellar, Bill Kennard and Dean Brenner of Verner, Liipfert, Bernhard, McPherson & Hand; Frazier, Gross & Kadlec, Inc.; Tom Buono, Broadcast Investment Analysts; Richard L. Geismar; David E. Schutz, Managing Director, ComCapital Group; Karl L. Kellar, Jones, Day, Reavis & Pogue; and Jana DeSirgh, Cadwalader, Wickersham & Taft.

Some portions of this book have previously appeared in the following publications:

- Erwin Krasnow and Jill MacNeice, *101 Ways to Cut Legal Fees and Manage Your Lawyer* (Washington, D.C.: Broadcasting Publications, 1985).
- Erwin Krasnow and Julian Shepard, "Myths and Misconceptions About Buying and Selling Radio and TV Stations," *Broadcasting*, September 23, 1985.
- Erwin Krasnow and Dean Brenner, "Choose the Right Acquisition Lawyer," *Radio & Records*, March 27, 1987.
- Erwin Krasnow and Michael Botein, "Broadcast Station Acquisitions: Valuation, Debt/Equity Financing, Preparing to Borrow," *New York Law Journal*, June 6, 1986.
- Erwin Krasnow and Michael Botein, "Financing to Buy a Broadcast Station—Preparing a Business Plan, Convincing Lenders," *New York Law Journal*, June 13, 1986.
- Frazier, Gross & Kadlec, Inc., *1987 Directory of Lenders and Investors to the Broadcast Industry* (1987).
- David Schutz, "Leverage Buyouts," memorandum prepared for the National Association of Broadcasters.
- Robin Martin, *Broadcast Lending* (Washington, D.C.: National Association of Broadcasters, 1984).
- Richard Geismar, "Evaluating and Financing the Broadcast Acquisition," in *Investing in Broadcast Stations* (Federal Publications, Inc., 1987)
- CCG, Inc., *Minority Ownership of Broadcast Facilities* (Washington, D.C.: Federal Communications Commission, 1979).

We would be remiss if we did not acknowledge our debt to Teri Lepovitz, Vice President, Station Services, National Association of Broadcasters, whose support made this edition of the book possible. She was tolerant of the desire of the authors to make multiple last-minute revisions in order to reflect new developments. Be advised that the book you hold in your hands represents our best shot at a moving target.

Erwin G. Krasnow
J. Geoffrey Bentley
Robin B. Martin

I. BROADCASTING AS A BUSINESS VENTURE

There are nearly 10,000 commercial broadcast stations in the United States, including over 1,000 television stations, more than 4,800 AM stations, and about 4,000 FM stations. For those considering the possibility of entering the business of broadcasting, the challenge is to make a sound investment. While broadcast ownership can be quite profitable, a broadcast license is not a license to print money. The challenges to successful operation are great. Broadcasting is a competitive business, and to to succeed, broadcasters must marshall considerable creative and managerial talents to deliver their product—the listening and viewing audience—to advertisers.

This section deals with the threshold question of whether broadcasting is the right investment for you. First, there is a discussion of why broadcast stations may be a good investment. Second, an overview is given of the technical, economic and legal aspects of broadcasting as a business. The section ends with an analysis of the most common myths and misconceptions concerning the process of acquiring a broadcast station.

A. WHY BROADCAST STATIONS MAY BE GOOD INVESTMENTS

Although broadcasting is very demanding in the combination of management and people skills required and may be more sensitive to general trends in the economy than many industries, there are many reasons why acquiring a broadcast station can turn out to be a good investment.

Protected Market Position

Broadcast stations operate within government-protected oligopolistic markets under licenses granted

by the FCC. Licenses for radio stations are for seven-year terms; television station licenses are for five years. Historically, both radio and television licenses are generally routinely renewed, with the exception of a relative handful of instances of egregious broadcaster misconduct. Technical limitations restrict the number of stations in a given market, thus creating an inherent "franchise" value, regardless of a station's operating performance, based on the owner's ability to transfer a protected right, the FCC license. On the balance sheet, the value of the license shows up under the catch-all heading of goodwill, but broadcasters have a much more meaningful term: "stick" value—that is, the value of owning a particular facility in a given market, assuming the station was on the air but had no meaningful audience or sales income. It would not be unusual for an experienced broadcast investment analyst to estimate the "stick" value of a 100-kilowatt FM station in a medium-size market with average estimated retail sales and population growth at anywhere from $3.5 to $5 million.

High Operating Leverage

As previously observed, broadcasting is a service business. No inventories or materials are required to create the service that is provided and rapid turnover of cash is common because billing terms are relatively rigid. A low capital requirement per dollar of revenue is the normal expectation. (That $3.5 million FM station may have an investment in physical plant of no more than $500,000.) As a result, broadcasters have the ability to achieve high operating profits as a percentage of sales.

Active Trading Market

The sale of broadcast stations is not only regulated but also publicly reported by the FCC. This generally available body of knowledge about prices is of considerable value in facilitating station sales. There is a continual turnover of stations each year. According to the February 9, 1987, issue of *Broadcasting* magazine, 1,139 AM and FM stations changed hands in 1986; 145 television stations were sold in the same period. The dollar volume of reported station sales in 1986 was twice that for 1985, although 1986 was unusual (and therefore not a particularly useful benchmark) for at least two reasons: (1) a huge volume of year-end transactions to avoid disadvantageous effects under the revised tax law, and (2) probably due to the year-end rush, an unusually large number of transactions approved by the FCC but not consummated because of the inability of many buyers to put together complex financing packages in a relatively short time period.

A review of 453 radio station sales in 1985 and 1986 showed generally increasing prices for radio stations. Compiled by David Schutz, managing director of Com-Capital Group, a New York-based investment banking firm, the study *(Radio Station Transfers—1987)* showed that 66 percent of the stations were sold at a profit, 30 percent sold at a loss and four percent sold at their previous price. FM stand-alones led the list with price increases representing an average annual (compounded) growth of 25 percent. AM-FM combinations showed an average 16 percent increase in value (also compounded).

TABLE 1

Appreciation (Depreciation) in Station Values

	Station Types			
	AM-Only	FM-Only	AM/FM	All Stations
Resold at Higher Price (#)	77	93	117	287
Resold at Lower Price (#)	90	11	31	132
Resold at the Same Price (#)	8	2	4	14
Average Change in Price (Gross)	+18%	+248%	+314%	+179%
Average Ownership Period	4.6 yrs	4.2 yrs	4.6 yrs	4.5 yrs
Average Annual (Compound) Change	- 2%	+ 25%	+ 16%	+ 11%
Median Annual (Compound) Change	0%	+ 19%	+ 11%	+ 7%

Experts generally agree that in 1987 radio station prices have continued to increase based on strong demand, although in television the increase have been less dramatic. The reason for radio's particularly strong growth is continued expansion of the radio listening audience and concommitant increases in radio advertising revenues. There is no denying the long-term trend declining interest rates through approximately the first quarter of 1987 has contributed to the trend in station prices over the past five years.

B. AN OVERVIEW OF BROADCASTING AS A BUSINESS VENTURE

Broadcast stations range from small AM and FM radio outlets serving rural and suburban communities to powerful VHF television stations blanketing major metropolitan areas. Within that range are a great variety of stations and markets. Stations may be very small businesses, operating quite efficiently with a handful of employees. On the other hand, VHF television stations in the largest markets may employ hundreds of persons. This diversity is reflected in the worth—and, therefore, selling price—of existing stations, and in the potential income and appreciation of new stations.

Commercial broadcasting began in the 1920s with the AM radio band. Television broadcasting began in the late 1940s and FM radio started to enjoy steady growth in the middle 1950s. During this 60-year period, the competitive environment has been one of continual change. At one time, AM was the dominant medium. Now, however, listeners have shown a distinct preference for FM's superior audio quality and FM has moved ahead of AM. For nearly 20 years, almost all television stations were VHF; now the VHF spectrum is virtually exhausted and there are more than 460 UHF commercial stations.

Historically, there were a relative handful of stations in each market and the principal competition for broadcasting came from newspapers. Now, however, there are many more stations and broadcasters must compete for audience loyalty not only among each other but also with a myriad of non-broadcast services, including video and audio programs distributed by cable systems and video cassettes. Broadcasters' responses to these competitive challenges are the same now as before: providing program services that meet the audience's interests. FM stations, particularly in major markets, seek to differentiate themselves by programming to reach specific demographic groups (for example, "women, 25-54" or "adults, 18-34") with particular program styles, known as formats. Commonly recognized formats include Contemporary Hit Radio ("CHR"), Album-Oriented Rock ("AOR") and "Beautiful Music," sometimes known as "Easy Listening." These different formats provide efficient ways for retailers to spend their advertising dollars aimed at listeners with similar incomes and common spending habits.

Several years ago, many AM radio stations turned to innovative formats, such as two-way talk, all-news, foreign-language and religious programming. AM licensees have recently received FCC permission to broadcast in stereo, but only a few AM stations have gone to stereo because most listeners do not have AM stereo receivers.

Some television stations also are seeking to reach more specialized audiences with foreign-language, religious, or family-oriented programming. Others are trying to develop more appealing and informative local programs and to acquire programs from more diverse sources. Some television stations are broadcasting in stereo to give viewers better sound.

One way in which broadcasters respond to competition is by providing ancillary services. Many radio stations program channels on the local cable television system. FM stations may offer background music and business information services on a subcarrier of the main FM channel.

In the future, continually updated encoded information services, called teletext, will be part of the standard television broadcast signal. This service will give viewers a broad directory of information such as the weather; stock market reports; airline, railroad and bus schedules; menus of local restaurants; schedules of movies, plays and exhibits at local theaters and museums; and a vast almanac of general information.

Many other technological advances are being considered, tested and developed by the broadcasting industry. These include High Definition Television (HDTV) which will permit home TV screens several feet square with a picture as sharp as the 21-inch sets that are now common. One popular electronics manufacturer already has marketed a portable television set the size of a portable radio with a 1-inch screen and another is introducing an even smaller set with a 2-inch screen.

Essentially, broadcasters make money from commercials they sell to advertisers. Unlike newspaper publishers, broadcasters have a limited amount of advertising to sell. Newspapers can expand or contract their size depending on the amount of advertising they have on any given day. For example, Monday's newspaper is usually thin and Thursday's newspaper is usually thick. This is not because there is always more news on Thursday than on Monday. It is because more retailers advertise on Thursday to attract the weekend shopper than do on Monday. In contrast, the broadcaster has only 168 hours a week in which to broadcast.

Both print and broadcast media have one thing in common and that is that they are in the business of delivering advertisers' messages to potential customers. The more listeners, viewers or readers that each medium can attract, the more money that medium can charge its advertisers. In fact, the price that is charged for advertising is often based on the cost per thousand potential customers reached.

Thus, the balance for which a successful broadcaster strives is to air programming that will attract the highest number of listeners or viewers so the station can charge advertisers the highest price for commercials. Still, the broadcaster cannot overpay for programming relative to the revenue the station receives from selling a limited number of commercial minutes.

Broadcasting, then, is a very people-oriented business. Broadcasters must meet audience preferences. They must have the creative talents necessary to produce the station's programming. They must also develop support among local advertisers. They must have strong ties to the local community. But they must also be effective managers. Too much attention to the creative side could cause the broadcaster to go broke. But constant attention paid only to the bottom line also probably will be

unsuccessful. Successful operation revolves around the constant interplay between these two facets of operations.

C. TEN COMMON MYTHS AND MISCONCEPTIONS

This section is intended to dispel some of the common myths and misconceptions about acquiring a broadcast station. The following is a list of ten such myths and misconceptions and a brief discussion of the danger of a simplistic and overly generalized approach to the acquisition process.

1. The Myth Of Comparable Pricing: Oranges And Apples

Estimating the value of a broadcast property based on the recent sales price of a "comparable" property in another market is a perilous exercise. At the very least, one needs to consider such factors as the facilities of the station, the growth rate of the market, the status of the competition and the structure of the transaction.

2. The Myth of Gross Revenue Formulas: Gross Input, Gross Output

One of the oldest myths is the oft-repeated formula of "2 to 2 1/2 times gross revenues equals selling price." The formula has its origins in the attempt to correct the loose accounting practices of a number of individual station owners. (Group owners are more likely to have financial statements that follow generally accepted accounting principles.) Historically, the profit statements of stations owned by individual entrepreneurs were distorted because the owners, rather than paying income taxes on bottom line profit, found ways to "expense" some items that otherwise would not be deductible. Buyers would compensate for this distortion by using the gross revenue formula rather than a multiple based on cash flow.

3. The Myth of Cash Flow Multiples: Watch Out For The New Math

Care must be taken in defining operating cash flow, which is pre-tax income before depreciation, amortization, interest and extraordinary expenses. Cash flow multiples, while useful, do not account for structural differences within a market, new competition (e.g., the construction of a new station), the change in management of a sleepy competitor, and the impact of other media such as cable television and newspapers.

4. The Myth That Current Revenues and Profit Growth Are Constant: The Herd Instinct Run Amok

There are "boom times" when revenue typically grows between 15% and 20% annually and cash flow growth is even greater than that. Myopic buyers mistakenly assume that revenue and profit growth will continue at peak levels for many years into the future. Conversely, when the economy or values are soft, many buyers blithely assume that such conditions are a long-term inevitability.

5. Real Estate Myths: Lots of Value

The independent value of real estate does not add proportionately to a station's fair market value. A station's antenna site is an essential operating asset that often cannot be used for any other purpose. Therefore, its value separate from the broadcast property is irrelevant unless the tower of the station can be easily moved.

6. The Myth of the 100% Leverage Purchase: Don't Bank On It

For most purchases, it is foolhardy to assume that banks or other lending institutions will supply all the necessary funds for an acquisition. For one reason, the lender's need for security and a purchase price equaling seven-to-ten times cash flow effectively stretches this cash flow too thin when 100% of the acquisition price must be repaid with interest.

7. The Lure of Turn-Arounds: An Attractive Nuisance

The belief that all properties are underdeveloped and have upside potential is a myth. Nevertheless, many purchasers acquire a station based on the blind faith assumption that they are smarter and better managers than the current owners. Turn-arounds generally demand considerable experience in the broadcast business and, as a general rule of thumb, should not be pursued by a first-time buyer.

8. The "Greater Fool Fallacy"

One of the major reasons for higher cash flow multiples is the "Greater Fool Fallacy" which states: "Regardless of what I pay for the station, there is a person out there willing to pay more when I am ready to sell." This theory has encouraged some buyers to pay astronomically high prices.

9. The "No Broker Is Best, One Broker Is Next Best" Theory

Many first-time buyers do not recognize the value of using qualified brokers to locate a property for them. Brokers play a useful role in bringing prospective buyers together with station owners desiring to sell their stations. Similar to the real estate business, most broadcast acquisitions involve the services of brokers. However, unlike the real estate business where multiple listings of properties are common, some media brokers tend to have exclusive listings.

10. The Myth That Murphy's Laws Are Inapplicable

Watch out for the following three of Murphy's Laws: (1) if something can go wrong, it will; (2) nothing is as easy as it looks; and (3) it always takes longer than you think. Some buyers underestimate their financial needs and are seriously undercapitalized. They underestimate expenses, overestimate revenues and do not allow for contingencies.

Many prospective buyers fail to research and evaluate a given market and do not understand the implications of a station's current and potential technical facilities. In particular, buyers should be leery of taking at face value a statement by the seller such as, "don't worry about the tower—you can move it closer to the big city."

II. BUYING A BROADCAST STATION

One point must be clearly understood about entering the broadcasting business. Whether the chosen avenue is the purchase of an existing station or the construction of a new one, the process is time consuming. In purchasing a broadcast station, much time will be spent in seeking FCC approval. It is hard to predict exactly how long FCC approval will take because of the variable factors involved. It can be done in as little as 45 days, with the normal time usually being 50 to 60 days (although some approvals take longer.)

Approval to build a new station is likely to take even more time, especially when the FCC requires a comparative hearing to choose among competing applicants. Then, after the FCC has finally awarded a construction permit there is the actual physical construction of the station: choosing the proper site for a transmitter, buying the land, purchasing equipment, getting the engineering done, securing financing, obtaining building permits and hiring staff—just to name a few of the steps involved in the time-consuming process of creating a new broadcasting property.

In other words, the acquisition or building of a broadcast station is not like the acquisition of a hardware store, which can take place as soon as the financing is arranged and the legal papers drawn up. From the time an agreement for the sale of a station is reached until the time the station actually changes hands can take six months to a year, and in some cases even longer. FCC proceedings to award new stations licenses commonly extend for a year or two or more.

In a sense, the long delays involved represent an important lesson for the aspiring broadcaster. If he or she is too impatient to take the time to do things by the book, as the FCC's substantive regulations often require, another line of business probably should be considered.

A. UTILIZING THE SERVICES OF CONSULTANTS: ASSEMBLING THE ACQUISITION TEAM

Given the nature of the broadcasting business, a wise buyer and a wise seller will enlist all the help they can get to give them the best competitive edge. There are a variety of professionals to provide this advice, including brokers, lawyers and consultants.

1. Dealing With Brokers

Although there are several ways to determine what stations may be available for sale, most individuals entering the business consult with one of the 50 or more brokerage firms specializing in communications properties.

The knowledgeable buyer will approach a number of different brokers. Unlike the real estate business where there is a multiple listing service that acts as an exchange and allows all brokers to have all listings, each broker has an exclusive set of listings that are normally not shared with other brokers. Thus, to ascertain what is available on the market, a number of brokers should be consulted.

While a broker's commission is usually paid by the seller, it often is an item of negotiation between the parties. In some transactions, the buyer and seller each pay half of the broker's commission. Traditionally, a broker's commission is based on 5% of the first million dollars of the sales price; 4% of the second million dollars; 3% of the third million dollars; 2% of the fourth million dollars; and 1% of the fifth million—any balance is negotiated.

Prospective buyers should understand that one of the important functions a broker performs for a seller is to qualify a prospective buyer or to weed out the curious lookers and casual shoppers so the seller doesn't waste his or her time with prospects who are either not seriously interested in buying or not financially capable of buying. In the market that currently exists in broadcasting properties, the supply of buyers exceeds that of available quality properties. Therefore, it is a responsibility of the prospective buyer to establish that he or she is serious and is qualified to pay the costs of acquiring a broadcasting property.

Moreover, the heightened demand for broadcasting properties has motivated some brokers to press station owners who were not intending to sell into considering a sale to the right buyer for the right price. This makes the broker's screening of prospects even more important to demonstrate his or her ability and good faith to the broadcast property owner.

A matter that needs to be established between the prospective buyer and the broker at the outset is the type of property the buyer is seeking and its general geographic location. The buyer should be aware that very few brokers operate on a national or industry-wide scale. The listings of most brokers tend to be limited to a regional geographic area. Also, some brokers tend to specialize in a certain type of communications property, such as medium-sized FM stations or independent television stations. Accordingly, at the beginning, prospective buyers need to decide what it is they want in a broadcasting property and then seek out the brokers who specialize in that type of property.

When dealing with a broker, prospective purchasers must be prepared to describe the general requirements of the desired property and to show their financial qualifications. (Brokers, in particular, are frequently confronted by unsophisticated buyers, and can be expected to weed out those who lack the resources to move quickly.) Thus, prospective purchasers will need to inform the broker concerning their financial resources for the purchase (both personal assets and contemplated additional investment capital or loans), preferences as to the type of facility, preferred geographical area, information about the broadcast experience of the buyers and their associates, and the extent of their personal involvement on a day-to-day basis following the acquisition.

As noted before, the broker's function is to bring prospective purchasers together with station owners desiring to sell their properties. Once the prospect has shown the financial ability to complete the sale, the broker should then make available at least skeletal financial data about the property (revenues, expenses, depreciation, interest and cash flow) and more detailed financial information to those who evidence a serious interest. The broker usually will be the most readily available source of much of the information needed to make a well-reasoned decision about buying the station (including market trends and the station's share of the market). However, obtaining independent counsel on such matters is imperative.

If there is interest in any of the properties the broker has listed, the broker can arrange an inspection visit which should be done on a confidential basis so as to protect the existing operation and not generate disturbing rumors. If the prospective buyer wishes to submit a bid after visiting the station, the broker can help negotiate the price and terms of a purchase.

At least two points should be kept in mind by the prospective buyer at this point in the transaction. First, the early impressions of the station's physical facilities and personnel may be misleading. A poorly run station

in financial trouble with an unpopular broadcasting format and programming plus ineffective personnel may be disguised by an impressive physical plant and pleasant-mannered personnel. While a technically up-to-date physical plant is an important asset, the most important attributes of a station are its ability to reach audiences and the capability of management to translate the audience into revenue and a solid bottom line.

Second, prospective buyers need to remember that the broker's final allegiance in any negotiation is to the person who is paying his or her commission, which in most situations is the seller. Brokers will not object when the buyer's lawyer and/or accountant are brought in at this stage. In addition to assisting in the negotiations, the buyer's lawyer and accountant can recommend advantageous ways to structure the financing of the acquisition, including tax shelter opportunities that stem from opportunities to recapitalize the fixed assets, taking depreciation on certain types of intangible assets, etc.

2. Choosing a Lawyer

Early in the process of locating and negotiating the purchase of a station, the prospective buyer should be working with a lawyer whose practice includes handling the acquisition and transfer of communications properties.

The reasons for utilizing a lawyer are fairly self-evident. The buyer needs advice on the most advantageous way to finance the purchase and complete the acquisition, including the tax and other consequences of the various business forms and methods of purchasing the property. A lawyer's advice is important in drafting the sale-purchase agreement as well as in the preparation of a prospectus or offering memorandum, if the prospective buyer contemplates enlisting the support of investors or in the negotiation of loan documents and preparation of security instruments when the financing will be coming from a lending institution.

Beyond these normal roles that a lawyer plays in most business transactions, the purchase of a communications property has the unusual aspect of requiring the approval of the FCC on even some of the minute details of the transaction. For example, the FCC not only reviews the qualifications of buyers, it must also review a host of contractual provisions in the sales purchase agreements, including control of station operations, preservation of station business, certain covenants by the seller and the timing of the closing of the sale. Many of these regulatory matters must be included in disclosure documents prepared for potential investors. Additionally, the drafting of loan agreements, promissory notes, security agreements, stock pledges and other documents requires the advice of an attorney.

A further reason for utilizing a communications lawyer early in the process has to do not with the lawyer's specialized legal knowledge and skill, but with his or her knowledge of the history of a specific property. He or she will know, or can find out about who has previously owned and operated the property, what kind of financial results it has had, how well it has been operated, the reputation of the seller and the station, and other factors that will help the prospective buyer evaluate the property.

In spite of all the essential work that an attorney can do in connection with the purchase of a broadcast property, prospective purchasers should also understand the lawyer's limitations. It is the lawyer's function to protect his or her client's best interests but, in most cases, the negotiation of business terms of the transaction is best left to the buyer.

Because a lawyer cannot sense every nuance of the buyer's mind, in many cases, interjecting lawyers into purely business negotiations may prolong the matter and yield the wrong result. The lawyer cannot always know on what business points the buyer wants to stand firm and on what he or she will be flexible. In short, the attorney plays a vital role, but not the entire role. There are roles that properly must be played by others, including the buyer.

The following is a list of points to keep in mind in choosing and using a lawyer in an acquisition.

a. Use a Lawyer Early: An Ounce of Prevention

Two months after the general manager of a radio station in the Northeast acquired a controlling interest in the licensee corporation, he was threatened with a fine and a possible revocation of the station's license. A competitor had requested that the FCC institute revocation proceedings after discovering that the general manager had consummated the acquisition without asking the Commission for prior approval of his stock purchase, a violation of Section 310 of the Communications Act.

All too often, lawyers are called in after the damage has been done, when an individual is on the verge of being sued or of losing a transaction. True, 11th hour attention from a good lawyer can limit the damage, but it will be too late to keep legal costs low. The most cost-effective service your lawyer can give you is "preventive" or "anticipatory" legal advice; he or she can identify potential problems and suggest corrective measures to avert unnecessary legal disputes. But remember that the old adage about bankers applies to lawyers as well: "The best time to get acquainted is when you don't need the money." Don't wait for the first hint of a legal problem. Consult a lawyer in the planning stages—before beginning to negotiate an acquisition.

b. Evaluate Your Legal Needs

You need a lawyer, a top-notch professional. But how do you find one? Before you begin to look for the right lawyer, determine the specific kind of assistance you need. You also should try to determine what size firm would be appropriate for your needs and whether you would benefit by retaining more than one law firm. You may need, for example, a lawyer familiar with the FCC for some matters and a local lawyer for others. Usually, in an acquisition, a full service law firm can handle the FCC filings as well as executing the necessary corporate work. Figure out what will work best for you before you begin looking at specific firms.

c. Seek a Specialist for Special Problems

Generally, lawyers specialize in one or more areas of the law, such as communications law, banking or corporate law. Many focus on a particular subspecialty. This practice is particularly common in communications, where some lawyers work only on broadcast-related matters while others deal solely with cable systems or common carriers. Look for an expert in the particular type of transaction you are considering, or, even better, look for a firm with specialists in various areas affecting the transaction. A lawyer who is unfamiliar or only marginally familiar with that area of the law may not do as satisfactory a job as the specialist. Or the lawyer simply may refuse to handle the matter in the first place. If the lawyer does represent you, he or she probably will take much longer and be more expensive, and may give you inappropriate advice or more conservative advice than a specialist.

d. Determine the Scope of the Service That You Need

Do you want a lawyer for a one-time legal service or are you seeking a long-term relationship to handle continuing or recurring problems? A solid, long-term relationship with a good lawyer who is familiar with your company will result in better and more appropriate legal advice and business counseling. You don't need to engage in an elaborate search for a lawyer for a one-shot, routine legal service such as drafting an option for an antenna site or reviewing a lease for your studios. You should, however, be much more careful in choosing a lawyer for a complex matter, such as handling your acquisition, and continuing or recurring problems and tasks, such as protecting your broadcast license.

e. Consider the Size of the Firm, But Hire A Lawyer, Not a Firm

The resources available to a lawyer can greatly affect the kind of service you receive. Approximately 50 percent of all lawyers in private practice in the United States are sole practitioners. Firms can range in size in small practices of under a dozen lawyers to mega-firms with as many as 150 lawyers or more. In the area of communications law, many lawyers practice in legal "boutiques"—small firms that handle communications law only; others practice in medium and large-sized firms.

A sole practitioner or a lawyer in a very small firm might give you extra attention because he or she has only a handful of clients. On the other hand, the lawyer may have only limited resources. Medium-to-large-sized firms may be somewhat less personal, but they generally have extensive libraries, computer research facilities and a sufficient number of lawyers and support staff to handle acquisitions of all sizes. These medium-to-large-sized firms are more apt to be able to handle acquisitions and any associated problems on short notice. Furthermore, with specialists in additional areas such as real estate, litigation and business law, they can offer you the legal equivalent of one-stop shopping. Most law firms will make available to you resumes or brochures describing their practices and listing representative clients and areas of specialization.

A law firm's size and reputation are important, but the success of your acquisition depends on the individual lawyer who will be doing the work. The quality of lawyers can vary, so select the particular lawyer first, and then look at the law firm and its resources in the communications industry.

f. Search for a Lawyer in a Systematic Way

Be as thorough in your search for a lawyer as you would be in search for a sales manager or corporate vice president. Shop around. Meet the top candidates. Question them closely and check references. Even if you know nothing about the area of law in which counsel is needed, the advice here will help you find a good lawyer.

g. Get Recommendations from Colleagues

Begin your search by getting recommendations from business associates who have had legal problems or needs similar to yours and were fully satisfied with the service they received. If you already have a lawyer who does not have expertise in the particular kind of legal service you need, seek his or her recommendations. Accountants, acquisition consultants, bankers, media brokers, engineers and other non-lawyer professionals you respect also can provide valuable suggestions. A good word is not enough—ask the individual about the services provided, the fees and the results.

h. Watch Out for Referral Fees

If you interview a lawyer who has been recommended by another lawyer, ask about referral fees. Such fees, which include forwarding fees, cash commissions and

fee-splitting, are justified only if the recommending lawyer will be working on your case or has already worked on your case and has not yet billed you. Rule 1.5(e) of the American Bar Association's Model Rules of Professional Conduct requires (1) that any division of fees among lawyers be made in proportion to the amount of work performed by each lawyer; (2) that there be full disclosure to and consent of the client; and (3) that the total fee be reasonable. You should note, however, that although referral fees are deemed to be unethical under the Model Rules, they are permitted under lawyer disciplinary rules in Massachusetts, California, Maine and Texas. In any event, do not tolerate any fee-splitting arrangement in which the lawyer making the referral has not provided legal services of value to you.

i. Use Directories to Check Credentials

Use directories only for obtaining additional information and checking the credentials of the lawyers already on your list of candidates. The most comprehensive directory is the *Martindale-Hubbell Law Directory*, available in most public libraries. It lists lawyers nationwide by name, geographical location and educational degrees and carries display advertisements which provide details on the background of a firm's lawyers, including education, honors, professional activities, publications, areas of specialization, and sometimes their major clients.

Other directories include *The Lawyer's Register by Specialties and Fields of Law*, the *Attorney's Register*, the *U.S. Lawyer's Referral Directory* (which publishes state and regional editions) and state-by-state *Blue Books of Lawyers* (published by the Legal Directories Publishing Company). One of the most comprehensive publications is the *Directory of the Legal Profession* published by the National Law Journal, an 1,100-plus-page tome covering over 300 large, general practice firms in 79 cities and over 250 specialty firms. It contains information ranging from billing rates to average salaries of associates.

j. Use Lawyer Referral Services Cautiously

Lawyer referral services, which usually are listed in the Yellow Pages, identify lawyers and their areas of specialization. The quality of these referral services varies widely. Some require minimum standards—such as experience in the area and accreditation by the state bar—before listing a lawyer as a specialist. Others have no requirement for a listing beyond payment of a fee by the lawyer. Many lawyers who specialize in communications or other types of corporate law do not ask to be listed because they believe that important clients would not use referral services.

Referral services sponsored by local bar associations may be more reliable than commercial referral services. Most bar associations publish lists of local lawyers with some rudimentary information about their credentials and expertise. Professional legal associations, such as the Federal Communications Bar Association (FCBA), publish lists of the names and addresses of their members. *Broadcasting/Cablecasting Yearbook* publishes a list of FCBA members and law firms active in communications law. These lists do not contain any biographical data.

k. Do Some Comparison Shopping Before You Decide

Make a list of candidates, check credentials and reputations, arrange to interview two or three of the top contenders and then choose the one who seems most qualified to deliver the services you need at a price you can afford. This process may be time-consuming, but if your legal problems are important to you, the time will have been well spent.

l. Use a Personal Interview to Make the Right Choice

The personal interview is the most important step in your effort to find the right lawyer. Through the interview you will learn about the lawyer's background, legal practice, rates and personality. At the same time that you are learning about the lawyer, you can help lay the groundwork for future relations by establishing yourself as a serious client who cares about quality legal service.

m. Ask the Prospective Lawyer the Right Questions

Prepare for the interview as thoroughly as possible. Know the kind of legal service you want, and draw up a list of questions that will reveal the candidate's qualifications. The end of this section has a checklist of questions to ask prior to and during the interview. It may be helpful to send the lawyer a brief sketch of your problem or background materials on your company so that he or she can be better prepared.

Most lawyers offer an exploratory session for free, but some do charge for this service. Before the interview, find out if there will be a charge. If there is a charge, request that it be credited toward fees for initial services.

During the interview, discuss the details of your problem with the lawyer. Does the lawyer do a good job of listening? Does the lawyer ask you probing questions? Has the lawyer had any recent experience with acquisitions like yours? How long did it take to complete the last transaction and what was the approximate cost? Ask for names and telephone numbers so you can contact these clients for an evaluation of the lawyer's performance.

Try to get a sense of what it will be like to work with the lawyer. Is the lawyer's style and approach to lawyer-

ing compatible with your idea of the type of lawyer you want to represent your company? Is the lawyer willing to work closely with you and keep you apprised of your case? Will there be open communication? Don't trust a lawyer who does not talk candidly and openly.

Will the lawyer do the work personally? If so, what are the lawyer's commitments to other clients (especially his or her travel and litigation schedule) and how will they affect the lawyer's ability to devote time to your matter? Does the lawyer plan to delegate some or all of the work to others in the firm? If others will be involved, who are they and do they have the requisite ability and experience? What impact will their work have on your legal bills? Get the names of all those who will be involved, and ask to meet with them. Also, get an assurance that the lawyer will supervise any work performed by others in the firm.

What are the lawyer's strengths and weaknesses? What is the lawyer's background? If you are interviewing a communications lawyer, find out if he or she previously worked in the communications industry, for a government agency such as the FCC, or for one of the industry trade associations. What other kinds of experience does the lawyer have? Correlate the breadth of this experience and the relevance of that experience to your problems.

Don't hesitate to talk about fees and out-of-pocket costs. What are the estimated fees? What are the billing

CHECKLIST OF QUESTIONS TO ASK PRIOR TO AND DURING AN INTERVIEW WITH A LAWYER

The questions which follow are suggestions.
How many you ask is a matter of judgment and discretion.

Prior to the Initial Interview

- ☐ Will there be a charge for the exploratory session?
- ☐ If there is a charge, how much will it be? Will this fee be credited toward fees for initial services?
- ☐ Do you currently have or anticipate any conflict of interest?
- ☐ Are you available to handle this case or matter?

During the Interview

- ☐ What kind of clients do you represent?
- ☐ Do you have clients of comparable size in the broadcasting industry?
- ☐ In addition to client matters, what other experience do you have that would be relevant to representing my company? For example, have you worked at a government agency or an industry trade association?
- ☐ Do you have any recent experience with acquisitions like mine?
- ☐ Could you give me some examples?
- ☐ What was the outcome, and approximately how much did you charge the client?
- ☐ Might I have the names and telephone numbers of those clients and your permission to call them?
- ☐ Why are you particularly qualified to handle this acquisition? What special background or expertise do you have that would be useful?
- ☐ Will you be doing all of the work? If not, will you introduce me to the other people working on my case or problem?
- ☐ Will you provide the necessary supervision of work performed by others in the firm?
- ☐ How long do you estimate it will take to complete my transaction?
- ☐ How will you keep me apprised of the progress in the transaction?
- ☐ What will be the fee arrangement for handling this matter?
- ☐ How much do you estimate the total fees will be?
- ☐ What is your billing procedure? Will the bills itemize the legal work done?
- ☐ Will you provide me with a contract or engagement letter describing the fee and billing arrangements on what we have agreed?

procedures and payment schedules? Is the lawyer sensitive to your desire for cost controls? Will the lawyer provide a contract or letter of agreement delineating the terms of representation, including the billing arrangement? Insist on getting the fee arrangement in writing.

Are there any potential conflicts of interest? Your lawyer is under an ethical obligation to be loyal to you, the client. If the lawyer represents clients whose interests are adverse to yours, he or she will be in the position of having to choose between serving your interests and those of another client. This matter is especially important in the communications industry, where lawyers or their firms often are asked to represent media competitors in the same market. Some communications lawyers even own broadcast properties or hold interests in other telecommunications ventures. Thus, when you retain a lawyer, ask them not to do any work until the lawyer determines that no conflict exists which would prevent him or her from representing you. If a conflict of interest does exist, the lawyer generally can represent you only after he or she fully discloses all the facts about dual representation to each of the parties involved and obtains their permission to represent both clients.

n. Check References

In addition to talking with clients, consult his or her colleagues. Remember that most lawyers are reluctant to denigrate one of their colleagues, although you might obtain some insight if you listen carefully to the way they phrase their comments. In addition, consult individuals who work with the FCC, trade associations, media brokerage firms and congressional committees. Do they respect and admire the lawyer? Have they seen the lawyer in action? Do they consider the lawyer competent or outstanding?

o. Look for the Right "Chemistry"

Credentials are important, and competence is essential, but don't minimize your visceral reaction to the lawyer you are interviewing. The right chemistry often can make the difference between satisfaction and disappointment. During the interview, pay attention to the lawyer's "desk-side manner." Is it abrasive, unctuous, or just right? Is the lawyer a good listener? Does the lawyer seem confident? Do you sense that the lawyer wants to work with you? Does the lawyer seem aware of the importance of your case or problem to your business? It is important that you feel a sense of rapport with the lawyer.

p. Things to Watch Out For: The Tell-Tale Signs of a Lawyer You Should Avoid

Avoid a lawyer who:

- seems too busy to put the requisite time and effort into your case;
- guarantees the outcome of your case or problem;
- is vague on the subject of fees;
- refuses to prepare an agreement spelling out the fee arrangement and billing procedures;
- tries to impress you with legal jargon;
- refuses to give you references.

Many of the pointers recommended for selecting a lawyer will be useful in choosing two important professionals who are too often overlooked in planning for the successful purchase of a broadcasting property—the engineering consultant and the management or financial consultant.

3. Working With Acquisition Consultants

Often, the prospective purchaser, especially one without management or ownership experience in broadcasting, will need the services of an acquisition consultant familiar with the unique nature of the broadcasting business. Aside from the complicating factors of time and regulatory oversight, broadcasting is far from the traditional franchise type of business. Each station represents different management, sales, programming, and engineering opportunities and problems. Answers found to problems in one market may not work well in another.

For the broadcasting novice, the consultant will interpret the financial data on possible acquisitions, putting such items as sources of station revenue and program, technical, sales, and general and administrative expenses into a useful perspective.

Indeed, even the experienced broadcaster may benefit from the assistance of the right sort of consultant. Few broadcasters are experts at financial management. Yet, clear-headed financial analysis is essential to a successful purchase. Moreover, many broadcasters, although they manage their stations successfully, have developed their management skills and operating policies by a trial-and-error method, suitable to the station and market in which the station operates but not necessarily transferable to another locale. The consultant can bring more generalized managerial and financial expertise to bear on the problems likely to be encountered at the station.

There is the very practical fact that buyers and sellers of broadcast stations generally make better deals when they utilize the talents and rely on the advice of professionals who know the business. Acquisition consultants specialize in the education of buyers in all aspects of the business of broadcasting. As part of the service, they help the buyer to determine overall acquisition strategy,

to choose brokers, lawyers, consulting engineers and accountants, to analyze and inspect possible station acquisitions, and to arrange and structure the entire financing package.

Thus, for both the novice and the experienced broadcaster, an acquisition consultant can help determine at an early stage if a project can be successful and financially workable.

Often one member of a purchasing group will provide much of the necessary expertise. If there is no such person within the purchasing group, a potential buyer should be able to locate suitable consultants from the ever-increasing number of individuals with broadcast experience and practical management skills to help guide the acquisition process and later broadcast operations.

Quite apart from the matter of acquiring broadcast management expertise, many persons embarking on their first large-scale business venture have a more general need for business or financial guidance. An FCC study exploring ways to increase diversity of ownership of broadcast properties found that many people seeking entry into the broadcast industry were at a serious disadvantage because they had relatively little knowledge of, or experience with, the complex and sophisticated arrangements for financing the acquisition of broadcast facilities.

It is important to note that many entrepreneurs are not successful in raising funds for their ventures. Would-be entrepreneurs should not be overwhelmed by this fact. Rather they should understand the difficulty in raising capital, and seek professional assistance.

Accordingly, when outside financing will be required, the first steps in many cases should be (1) to locate a financial advisor or acquisition consultant who will provide introductions to financial institutions and (2) to develop credible contacts who can vouch for the would-be entrepreneur's competence, honesty, drive and capacity to work hard. The acquisition consultant, who may or may not have experience in the broadcasting business, will be in a position to critique the business plan, review financial strategies, and assist in negotiations.

4. Using a Consulting Engineer

The experienced engineering consultant will provide advice in at least two critical areas: the value and effectiveness of the station's current physical and engineering assets plus an evaluation of how these assets compare with the competition in the market.

In the first area, the engineering consultant might be asked to inspect all physical assets of the station including the transmitter, tower, remote units, cameras, consoles, recorders, turntables, wiring and control rooms. The engineer also might prepare a report that includes information as to the age and condition, type, location, FCC specifications, recommended replacements and possible improvements needed.

Obviously, knowing the serviceable life left in equipment will allow the buyer to calculate future capital improvement needs and expenditures. It will also alert the buyer to assets that may be overvalued by the seller or that are inappropriate to the kind of operation the buyer envisions.

The engineering consultant's second function is to advise the buyer about the merits of the station's technical facilities relative to those of its competition. What is the station's relative technical competitive position in the marketplace? How does the station's broadcasting power and antenna location compare with those of the competition? Does the station's broadcast signal reach listeners and viewers the current or previous management has not tried to cultivate? What will or what could future technical operations be like? Is it possible that the FCC may permit more competition to enter the marketplace because of the availability of more space on the broadcasting spectrum or through other technical means? What are the future prospects of increasing the station's competitive position in the marketplace through longer broadcasting hours, more operating power or by other means?

All of this is vital information needed for a prospective buyer to evaluate the current value of the property as well as estimating future value and potential.

B. LOOKING FOR A STATION TO BUY

Once the necessary expertise is assured, the search for a property can begin. This stage of the venture can be called the developmental stage. At this point the prospective purchaser will require seed capital to conduct feasibility studies and meet organizational expenses. This phase is an important time for the fledgling business to develop a track record for future stages.

The entrepreneur's commitment of personal resources and, particularly, the investment of capital, during the developmental stage, are evidence of a commitment to the success of the venture. This type of evidence increases the likelihood of receiving assistance from financial institutions.

There are two annual publications which contain the names of communications brokers, acquisition consultants and lawyers practicing before the FCC:

Broadcasting Yearbook
Broadcasting Publications, Inc.
1705 DeSales Street, N.W.
Washington, D.C. 20036

Television Factbook
Television Digest, Inc.
1836 Jefferson Place, N.W.
Washington, D.C. 20036

As mentioned earlier, brokers prefer to handle properties on an exclusive basis and, therefore, virtually every broker has listings that are not shared by other brokers. Thus, it is generally prudent to contact as many brokers as possible. Acquisition consultants may act as intermediaries, and will contact brokers appropriate to the buyer's desires on behalf of the buyer.

In addition, stations available for sale may not always be listed with brokers or known to lawyers. Thus, even when brokers have been contacted, would-be buyers may also want to seek out properties on their own. Owners trying to sell stations without a broker sometimes take classified ads in *Broadcasting* magazine, a weekly publication of Broadcasting Publications, Inc. Other ways of learning of available properties would include placing an ad in *Broadcasting* to solicit responses from owners interested in selling, or simply asking a local broadcaster (or a broadcaster in a market where the prospective buyer has an interest in buying) whether they know of a station that might be for sale.

A tactic used by some prospective purchasers is to make a direct, unsolicited offer to a station owner operating in the area where the prospective purchaser would like to locate. Such an offer should explain why the buyer is interested in acquiring the station and provide some evidence of financial ability to buy the station (for example, providing the name of a banker or lawyer the seller might contact). Even if not successful, the offer may lead to information on other stations that might be for sale if the right offer were made.

Various trade publications should be consulted to obtain some idea of the current market values of broadcast properties. Each week, *Broadcasting* publishes a column called "Changing Hands" which gives the basic details, including the purchase price, of most transfer applications filed with the FCC. Following this information for several issues will provide some basic "ball park" estimates of prevailing values for properties in various size markets. Once a year, *Broadcasting* publishes a special report on trading of broadcast properties during the previous year. *Broadcast Investors*, a twice-monthly newsletter published by Paul Kagan Associates, Inc. (126 Clock Tower Place, Carmel, California 93923) gives information and advice on broadcast investments. *Television/Radio Age* (666 Fifth Avenue, New York, New York 10019), a bi-weekly trade periodical, regularly publishes reports on station sales. Broadcast Investment Analysts, Inc., Paul Kagan Associates, Inc. Com Capital Group and Duncan Publications publish annually statistics on station sales during the previous year.

This type of analysis quickly will lead to a determination as to whether additional investment will be needed to finance a projected purchase. If additional individuals are needed to supply more capital, discussions should be conducted on at least a preliminary level to ascertain their interest and the availability of their capital. If a group is formed, of course, decisions as to the future legal status of the group (i.e., partnership or corporation) must be addressed and, at this juncture, legal counsel is necessary.

When information about the station is in hand, the prospective buyer must make a judgment concerning the market area in which he or she wants to operate. Generally speaking, the market must be (1) small enough for the buyer to compete effectively and (2) large enough to make a profit from operations, after covering debt service. If the property meets this test, the broker can be asked to arrange an inspection visit.

C. VALUING A STATION AND SETTING A PRICE

Once the buyer finds a station to buy, the crucial question is how much to pay for it. Every property is worth something to someone but if the price isn't right, neither is the property.

There are various methods for ascertaining the right price for a station. However, the bottom line remains that there is no foolproof way of determining the value of a station. As discussed earlier, off-the-cuff formulas exist, such as two to two-and-a-half times gross annual revenues, or "x" times annual cash flow (cash flow is the station's net operating income before taxes, interest or debt and depreciation.)

The problem is that guidelines such as these are seldom reliable without the benefit of further analysis. In most instances, a buyer will be willing to pay on the high side of the price arrived at by any method for an established station with a track record of increasing sales in a growing market. Conversely, if the station is new and without stable earnings, or is in a contracting market, the buyer will pay on the low side of a calculated value. A detailed discussion of station valuation is provided at Appendix B of this book. What follows is a general

description of factors affecting station prices and buyer considerations in deciding what to pay for a station.

1. General Factors Affecting Station Prices

A major consideration in any valuation of a broadcast property is supply and demand for the property. The supply and demand picture encompasses the local and the national market in which the property acts and interacts. It is reflected in the prices agreed to by buyers and sellers of other stations, and ultimately affects the price of the station in question. A prospective buyer will want to look at all the prices, nationally and locally, which make the property more or less attractive to other potential buyers.

Another factor that affects prices is the general health of the economy. During a recession or economic downturn, retailers cut back on the amount of advertising, and advertisers generally resist paying premium rates. This tends to force station revenue down and, with it, prices. On the other hand, in good times, stations may sell out their spot inventories relatively easily. As a consequence, station prices will go up.

2. Deferred Payment Plans

The type of payment plan which the buyer utilizes to purchase the property must also be considered. Under a deferred payment purchase, the buyer completes payment for the property at a future date and over a period of time. If a buyer makes this type of purchase, current and possible future interest rates must be considered. If interest rates increase greatly in the future, then the present value of the station to the buyer is reduced. The buyer will be facing higher overall interest charges to be paid out over the period of the payment contract.

Therefore, the question to be answered is: what is the station worth to the buyer at various levels of interest on the debt? From a buyer's standpoint, the buyer will adjust the present value of the station to reflect the various interest rates considered under the deferred payment purchase plan. The higher the interest rate, the lower the present value. The theory is that the buyer will end up paying the same amount over an extended period (with interest added for the time value of the money payment deferred) for the station that he would pay if he or she paid the total price in cash on the day of the purchase.

If a portion of the purchase price is deferred, that portion of the purchase price is worth less to the seller than the same amount of cash received today. Also, the longer the payment of the full price is deferred, the less that portion of the price is worth to the seller in today's terms. Thus, if a seller offers to defer payment of a portion of the purchase price over a number of years at below market interest rates, it can be safely assumed that in setting the asking price the seller has taken into account the lesser present value of the deferred portion and the favorable interest rate.

3. Specific Factors Affecting Value

In addition to the quantitative analyses which go into determining station prices, the final estimate of market value must necessarily reflect qualitative analyses of a number of factors—both alone and in various combinations. These factors include the market size, competition, technical facilities, management, etc. The single most important factor is station revenue—past (to a lesser extent), present and potential. Past revenues tend to show trends in the station's and sometimes the market's development. A buyer may be able to determine if station growth has slowed, has peaked, or is growing. Estimates of potential revenues determine how much a buyer can afford to pay for a station and still make a reasonable return on his or her investment. A useful working assumption is that station revenues should be roughly equivalent to total radio (or television) revenues in a given market multiplied by that station's share of the total audience.

A seller normally will give a potential buyer information on the property's revenues but, sometimes, the seller may not wish to disclose this information at an early stage of negotiations, and a buyer may want to make an independent investigation. In these situations, it naturally is more difficult to get a complete picture of a station's revenues, but there are ways of making an informed guess. Very useful information is contained in *Investing in Radio* and *Investing in Television*, published annually by Broadcast Investment Analysts, Inc., McLean, Virginia, and *Duncan's American Radio* and *Duncan's Radio Market Guide*, published by James R. Duncan, Jr., Kalamazoo, Michigan. These publications provide relatively detailed estimates about broadcast revenues and station ratings in ranked markets.

Before beginning serious negotiations, however, the buyer must have complete financial records on the station. This is essential in order for the buyer to develop, as completely as possible, a financial profile of the station. These financial records usually take the form of a balance sheet, a financial statement and statements of sources and uses of funds (sometimes referred to as statements of changes in retained earnings) for the last three to five years. Preferably, the financial statements will come from the station's out-

side independent accountants. Such outside financial reports come with three different degrees of assurance. "Compiled" financial statements simply reflect information provided by the station to its accountant. This means, from the accountant's standpoint, that all figures are unverified; transactions have simply been "compiled" and categorized in accordance with generally accepted accounting principles. The term "reviewed," when applied to financial statements, means that the accountant has systematically looked at the client's original books of entry for a number but not all the transactions reflected in the financial statements and has formed a general conclusion that those transactions have been accurately portrayed. The greatest level of assurance is provided by "audited" financial records. In preparing an audit, accountants examine all original records of revenue and expense and independently verify the existence of assets and obligations listed in the financial statements. Unfortunately for buyers, few companies undertake the substantial expense represented by audited financial statements, except publicly traded companies or where audited financial reports are required by lenders as a condition of loans.

With all financial statements, whether compiled, reviewed or audited, the accountant's "notes" following the statements are an integral part of the report and should be carefully reviewed to ascertain the accountant's reservations about the statements and the limitations on the report.

Most banks require independently prepared financial statements when reviewing a loan application. When a buyer intends to resort to the private capital markets for financing, e.g., through a limited partnership offering and depending on the size of the offering, audited financial statements may be required. And when the acquisition is to be made through the purchase of stock rather than simply the sale of assets, the availability of audited financial statements takes on added importance.

Where there are any material doubts about a station's financial history, the buyer should insist on the opportunity to make what accountants refer to as a "businessman's review" of the financial records and seek to make the satisfactory completion of such a review (that is, verification of previously supplied financial reports) a condition of the buyer's obligation to complete the purchase.

A factor at least as important as the station's revenues and overall financial condition is the market in which the station is operating. Since no station broadcasts in a vacuum, an analysis of the station's market can reveal who the station is reaching, who it can reach and, as naturally follows, the audience advertisers can reach by buying spots on the station. A station's present and potential interaction with its market should be considered in determining a station's value. Market characteristics affecting station value include population growth, disposable income, total market retail sales, and the media competing for audiences and advertising dollars. After taking these and other factors into consideration (e.g., whether the station is AM, FM or TV; its operating power and position on the dial; the number of facilities and formats of other stations in the market), one should be able to make a prediction as to the station's potential share of the available advertising dollars.

It is therefore possible to determine the total amount of advertising dollars that the level of retail sales in the market will support and the potential of a given station in the market to increase its share of these dollars. Many knowledgeable buyers say that they do not buy a station, they buy a market. For these reasons, it is essential for any potential buyer to learn about the present make-up and potential for growth of the market in which the station is located.

4. Financial Models for Valuation

a. Payback Multiples Based on Expected Cash Flow

The buyer of a broadcast station, like buyers of most other businesses, is concerned primarily with the length of time it will take to recover the investment—the break-even point. This can best be estimated from an analysis of future cash flow. As noted earlier, cash flow normally refers to operating profit before depreciation, interest and taxes. In addition, certain items may be of an extraneous or non-recurring nature and should be added to or subtracted from cash flow as the case may be. For example, there may be above average salaries or benefits taken by absentee owners or officers who are not involved in the daily operation of the station. There may also be personal expenses of the owner paid by the station such as personal life insurance, travel and entertainment, country club dues, etc. These are items which should be added back to calculate the true cash flow. On the other hand, if there are many outstanding trade deals—that is, trading advertising time for goods and services—these non-cash expenditures should be subtracted from the stated cash flow. Because cash flow is needed to amortize debt, multiples of cash flow are sometimes used to determine purchase price. By focusing on the cash flow multiple, the buyer can determine how many years it will take to recover the investment, not including interest. When used in this fashion, cash flow multiples measure the current return, i.e., the simple annual rate of interest that will be earned, that is required by the buyer to justify the investment. Take this hypothetical example:

> The asking price for station WBPE is $500,000. Cash flow analysis suggests that it will take 8 to 10 years to recover 100 percent of the $500,000 purchase price. Dividing 100 percent by eight years results in a current return of 12.5 percent per year; dividing by 10 years results in a current return of 10 percent. Therefore the annual cash flow from this station should be somewhere between $50,000 a year if the desired rate of return is 10 percent and $62,500 a year if the desired return is 12.5 percent.

The higher the risk associated with a particular investment, the higher the current return that will be required by the buyer. Thus, the greater the risk, the lower the multiple for which a property will sell. The buyer will be unwilling to pay a higher multiple when the return is not as sure. A buyer who assesses a station as an "8" times rather than "10" times cash flow property is making a judgment about the relative degree of risk.

Sellers and buyers typically use cash flow multiples for a particular property from different perspectives. Sellers want a buyer to pay a multiple based on the projected cash flow that a buyer should be able to generate with improvements and future development. Sellers are basing their multiple on what they project the future will be. Buyers may feel that they should pay for what they are getting rather than what they might get with development. Their viewpoint is that the multiple should be based on an "as is" analysis. Usually, the purchase price will reflect a compromise of these points of view.

Cash flow multiples vary from time to time depending on circumstances. The cash flow multiple is a measure of the cost of attracting money to a particular investment. Said in another way, it is a mark of the rate of return required to attract an investor's money to a particular investment. The appropriate multiple will also be affected by the quality of the station's facilities and the type of facility involved. Obviously, in view of the importance of a station's technical facilities, a daytime—only AM station at a high position on the dial will not bring the same multiple of cash flow as will a 50,000 watt, full-time AM station in the middle of the dial. Similar distinctions exist among FM stations (low power Class A's compared to high power Class B and C stations) and TV stations (UHF versus VHF). Industry experience seems to indicate that the value of VHF network-affiliated television stations falls in a range of 10 to 14 times annual pre-tax cash flow. Stations in the larger markets fall in the upper range and those in the smaller markets in the lower range. The value of network-affiliated UHF stations seems to be about 8 to 10 times cash flow. For radio it is 6 to 9 times for AM stations and 9 to 14 times cash flow for FM stations.

Stations fall in the low end of the range when they have poor records of earnings or inferior facilities or are located in weak markets. Some stations, such as those with *no* record of earnings, and stations requiring substantial improvement are impossible to value meaningfully by using cash flow multiples.

In certain circumstances, even when a station has a solid track record of earnings and sound technical facilities, cash flow multiples may be largely irrelevant. This is particularly likely to be true in the case of AM stations. Many lending institutions are unlikely to consider an AM station, no matter how profitable, to be sufficient collateral for a loan unless coupled with a companion FM station. The relative unavailability of bank financing for such properties has an obviously depressing value on price. Thus, in addition to historical earnings, a lower cash flow multiple paid for an AM station may reflect the buyer's ability to make an all cash purchase with no or relatively little bank debt. And a high multiple may reflect the seller's willingness to provide a favorable long-term payment arrangement. Cash flow multiples are also of less value in the case of stations that have reached a dominant position in the market.

If a station is pre-eminent in the market, and is relatively efficiently managed, how will the buyer achieve the *increase* in cash flow necessary to service the debt on a premium price? Indeed, station performance may be vulnerable to new competition. In such a situation, unless growth of advertising revenues in the market is exceptionally strong, both the cautious buyer and the cautious lender ask the question, where can the station's performance go, except, possibly, down? The highest cash flow multiple is likely to apply to an established but underperforming station in a growing market.

Sound use of cash flow multiples requires thoughtfully prepared cash flow projections which take into account market revenue growth characteristics, demographics, quality of facilities, media competition, the station's projected shares of audience and revenues in relation to its present share of audience and revenues, and new depreciation and amortization. Any thorough cash flow analysis will also include state and federal income taxes (including tax benefits), working capital requirements, property replacement schedules and debt service payments.

b. Analysis of Discounted Cash Flow

A second way to determine value is to use the investment analysis technique known as "discounted cash

flow." The basic premise underlying discounted cash flow analysis is that a given amount of money to be received at any time in the future is less valuable than the same amount of money currently in hand today. Presumably by the time the amount of money is received with interest at a future date it will be equal in value to the amount which was received in cash today. Using the cash flow projections that have been developed, the method implies that a station's value today is equal to a cumulative total of all future yearly cash flows discounted back to the present at an assumed annual rate of interest. Cash flows to be discounted include both yearly operating cash flows as well as the final cash flow to be received at the end of the investment period representing the assumed value of the station at that time. In performing a discounted cash flow analysis, the buyer should consider the current and projected interest rates reflecting not simply the interest to be paid but also the rate of return that would be available from other investments over the same period of time, the amount of money being deferred and the length of time that it is being deferred. For these reasons, discounted cash flow analysis should always be done at varying rates of interest (for example, from 10 to 25 percent), and for varying periods of time (for example, five to 15 years). It should be noted that cash flows to be received far into the future, in say 15 years, add very little to the value of the station today.

Cash flow data to be used for discounted cash flow analysis should always be stated in current or today's dollars for purposes of benchmarking the true economic value of a station; thus, cash flows should not reflect inflation, i.e., increases in the dollars required to buy the same goods and services, which otherwise would cause an excessive price to be paid for the station.

c. Comparable Sales

A third method of valuing a broadcast property is by a comparable sales study. This is a difficult type of study which attempts to relate the value of one station to the value of another which was sold in a comparably-sized market, with approximately identical revenues, approximately the same audience and approximately the same earnings within a large market. With a large number of stations, recent sales may be a useful basis for comparison. But all too frequently there is no well-founded basis for a comparison of the station being valued and "comparable" stations. Every station in every market will have some unique characteristics which affect its value.

These characteristics will skew any comparable sales study and any attempt to relate the value of the target station to the station or stations which are being compared. Therefore, the best use of this type of analysis is as a check on the values reached through other analytical methods.

5. Other Factors Affecting Station Prices

a. Station Assets and Facilities

Regardless of the formula used to determine an offer, other factors must be considered. These include business trends in the area, the value of the physical plant and any real property and other assets included in the sale, and the extent of long-term obligations that might have to be assumed. (See Appendix C, Station Review Checklist.) With regard to the real estate valuation, it should be noted that broadcast stations often have several acres of real property for their transmitter and tower site and additional space and structures for studios. While extensive holdings might be involved, the property may be unavailable for development under local zoning laws. (The fact that a station is federally licensed does not affect the authority of local zoning bodies.) In some instances the station may be leasing its transmitter site; if so, the seller should have a favorable and assignable long-term lease. If there is only a short-term lease, it may be extremely difficult if not impossible to find another site should the station have to move. This is especially true for AM station directional antennas where multiple towers may be involved and only a very limited area into which the station can move.

Because the acquisition of broadcast properties involves the purchase of technical equipment, a buyer should make arrangements to have a broadcast engineering consultant inspect the premises and evaluate the equipment before making a binding offer.

In addition to estimating revenue levels, the buyer also must compute the annual costs of operating the station. The buyer must determine if any economies can be achieved in the station's operations and the rate of expected increases in costs. Included in this computation must be any debt service (namely, repayment of principal and interest) the buyer will face.

b. The Market

Also, as noted above, it is critical to obtain information on the financial condition of the area served by the station. (See Appendix C, Market Review Checklist.) A review of the station's prior financial statements or reports will reveal past strengths or weaknesses of the sales staff. It is possible that the analysis will show market segments which can be targeted and reached for future sales. The interaction and match between the audience being reached and the potential audience, and the present and potential advertisers, is an important exercise in evaluating the market. The buyer must consider overall economic trends in the area for factors

such as retail sales, commercial relocations, dependence on government spending, median income trends, median age levels, and number of families relocating in the area. All of this information will result in a useful financial profile of the market. The key factor to estimate is the overall value of the advertising market in the area to be served and the portion of that market which can be expected to buy advertising on the station. In making projections of revenues, evaluation of audience research studies for the station is particularly important in view of the direct relationship between audience ratings and advertising rates.

c. Financial Goal of the Buyer

After estimating revenues and costs as accurately as possible, the buyer must establish realistic financial goals for himself or herself and the station. Basically, the buyer must determine what financial performance is expected from the station. Is the buyer able to lose money for a few years in order to increase the value of the station? Or must the station make enough profit for the buyer to live on during the first year? Will interest and depreciation deductions be used to create a tax shelter? Depending upon the situation, the station can be used for any one of these purposes but the buyer should choose a purpose before acquiring a station.

SUMMARY

In valuing a station and setting a price, the buyer should keep several things in mind:

- ☐ What are the current and projected revenues of the station?
- ☐ What is the composition of the station's audience?
- ☐ Who are the station's advertisers?
- ☐ What is the growth pattern of the market?
- ☐ What is the station's competition?
- ☐ What type of payment plan will be used?
- ☐ What are current and projected interest rates and required rates of return?

D. REGULATORY FACTORS

1. FCC Qualifications of the Buyer and Seller.

A factor critically important to sellers is whether the prospective buyer will be found qualified by the FCC to hold the license. This is not always a cut-and-dried proposition. In some cases, the buyer may require a waiver of the FCC's rules to acquire a particular property. For example, a buyer who already owns 12 FM stations will need to find a qualified buyer for one or more of those stations before the FCC will permit him to acquire another. In negotiating the purchase price, sellers in such cases will keep in mind the longer time required for FCC approval, and indeed the possibility that FCC approval may not be forthcoming, and insist on what amounts to a premium in exchange for taking the station off the market.

2. Multiple Ownership Rules

The FCC has a number of policies directed toward limiting concentration of control of mass media, including the "twelve station," "duopoly," "one-to-a-market," "newspaper/broadcast cross-ownership," and "TV/cable cross-ownership" rules. All of the FCC's multiple ownership rules and policies, except the "twelve station" rule and certain aspects of the newspaper/broadcast cross-ownership rules, are *prospective* in nature. As such, existing ownership combinations do not violate the rules because these properties had been rightfully acquired prior to each doctrine's adoption.

a. General Guidelines

Under each of the following multiple ownership rules, a party may not directly or indirectly "own, operate or control" a prohibited combination. An individual having an "attributable interest," an interest of five percent or greater, in a corporate licensee of one station (e.g., as a stockholder, officer, or director) may not have an attributable interest in another station or newspaper which could not be commonly owned under the multiple ownership rules, nor can that person be a principal, officer, or director of the conflicting station's licensee or the licensee's parent company. A General Manager, while not classified as having an "attributable interest," has been deemed by the FCC to have "control" of a station and as such joins stockholders, officers and directors in being precluded from participating in certain activities under these rules. Also, limited partnership interests will be cognizable unless the FCC is satisfied that the limited partner is not materially involved, directly or indirectly, in the management or operation of the station.

Under the current rule, the FCC generally will not

be concerned with non-attributable ownership interests of less than five percent (except under its cross-interest policy as explained later in this section). However, discreet ownership interests will be cognizable if (a) the sum of the interests held by "passive investors" is equal to or exceeds ten percent, or (b) the sum of the interests held by non-passive investors is equal to or exceeds five percent, or (c) the sum of the interests of both passive and non-passive investors is equal to or exceeds ten percent.

b. Twelve-Station Rule

The "twelve-station" rule established an absolute limit on an individual's commercial broadcast station ownership. No party may have an interest in more than 12 commercial broadcast stations in each service—that is, a total of 36 stations of which no more than 12 may be AM, 12 FM, and 12 TV (excluding satellite TV stations). However, if the stations are "minority controlled," an individual may own 14 stations in each service. For the purposes of this rule, "minority controlled" means that a station is *more than* 50 percent owned by a member of a minority group.

In addition, the FCC places further limits on TV station ownership. An individual may not have a cognizable interest in TV stations which have an aggregate national audience reach exceeding either 25 percent, or 30 percent if minority controlled. "National audience reach" means the total number of TV households in the stations' Arbitron ADI markets divided by the total number of TV households in the nation. However, UHF stations will be attributed with only 50 percent of the TV households in their ADI markets. As a practical matter, this rule affects only the largest station groups with outlets in the very largest (top five) markets.

c. Duopoly Rule and Cross-Interest Policy

The "duopoly" rule prohibits any party from owning two or more stations in the same service if there is an overlap of the station's duopoly contours. Thus, two AM stations may not be commonly owned if their 1.0 mV/m daytime groundwave contours overlap. For FM stations, the duopoly yardstick is the 1.0 mV/m contours, and for TV stations, the Grade B contour is used.

While not a multiple ownership rule, the FCC's "cross-interest" policy has the effect of such a rule. The cross-interest policy, designed to ensure "arms-length" competition, prohibits any interest in two stations in the same service (for example, two FMs) in the same area or market. Therefore, a party may not have an interest in two TV stations licensed to the same community, nor hold an interest in one TV station and lend money to another local TV station. This policy has also been used to bar certain cross-service (AM/TV, FM/TV) interests.

The FCC has begun proceedings considering relaxation of the duopoly rule and the cross interest policy. As of the date of this publication, the FCC had not acted on this matter.

d. One-to-a-Market Rule

The so-called "one-to-a-market" rule prohibits the direct or indirect ownership, operation or control of both a radio station (AM or FM) and a TV station if the AM's 2.0 groundwave mV/m or the FM's 1.0 mV/m contour encompasses the entire community of license of the TV station, or if the TV's Grade A contour encompasses the entire community of license of the AM or FM station.

However, there is an exception for UHF and radio stations. The FCC will consider, on a case-by-case basis, applications for the common ownership of one or more radio stations and a UHF station in the same market. Note that there is no prohibition with regard to ownership of AM-FM combinations. The FCC is also considering modifying its one-to-a-market rule.

e. Newspaper/Broadcast Cross-Ownership Rule

Common ownership of a radio or television station and a daily newspaper (i.e., published at least four times weekly) is prohibited if the contour for the AM (2.0 mV/m), FM (1.0 mV/m), or TV (Grade A) encompasses the entire community in which the newspaper is published.

f. TV/Cable Cross-Ownership Rule

As part of the Cable Communications Act of 1984, Congress codified the FCC policy that prohibits the ownership of a "reportable interest" in both a cable system and a TV broadcast station if the station places a Grade B contour over any part of the service area of the cable system. A "reportable interest" is an interest of five percent or greater in a corporate licensee. Also, no cable television system may carry the signal of any television station if the cable system directly or indirectly owns, operates, controls or has any interest in a national television network.

Buyers will also take the seller's regulatory situation into account. Also, as pointed out earlier, a sale which is contingent on FCC approval of another transaction, for example when a station owner is selling one or more stations in order to acquire another, presents the buyer with an additional element of risk and a potential source of delay. This too will affect the buyer's judgment on how much to pay. Here, again, it is important to have a lawyer—especially one versed in the rules and policies of the FCC—to participate in the sales process.

3. Special FCC Incentives for Minorities

Two specific actions—tax certificates for sellers and "distress sales" to minority buyers—have been taken by the FCC in the hope of making more broadcast properties available for sale to minority group members and providing additional leverage to minorities in negotiating station acquisitions. While neither approach works perfectly, both deserve investigation by prospective minority buyers.

a. Tax Certificates

In May 1978 the FCC announced in its Statement of Policy on Minority Ownership of Broadcasting Facilities that, when an application is made to transfer or assign a broadcast license to a minority-controlled enterprise, the FCC will grant the seller a tax certificate under Section 1071 of the Internal Revenue Code. A person holding such a certificate may defer payment of capital gains taxes on the proceeds from the sale of the station indefinitely, if that person reinvests in another broadcast property within two years. (Thus, the certificate may be of less value to an owner who is selling in order to retire from broadcasting. However, reinvestment by purchasing a minority interest in a broadcasting company, including the stock of a publicly traded company engaged in the broadcasting business, will qualify for deferral of capital gains taxation. At the worst, the certificate gives the seller some control over the timing of his or her capital gains liability.)

Where the station being sold has been appreciating in value for a number of years (and, in general, properties have been increasing in value at a double-digit rate over the past five years), this certificate can be of substantial value to the seller. In a recent VHF television sale, the value of the certificate to the seller, as reflected in the purchase price, was estimate at $100 million. The FCC permits a seller to qualify for the certificate where the sale is to a partnership if the minority group member is the sole general partner and owns a substantial (more than 20 percent) interest in the partnership. This FCC ruling allows some minority group members to make advantageous deals with investment dollars provided by non-minority limited partners. More recently the FCC has expanded its view of minority "control" to include circumstances in which the minority group member has control over a majority of a corporation's voting stock but only a minority (but still substantial) interest in the total equity of the corporation.

There are other ways in which minorities can use the tax certificate policy to attract investors to provide "start-up" capital. Investors who purchase ownership interests in a minority-controlled company within the first year of its operation are eligible for a tax certificate upon the eventual sale of their interests in the company. Such investors will be able to defer capital gains otherwise due upon the sale of their shares, provided that the company remains minority controlled.

b. Distress Sales

In its May 1978 Minority Ownership Policy Statement, the FCC declared that in certain limited instances it will permit a broadcast licensee whose license is about to be revoked or not renewed to sell the station at a "distress sale" price. Permission to sell at a "distress sale" price is available only if (1) minorities will participate significantly in the new ownership of the station and (2) the sale occurs before the FCC renewal or revocation hearing actually begins. Because the FCC policy generally prohibits the sale of a broadcast station after the station's license has been set for hearing, the FCC believed its action would stimulate the sale of stations to minorities. The FCC thought that a licensee facing a potentially costly and time-consuming hearing might choose instead to keep losses to a minimum and sell the station to a minority enterprise. The FCC has said that it will look to a station's fair market value as a benchmark for determining whether the proposed sale price is in fact a "distress" price. "Fair market value" is usually determined (for purposes of the distress sale policy) by averaging two independent appraisals. A distress sale will be approved only if the purchase price does not exceed 75 percent of the fair market value.

The distress sale has two particular shortcomings. First, only a very small number of properties are eligible for distress sale treatment. Second, as a matter of historical record, most of the properties that have been transferred under this policy have been marginal or unprofitable, and have been further neglected by their owners from the onset of the FCC problems leading to designation for hearing. A distress sale buyer, therefore, may well acquire a station which has substantial problems—poor management, unmotivated staff, and deteriorating equipment. Thus, distress sales are an avenue for minorities to acquire stations at below-market prices. But distress sale stations may well have only limited prospects, and may be poor candidates for outside financing because prospective lenders will be influenced adversely by the problems likely to be encountered in turning the station around.

E. TAX AND OTHER BUSINESS CONSIDERATIONS IN STRUCTURING THE TRANSACTION

1. General Guidelines

The operation of a broadcast station is the operation of a business. Although it may differ from other types

of business entities because of licensing and other regulatory requirements regarding programming, a broadcasting business also involves the purchase and sale of assets, the compensation of employees, and the acquisition and disposition of ownership interests. The choices made in the formation and management of stations affect the present and the future financial well-being of both owners and employees, and of their families. In particular, tax considerations, always important, have become even more crucial after the Tax Reform Act of 1986 ("1986 Act"), which did away with many tax planning devices previously available to business taxpayers.

In this light, the decision about what form the business should take is among the most important in the whole acquisition process. In order to make an informed decision about what form of business operation should be adopted, it is first necessary to understand two fundamental concepts of Federal income taxation.

2. Overview—Fundamental Concepts of Federal Tax Law

a. A Corporation: A Separate Taxable Entity

The first concept to bear in mind is that a corporation is a separate and independent taxable entity. While there has been persistent discussion of various proposals to integrate corporations and their shareholders for tax purposes, in effect treating the corporation as a pass-through entity, the recent trend in Congress has actually been the reverse: various corporate non-recognition or deferral benefits have been eliminated. This means that investors doing business in corporate form are subject to double taxation—once at the corporate level and again at the individual shareholder level. For example, if a corporation sells its assets, it realizes a gain (or loss) at the corporate level and has to pay corporate income tax on that gain. When it distributes the net proceeds of that gain to its shareholders, in the form of a dividend, the shareholders pay a separate individual income tax on the amount distributed. One of the prime goals of tax planning is to structure a business to avoid this double taxation.

b. Maximizing Depreciation and Amortization Deduction

The other fundamental concept which underlies much business tax planning is the ability to recover the cost of business assets through depreciation or amortization. Taxpayers are allowed to take depreciation deductions from income based on the cost of their business assets. The theory behind depreciation is that the costs of assets acquired for the production of income should be recovered over the useful life of the assets. But in recent years, Congress has provided an accelerated depreciation system whereby the cost deductions can be taken at a rate faster than the actual decline in value. In fact, depreciation deductions can be taken even if the asset actually increases in value. Since depreciation deductions are paper losses, they can serve to shelter income, and therefore a primary goal of tax planning should be to maximize them.

The concept of amortization is very similar to depreciation, but usually amortization applies to intangible assets like employee contracts, and is available on a straight-line basis. Throughout this discussion, references to depreciation will often be used as a shorthand for both depreciation and amortization.

Since depreciation can only be taken with respect to certain types of property (for example, as will be seen later, it cannot be taken on the cost of acquiring an FCC license for a broadcast station), allocation of the purchase price of a broadcast station to depreciable assets is very important.

Keeping these basic principles in mind, we can now turn to specific tax considerations which the buyer and seller should bear in mind in structuring a transaction.

3. Formation of the Optimal Business Organization

a. Types of Business Entities

There are five basic forms in which a business can be organized. They are: (1) sole proprietorship; (2) general partnership; (3) limited partnership; (4) C corporation; and (5) S corporation.

(1) Sole Proprietorship

This is the simplest form of doing business, from both a tax and a non-tax standpoint. No new legal entity comes into existence for purposes of operating the business. Rather, an individual simply segregates a portion of his or her assets for the operation of the business. The individual is taxed on the income the business makes just as he or she would be on any other income. While it is possible in theory for an individual to own a broadcast station as a sole propretorship, it would not be practical.

(2) General Partnership

A partnership is an association of two or more persons (including certain legal entities such as corporations that are treated as "persons" under the federal tax laws) to carry on business as co-owners for profit. Under the tax laws, a partnership is a conduit or pass-through entity. That is, in contrast to the rule for corporations discussed above, a partnership as such is not liable for federal income tax on its profits. Rather, those profits are deemed to flow through the partnership to its partners, whether or not the partners actually receive any distribution from the partnership. Each partner is taxed on his

share of the partnership income, and also can deduct his share of partnership business expenses and losses. There are a number of complex tax rules governing the allocation of income and deductions between partners, when a partnership's losses cannot be deducted by partners, and similar issues. Competent tax advice is a must in this area. The important thing to remember for present purposes, however, is that a partnership is not subject to a separate level of tax on its business profits or gains—only one tax is collected, at the partner level. This is obviously a big advantage over a corporation, as discussed further below.

(3) Limited Partnership

A limited partnership is a partnership formed by two or more persons under the laws of a state and having one or more general partners and one or more limited partners. A certificate of limited partnership must be executed by two or more persons to form a limited partnership; the certificate is then filed in the appropriate state office. A limited partner is not liable for the obligations of the partnership beyond the amount of his or her capital investment unless he or she also owns a general partnership interest or takes active part in the management and control of the affairs of the business. The general partner is liable for partnership obligations, but limited liability can be effectively achieved by making the general partner a corporation. Under IRS guidelines, however, a corporate general partner must be adequately capitalized—in general, the net worth of the corporation must be at least 10% of all contributions to the partnership. Further, the limited partners should own less than 20% of the stock of the corporate general partner to comply with IRS ruling guidelines.

Because a limited partnership is a pass-through entity for tax purposes, just like a general partnership, only one level of tax is collected. Accordingly, the limited partnership form combines the tax advantages of partnership with the limited liability advantage of the corporate form of doing business. (It should be mentioned that Congress is actively considering treating large, publicly traded limited partnerships as corporations for tax purposes, doing away with the tax advantages of the limited partnership form in those cases.)

(4) C Corporation

A regular corporation is called a "C" corporation because taxation of such corporations is governed by Subchapter C of the Internal Revenue Code. As discussed here, a C corporation is a separate legal entity for tax as well as other purposes. It is created under the laws of a state upon the filing of articles of incorporation. Those persons (or entities) owning an interest in a corporation are called shareholders (or stockholders), and such ownership interests are represented in the form of stock certificates issued by the corporation. A corporation may have more than one class of stock (e.g., common and preferred) and each class may afford different shareholder rights and privileges.

(5) S Corporation

An S Corporation is a corporation, incorporated under state law, which meets the qualifications, under the federal tax laws, for such organizations. (As might be guessed, these corporations are governed by Subchapter S of the Internal Revenue Code.) To qualify as an S corporation, there must be no more than 35 shareholders, the shareholders must (in general) be individuals, and the corporation can neither own nor be owned by another corporation. S corporation status achieves tax advantages similar to a limited partnership i.e., only one level of tax, with the shareholders taxed on their respective shares of the S corporation's income. To be treated as an S corporation, a special election must be filed with the IRS.

b. Impact of Rate Changes and Other Tax Law Changes

Keeping the above attributes in mind, an informed decision concerning the optimal form in which to conduct the business can be made. Even though use of a C corporation would subject business profits to double taxation, the C corporation traditionally has been the form in which most broadcast businesses have been held. This was because, for over 50 years, the corporate tax rate was much lower than the individual tax rate. The differential in rates, combined with the ability of taxpayers to defer recognition of individual income by retaining the profits in the corporation, made it advantageous to use the corporate form. Further, individuals could eventually take their profits out of the corporation, either by liquidation or sale of the corporation's stock, at the cost only of an individual level capital gains tax, which was at a much lower rate than the ordinary income tax.

In recent years, Congress has eliminated these advantages. Starting in 1988, individuals (and partners and S corporation shareholders) will be taxed at a top rate of 28%. C corporations, in contrast, will be taxed at a top rate of 34%. So even if the C corporation retained its net after-tax income and did not distribute any dividends, its income would be subject to 6% more tax than if it had been earned by an S corporation. If dividends are distributed the situation is even worse. To illustrate these adverse consequences, consider an example where a broadcast station makes $100,000 in taxable income in 1988. If it were held as an S corporation or partnership, its shareholders would pay $28,000 in tax. No corporate level tax would be due, so there would be net after tax of $72,000. If it were held as a C corpo-

ration, it would pay $34,000 in corporate level tax, leaving $66,000 for distribution to shareholders. When the $66,000 is distributed, the shareholders would pay $18,480 in taxes. The total combined tax would be $52,480, compared to $28,000 in the first example. In other words, the shareholders would get to keep less than half of the income after taxes.

In addition, Congress has done away with the prior favorable tax treatment of liquidations, making it more expensive to remove the business from the corporation. Previously, a liquidating corporation paid no corporate level tax on the unrealized appreciation in its assets, and shareholders were only taxed at the favorable capital gains rate when they received the liquidating corporation's property. Now the corporation must pay a corporate tax when it liquidates. Further, Congress has done away with favorable capital gains rates so the shareholders must pay tax at the ordinary income tax rate. There is a limited transitional exception to this rule, enacted as part of the 1986 Act, which allows for non-recognition or, in some cases, only limited recognition, of gain at the corporate level pursuant to a distribution in liquidation. This rule only applies to certain closely-held corporations whose value does not exceed $10,000,000. To qualify for this exception, the corporation must liquidate prior to January 1, 1989. There are a number of technical requirements, so advice from tax counsel is essential if a corporation seeks to utilize this transition rule.

These factors indicate that, all else being equal, it is preferable to do business as a pass-through entity—i.e., an S corporation or a partnership. This should in most cases be the preferred method if the investor contemplates starting a new business or buying assets of an ongoing business to put into a new company. It is not necessarily the best approach, however, if the taxpayer already owns a C corporation or the seller insists on selling stock in his or her C corporation as opposed to assets. This is because there can be significant tax costs associated with converting from a C corporation to an S corporation or a partnership.

4. Drawbacks to Conversion of a C corporation to a Pass-Through Entity

In the case of an S corporation, a tax provision added in the 1986 Act eliminates much of the ability to avoid a corporate level tax by imposing a tax on the new S corporation's "built-in gains." This only applies to S corporations that were formerly C corporations. It was enacted by Congress to prevent taxpayers from avoiding the corporate level tax on income earned or appreciation accrued while doing business in corporate form by switching to an S corporation.

In the case of a C corporation which seeks to convert to a partnership, the consequences can be even worse. This is because the corporation must first be liquidated. This triggers a corporate level tax on previously unrealized appreciation of its assets, just as if it had sold the assets for fair market value. It also triggers a shareholder tax on the difference between the value of the property (the assets) distributed in liquidation and the shareholder's basis in the stock. (As mentioned previously, prior to the 1986 Act, a corporation could liquidate and only a 20% shareholder-level capital gains tax would be due.) As discussed above, however, there is a limited transitional rule exception which might prevent or reduce the corporate level tax. Similar transitional relief from the built-gains tax is afforded to small corporations making the S election before 1989.

In general, even though pass-through entity status can be attractive, tax advice should be sought to be sure there are no pitfalls before converting from a C corporation to some other form of doing business. But all else being equal, a pass-through entity is preferable to a classic C corporation from a tax perspective.

5. Asset Purchase Versus Stock Purchase

As well as choosing in which form to conduct the business, a buyer must choose which form the purchase transaction should take—whether it should be a purchase of assets, or of stock (assuming the business was conducted as a corporation by the previous owner). This choice can be crucial from a tax planning perspective. From the seller's viewpoint, only one level of tax is imposed on a sale of stock, based on the difference between the sale proceeds and the stock's basis (generally basis equals the cost of an asset, including the costs of any improvements thereto, less any depreciation of amortization previously claimed.) In contrast, if a C corporation sells assets, it must pay a separate tax on its gain—i.e., the difference between its basis in the assets and the sales proceeds. Then, when the gain is distributed to the shareholder, the shareholder must also pay a tax, as discussed above. Therefore, most sellers will prefer to sell stock, not assets.

The buyer, on the other hand, does not care whether the seller has to pay two levels of tax (except, of course, as the seller's additional tax cost impacts the sales price). The buyer is concerned with two main factors: (1) making the purchase in a manner that allows him or her to put the business in the desired form—for example, an S corporation; and (2) maximizing his or her depreciation deductions so that the business's income can be sheltered.

If the buyer wants to conduct his or her business as a partnership or S corporation, he or she will probably

prefer an asset purchase. This is because, as just discussed, if he or she has to buy C corporation stock, there could be significant taxes imposed on conversion of the C corporation to some other form.

6. Stepped-Up Basis

Following closing, the buyer will want to maximize his or her depreciation deductions. If he or she buys stock, the purchased corporation's basis in the broadcast assets remains the same as it was before the purchase. Therefore, if it has owned the assets long enough, it will already have taken most or all of the available depreciation and there will not be any tax benefit available. On the other hand, if the buyer can purchase assets, he or she receives what is called a stepped-up basis in those assets. This means that the new owner can start taking depreciation all over again, based on the new costs of the assets, not on the old owner's basis.

Of course, if the selling corporation has a high basis in the assets and they have declined in value, the buyer would rather buy stock so he or she can preserve the high basis and get greater depreciation. Additionally, a stock sale can be considerably less complicated than an asset sale from a non-tax viewpoint. For instance, there could be only a simple sale of stock at the closing rather than the necessity for transferring deeds to several different parcels of real property. Finally, if the target corporation has large net operating losses ("NOLs"), the buyer might want to buy stock so he or she can use those NOLs to shelter other income or, if the target corporation has turned the corner and is now producing profits, to shelter the anticipated profits of the target. The buyer should get the advice of tax counsel if he or she wants to utilize target NOLs because complex tax rules limit the ability of a purchaser to use such losses. At any rate, in the majority of cases, the buyer will want an asset purchase to get a stepped-up basis.

7. Section 338 Election—Deemed Asset Purchase

Even if a seller insists on a stock sale, the buyer can achieve a stepped-up basis in the assets by making a Section 338 election. This election treats the transaction as if the target corporation had sold its stock to a new corporation on the day after the stock sale. The new corporation gets a stepped-up basis in the assets, but there is a drawback: it must also recognize gain on the deemed sale. In other words, under Section 338 election, the tax costs of the asset sale are transferred from the seller's side to the buyer's side. Usually these tax costs will be greater than the benefit gained from the stepped-up basis. But if the acquired corporation has losses sufficient to absorb the gains on the deemed sale, the purchaser can get the best of both worlds. The law and regulations governing the Section 338 election are complex, so competent tax advice is a must if such an election is contemplated.

A variation on the regular Section 338 election is that a Section 338(h)(10) election can be made, under certain circumstances. Normally, a Section 338 election only affects the buyer—the seller is still treated as having sold its stock. In a case where the selling shareholder is a corporate parent filing a consolidated return, however, the Section 338(h)(10) election treats the transaction as if an asset sale had taken place on the seller's side as well as the buyer's. If made, it means the seller, not the buyer, will recognize the gain on the appreciation of assets. The Section 338(h)(10) election therefore must be a joint election. If the selling affiliated group has sufficient losses, or if the parent's basis in the target stock is close to the target's basis in the assets, the seller might be willing to make this election, giving the buyer a stepped-up basis without an associated tax cost.

8. Allocation of Purchase Price

Assuming either that an asset sale has taken place, or that a Section 338 election has been made so the buyer achieves a stepped-up basis in the assets, the topic of allocation of the purchase price becomes very important. The goal of the buyer is to allocate as much of the purchase price as possible to depreciable assets, such as buildings, the broadcast tower, equipment, and employment contracts, and as little as possible to non-depreciable items like the FCC license, good will and land.

Prior to the 1986 Tax Reform Act, there was a real tension between buyers and sellers as to allocation of the purchase price. In contrast to the buyer's goal of maximizing the amount allocated to depreciable property, the seller wanted to minimize that amount, because it was subject to depreciation recapture at higher ordinary income tax rates. Therefore, the IRS would tend to accept allocations arrived at by arm's length negotiation between the parties. Now, however, depreciation recapture is not a factor, because the preferential rate for capital gains has been eliminated. In other words, all the seller's gain will be taxed at the same rate whether or not it is allocated to depreciable assets. Therefore, the IRS has a goal of lowering tangible asset value used by the buyer, to reduce depreciation deductions following closing.

Under these circumstances, it becomes very important to the buyer to get a credible contemporaneous asset appraisal. It is extremely helpful if this appraisal is used by the parties as a basis for their negotiations, as opposed

to an after-the-fact appraisal conducted for the buyer. Recognizing, however, that business exigencies sometimes make it impractical to get a pre-purchase appraisal, the buyer should at the least get an appraisal as quickly as possible after the sale takes place. It is also essential that the appraiser be truly independent and have sufficient expertise in the broadcast field that his or her opinion as to relative values will have credibility. Finally, it is important that the appraisal be reasonable and not overly aggressive. Such an appraisal will be well worth its cost if the allocations are challenged by the IRS during an audit several years later.

9. Depreciable and Amortizable Assets

The specific types of broadcast assets upon which depreciation or amortization are available are discussed below.

a. Broadcast employee contracts

One type of amortizable asset that is sometimes overlooked by taxpayers is an employment contract with a key broadcast employee—for example, a popular disc jockey. Cases have recognized that a portion of the purchase price can be allocated to such contracts and that the price so allocated is amortizable on a straight-line basis over the life of the contract.

b. Covenants not to compete

A covenant not to compete is separate from good will and the price allocated to it can be amortized over the life of the agreement, just as with an employment contract. It should be recognized that there must be some economic reality to the covenant, however. For example, a covenant not to compete with an active owner who has great experience in the broadcast field would have real value. A covenant not to compete by an uninvolved child who had just inherited the business and had no experience would be very likely to be challenged by the IRS.

c. Television and motion picture films

Television and motion picture films can be depreciated on a sliding scale income forecast basis. This means that the bulk of the cost of the film rights can be deducted the first time it is broadcast—on the theory that most of its value is associated with the fact that it has not been seen before, or at least is relatively recent. However, given the current crackdown on tax shelters, which utilize similar methods, it is likely the IRS would challenge such an attempt. As a fallback, the straight-line method over the life of the contract is available, and is appropriate in any event for older films.

d. FCC licenses and network affiliation contracts

These nominally have a limited term. Taxpayers have tried to take amortization on these assets over their nominal term. Overwhelming authority has long held, however, that such assets are not amortizable because the reality of the situation is that they are rarely or never cancelled. Thus, the purchaser should attempt to allocate as little cost as reasonable to such contracts or licenses. In the rare event that they are cancelled or not renewed, a loss can then be taken.

At least one commentator has suggested that a recent series of private letter rulings issued by the IRS would support an amortization deduction under Section 1253 of the Internal Revenue Code based on the cost allocated to a network affiliation contract, and perhaps even to the FCC license, on the ground that these items constitute "franchises" in which the franchisor retains an interest. However, the letter rulings referred to deal with traditional franchise agreements, and not broadcasting assets like FCC licenses or network affiliation contracts. Further, such private letter rulings by law cannot be used as precedent by anyone other than the taxpayer to whom they are issued. Finally, while there may be some argument that a network affiliation agreement falls under the definition of a franchise, an FCC license, like any other governmental-created license, right, or privilege, does not seem to fit the definition. Given these considerations, claiming such amortization deductions would at best be a very aggressive position which should only be taken after consultation with a competent tax advisor, and at worst could result in the imposition of penalties by the IRS.

e. Tangible assets

Tangible assets are eligible for accelerated depreciation. They are categorized by a deemed useful life. For example, most broadcast equipment is deemed to have a 5-year life, and transmitting towers and office equipment have a 7-year life. Depreciation of these assets can be taken over these periods on a 200% declining balance method. This is one area where the 1986 Act actually helps broadcasters, because the depreciation periods in general remained the same as prior law, while under the old law only the slower 150% declining balance method was available.

10. Amortization of Business Start-Up Costs

In cases where investors are starting a new station, as opposed to purchasing a going concern, the tax treatment of "start-up" costs can be important. Although such costs are not generally deductible currently (other than those deductible as interest, taxes, or research and development costs), such costs may be deducted ratably

over a period of at least 60 months, beginning with the month in which the business begins. Otherwise, such costs must be capitalized over what may be a longer period. Costs to which this provision applies are those paid or incurred in connection with: (i) investigating the creation or acquisition of an active trade or business, (ii) creating an active trade or business, or (iii) engaging in any activity for profit before the day on which the active trade or business begins, in anticipation of the activity becoming an active trade or business (i.e., pre-opening costs). Furthermore, the costs must be of the type that would be currently deductible if paid or incurred in connection with the expansion of an existing business in the same field as the one entered into by the taxpayer.

Generally, any expenses incurred or paid prior to a broadcast station's receiving its license to operate may not be deducted currently, but rather must be amortized over the 60-month period.

11. Debt Versus Equity

Interest payments on debt are generally deductible by a corporation; dividends paid out to shareholders are not. The use of debt, therefore, can reduce corporate taxes. However, if the ratio of debt to equity is too high, this can result in the loss of the corporate characteristics of limited liability (for shareholders). Courts may look through the corporation to the individual shareholders for payment of the corporation's debts in circumstances in which the corporation is too thinly capitalized. Moreover, in cases where the debt-equity ratio exceeds 3:1, the IRS is likely to attempt to recharacterize a portion of the debt as equity. The courts look to a wide variety of factors to determine if the purported debt is in economic substance more akin to an equity interest; the most important factor is whether the "lender" reasonably expects repayment, or if he or she has in reality put the proceeds "at the risk of the business." If the investor wishes to make a loan to the corporation, he or she should seek advice of tax counsel to avoid such inquiries.

12. Use of Different Classes of Ownership Interests

Use of more than one class of corporate or partnership ownership interest (e.g., common and preferred) may be particularly advantageous to satisfy certain management or estate planning objectives of the business owners. Corporations and limited partnerships generally provide the most flexibility for this purpose. Note that this tool is not available to an S corporation, which by definition can only have one class of stock.

The control and management of a business also can be organized through devices affecting voting rights, such as shareholders' agreements, voting trusts and proxies, or through creating binding restrictions upon the transfer of ownership interests.

13. Ownership of Business Assets

In the initial structuring of a business, it may be desirable for tax and other business reasons (e.g., improvement of credit status for the business where the assets are leveraged) to keep real estate and equipment out of the business, and to have such assets held in individual or partnership ownership by the owners of the business or by their family members. If this is not done at the outset, it may be possible to do so later by way of a sale-leaseback arrangement, as, for example, where the business sells the property to the owners (or to an entity controlled by them), who in turn lease it back to the business. Due to the crackdown on tax shelters the IRS will often question such sale-leaseback transactions, but so long as the arrangment is not a sham, has the elements of an arms-length transaction, and makes economic sense, it should withstand IRS scrutiny.

14. FCC Tax Certificates

This item is really more geared to an owner who wants to dispose of his or her interest in a station, but should be kept in mind for the future. A provision in the Internal Revenue Code provides for the tax-free disposition of broadcast stations, including disposition of stock in a corporation owning such a business, in cases where the FCC certifies that the disposition is necessary in order to effectuate a change in its policy, or the adoption of a new policy, with respect to the ownership and control of broadcasting stations. Under such circumstances, any gain realized by the seller will not be recognized to the extent that it is reinvested in property similar or related in service or use to the property sold. Alternatively, the seller can elect to reduce the basis of other depreciable assets still held by the amount of the gain realized. Either election must be filed with the tax return of the seller for the year in which the sale took place, and normally may not be made on an amended return.

F. FINANCING THE PURCHASE

There are a number of ways in which a purchase can be financed. Some of them are as follows:

1. The seller takes a down payment and accepts a promissory note on the balance over a period of years.

2. The seller takes some cash and the buyer assumes the balance of the seller's debts.

3. The seller receives cash for the entire purchase price, which the buyer must raise from personal resources or through another source such as a bank, insurance company, partners or other outside investors.

4. The seller and the buyer agree to exchange stock.

Whether to seek financing from a seller, bank, insurance company, pension fund, Small Business Investment Company or commercial credit company, etc., depends upon many factors.

1. Seller Financing

The best opportunity for a buyer frequently occurs when a seller will take a note (a process known as a "purchase money mortgage" or "seller paper") because a seller usually will give more favorable terms than other lenders to facilitate a purchase or as a means of mitigating income tax effects. In many cases, sellers will provide longer repayment periods than financial institutions. Moreover, most seller financing is at a fixed rate of interest rather than a rate which floats with the prime rate. (Bank loans typically "float" or are adjusted to two or three percentage points over the current prime interest rate.) Because the seller has no direct cost of acquiring the deferred portion of the payment price, the seller often can make the loan at less than bank rates. This is a significant advantage in times of high interest rates. These lower-than-market interest rates are sometimes coupled with a balloon payment after three to five years.

It is very difficult to obtain an institutional loan unless the property has a profitable history, good management and relatively good facilities. Also, many institutional lenders will not consider loans for less than several million dollars. The larger the lending institution, the higher the "floor" on the amount of the loan. For example, a large Texas bank will consider only loans to acquire a "group" of stations (two or more) and for more than $5 million. A smaller, more aggressive bank in the same city will make loans of $2 million or more. Some banks have venture capital subsidiaries that may be in a position to make smaller loans. But, as will be discussed elsewhere, venture capital typically carries both a higher rate of interest and a right to take an equity position in the borrower. Thus, in smaller markets, seller financing will be the principal, if not the only, means of facilitating the sale. Where a station is a loss or turnaround operation, it makes good sense for the seller to take back paper and provide comfortable terms, such as a moratorium on payments of principal for the first year or two.

Seller financing also may involve a buyer's assumption of the seller's existing indebtedness. Assumption of indebtedness as part of the purchase price can be good or bad. If the debt has a favorable interest rate, has a long term to run or substantially reduces the cash needed for a down payment, an assumption is good. But if an existing note has a high interest rate, an early "balloon" (or lump sum payment) or an accelerated payout, an assumption is bad. Or if a note carries the seller's personal guarantee, the seller may want to be rid of it as a contingent liability. When a station's cash flow is insufficient to pay off both an existing liability and a note to the seller, provisions must be made at the time of purchase which provide that payments to the seller wait until the previous note is paid off.

The terms of seller financing are important if the buyer also desires bank financing. Obtaining bank financing is easier if most or all of the principal payments to the seller are deferred or limited until the bank loan has been paid off.

The seller usually will agree not to compete in the same market, but there frequently is disagreement about whether there should be a specific payment earmarked to the seller. Such a covenant is a deductible expense to the buyer (assuming, of course, that the Internal Revenue Service finds that the amount paid is reasonable) and carries no interest. Thus, a non-compete agreement or a consulting agreement sometimes is a good way to bridge the gap on price between buyer and seller. Similarly, when the parties have agreed in principle on seller financing and the amount of future periodic payments, the interest rate can be increased and the principal amount reduced as a device to make a greater portion of the future payments tax deductible for the buyer.

2. Raising External Capital: An Overview

The first and most important step in raising external capital is to get a working knowledge of the capital market—the various types of financial institutions, the type of funds each will lend or provide for investment and the conditions under which such funds are available. As noted here, buyers who lack personal knowledge or familiarity with banks and other financial institutions should seek out an acquisition consultant who can provide introductions, independently critique the business plan and help prepare the necessary cash flow statements for presentation to prospective sources of financing. Table 2 identifies the primary sources of capital and the terms generally associated with each.

TABLE 2
SOURCES OF CAPITAL

	BANKS	INSURANCE COMPANIES	PENSION FUNDS	CREDIT FIRMS	SMALL BUSINESS INVESTMENT COMPANIES/ VENTURE CAPITAL FIRMS Subordinated Debt	Equity
Term	Usually 5-7 years (Max. 10)	Up to 12 years (Max. 15)	5-15 years	5-10 years	Up to 5 10 years	N/A (a)
Rate of Interest	Usually floating	Fixed	Fixed	Fixed or Floating	Fixed or Floating	(b)
Security	Secured	Secured or Un-secured	Secured or Un-secured	Secured	Secured or Un-secured	Unsecured
Personal Guarantee Required	Sometimes	No	No	Sometimes	Sometimes	No
Minimum	None	$2 million	$500,000	$100,000	$100,000	$100,000
Sweetener Required	No	Sometimes	Sometimes	Sometimes	Usually	N/A
Equity Prepayment	Somewhat Flexible	Yes	Yes	Yes	Yes	N/A
Balloon Repayment	Available	Available	Available	Available	Available	N/A
Moratorium On Principal Payments	Yes	Yes	Yes	Yes	Yes	N/A
Commitment Fee	Sometimes	No	No	Usually	Usually	Sometimes

(a) Most SBICs and Venture Capital firms use a practical guideline of liquidating equity investments within 5-7 years.
(b) Most target a minimum 30 to 40% compounded return on their investment.

This is only a general guide. For example, a commercial bank *sometimes*—but only in rare cases—will extend credit on a term basis for longer than five years. The table, therefore, summarizes the *most likely* terms to be offered in connection with broadcast loans.

Axiomatic in the world of credit is the concept that risk varies directly with return; the more risk involved, the greater the return that must be offered to attract investment capital. With this information and these sources of capital in mind, a prospective borrower must then determine the method pursuant to which the financing is likely to be structured.

3. Preparing a Business Plan

In preparing a business plan, the transaction should be viewed from the perspective of the lender. A lender's primary criterion for granting a loan or making an investment is the degree of risk involved. In determining the degree of risk, a lender assesses three major factors: the borrower's ability to generate cash flow for repaying the loan, its own ability to recover principal in the event of default, and the character of the borrower. Lenders are primarily interested in operational results, both historical and projected, and, especially, cash flow after taking into account debt service (principal and

interest payments) and equipment replacement costs.

Satisfying a prospective lender or investor on these points is the main purpose of a business plan, otherwise known as a financing proposal or offering memorandum. The preparation of this document serves other useful purposes. In compiling the necessary information, the borrower must rethink the basic soundness of the acquisition decision, improve his or her knowledge of the overall financial condition of existing operations, and create the proper structure for the financing. A complete example of a financial proposal for the purchase of a broadcast station is set out in Appendix D of this book.

A thoughtfully prepared business plan can make the difference between obtaining capital or being denied financing. A financial institution should not be approached until the buyer has selected a specific station for which financing is required and a business plan has been prepared that includes information on the following aspects of the property to be financed:

- History and description of the station's operations and assets to be purchased, including facilities, coverage, programming, staffing and reputation.
- Market information, including audience surveys, descriptions of competing stations, demographic data on potential and target audiences, advertising dollars in the market and dollars directed at target audiences. Some of this information may be unavailable in smaller markets, or difficult to obtain.
- Financial statements for the past five years (if available).
- Five-year *pro forma* projections of operations, including assumptions about revenues and expenses and sources and uses of funds for five years (or, if a longer term is sought, for the full term of the loan).
- Description of the proposed financing, including investor equity and debt participation and use of proceeds from the financing.
- Operating strategy, including programming, promotional activities, sales policies, expenses, management and any other borrowing plans.
- Description of the buyer, including biographical material on key officers (which demonstrates their character and financial, organizational and management skills), financial structure, and any outside consultants.
- Discussion of applicable FCC regulations.
- Purchase price rationale, based on analysis of cash flow, similar station sales, discounted cash flow analysis and so forth.

The need for *pro forma* operating statements deserves amplification. These projections should be prepared first, since they serve as a guide in structuring the financing. Accurate projections are essential; the buyer has nothing to gain by being overly conservative, but surely will lose by being too optimistic. Thus, the projections must be realistic. Lenders often prefer projections with a range of possible outcomes, i.e., optimistic, pessimistic, and most probable. Any assumptions must be realistic, well-documented, clearly stated, and correlated with existing as well as future market conditions.

Prospective lenders also want assurance that the borrowing group has management expertise—preferably in broadcasting. In some cases it also may be desirable to add someone with *financial* expertise to the management team. A key point which must be kept in mind in dealing with lenders is that many financial institutions (especially those outside of major and regional centers) are unfamiliar with the business of broadcasting. Thus, a borrower must be prepared to educate the lender about the broadcasting business.

It would be difficult to overemphasize the importance of providing background information about members of the acquisition group and persuading lending officials of the group's management skills and financial strength. Lenders commonly regard demonstrated management expertise as worth a reduction of up to a full percentage point of interest. Deferral of principal and interest during the early years of a loan, moreover, requires lender confidence that there are "deep pockets" standing behind the company willing and able to infuse additional capital or provide additional, subordinated debt should further working capital be required.

4. Selecting Potential Lenders

The projections discussed above should be interpreted in conjunction with the information in Table 1 and the following guidelines in determining which type of lender to approach.

a. Insurance Companies

The investments of insurance companies are regulated closely by state law. Their investment practices, therefore, are very conservative. Insurance regulations in most states prohibit loans to partnerships and sole proprietorships, and require companies to obtain five years of audited financial statements. Insurance companies prefer large deals (usually including more than one station), and operating companies with an established track record. Insurance companies are the financial institutions most likely to be able to make a large loan involving many millions of dollars. Interest rates on insurance company loans tend to be fixed at several points above the prime rate or the rate of United States government securities of equal terms.

One potential advantage of insurance company financing is loans run between 8 and 10 years and terms as long as 15 years may be available. Generally, if the amount of the loan is more than $2 million and the average annual cash flow available for debt service from existing operations for the previous three years combined with the projected cash flow for the current and succeeding two years is sufficient to provide equal amortization of 150% of the loan value over a ten-year period, the proposal will be received favorably from many insurance companies. It must be re-emphasized, however, that, with few exceptions, insurance companies lend only to relatively strong, well-established corporations. Many insurance companies now invest on a debt and equity basis with the same owner.

b. Banks

Commercial Banks. For loans of less than $2 million, banks are the primary sources of capital. Commercial banks will make loans in excess of $2 million but seldom lend money for more than eight years. Banks usually will require a first priority security interest or lien on all of the assets and a pledge of the stock of the operating company.

Borrowers need to determine whether to seek a fixed rate (which is generally long term) or a floating rate. Floating rates normally are fixed at 1 or 2 percent above the bank's prime rate, and sometimes include a cap or deferral. While interest rates have been favorable for the past several years, borrowers should keep in mind that floating bank prime rates have ranged all the way to 15 percent and beyond. Choosing between a fixed rate and a floating rate involves a crap shoot on the future course of interest rates. A good investment at a low fixed interest rate will remain sound whether interest rates generally rise or fall. A sound investment under a current floating interest rate may turn sour, however, if there is an unexpected climb of two or three points in the prime rate.

There are some important distinctions among banks. "Money center" banks—that is, large institutions in major cities—and regional banks are most likely to be familiar with financing broadcast stations. Local banks tend to have less experience with broadcast properties; also, their lending limits often require them to bring in participating banks in order to commit to the full amount of the loan—often a time-consuming process. A buyer may approach several different types of banks to locate financing. Lending policies may differ substantially from one bank to another, as discussed below.

Local Banks. Local banks serve a very limited geographic area—often a single town or county. These banks typically know very little about broadcasting. They prefer to lend on the basis of hard assets, rather than potential cash flows. Because only a small portion of most stations' value consists of tangible assets, local banks are exceedingly cautious about lending large sums to finance station purchases. Also, local banks tend to rely heavily on the management capabilities of the principals. A prospective buyer should therefore anticipate spending a lot of time and energy explaining the broadcasting business to a local banks and probably should not expect to finance most of the purchase price through such an institution.

On the other hand, a financial relationship with a local bank can be extremely productive for the buyer. First, a local bank may provide seed money to begin the process of station acquisition. (This type of loan usually requires collateral and/or a personal guarantee). Second, local banks can provide short-term financing or lines of credit to cover seasonal fluctuations in station income. Third, a strong relationship with a local bank can provide a new station owner an entree to potential local advertisers.

Regional Banks. Regional banks serve one or more states, but are significantly smaller than money center banks. A station buyer is much more likely to find experience with and understanding of the broadcasting business at a regional bank than at a local bank. Indeed, regional banks are the most likely source of financing for individual station acquisitions. Moreover, regional banks may be able to lend enough money to cover most of a station's purchase price. But virtually none lend more than 60% of the purchase price.

Because regional banks frequently are distant from a station and base loans on past and anticipated cash flows, their lending officers want very complete financing proposals. These may include exhaustive descriptions of the station and its market, as well as a detailed operating and financial plan for the life of the loan.

Money Center Banks. Money center banks are located in very large cities and have a national—and often international—clientele. Some money center banks have developed significant expertise in broadcast station financing. Because of their experience, these banks may be likely sources of financing. Large banks tend to make only large loans ($5 million and up), however, and prefer to deal with established corporations. The purchase of a single small property may not interest these banks, unless the borrower has a strong financial history and other sources of financing. Like regional banks, money center banks require very detailed financing proposals.

Two characteristics apply to banks of any size. First, they prefer to make relatively short term loans—

frequently no more than five and almost never longer than eight years. Given many stations' limited cash flows to cover interest and principal, this is a shorter repayment period than most new station owners are comfortable with. Second, most banks base their lending decisions largely upon the applicant's character, management and broadcasting experience. A loan applicant thus needs to impress lending officials on a very personal level. The financing proposal is an excellent vehicle for demonstrating these qualities. According to the *1987 Directory of Lenders and Investors to the Broadcasting Industry* published by Frazier, Gross & Kadlec, Inc., the average 1986 loan terms that banks reported ranged from five to ten years. In 1985, the typical amount banks were willing to lend was based on a multiple of four to six times cash flow. In 1987, the multiple improved noticeably in a range of five to seven times cash flow. Appendex F contains a listing of banks which have loaned money for one or more broadcast aquisitions.

A recent change in some banks' lending policies now permit banks to loan more than one layer of debt. In addition to traditional senior debt, some broadcast banks now loan funds on subordinated or even mezzanine bases.

c. Pension Funds

Like insurance companies, the investments of pension funds are closely regulated. Because most pension funds have smaller asset bases than insurance companies, they are less likely to be in a position to finance large transactions.

d. Venture Capital Companies

A prime source of loans or equity is private venture capital companies. Wealthy individuals and institutional investors often pool their investment capital through a venture capital firm. Their loans do not meet normal lending requirements, but have at least a strong possibility of generating extraordinary profits. Because venture capital companies raise funds in the private market, their interest rates tend to be several percentage points more than charged by institutional investors. Appendix F contains a list of venture capital companies with a record of investing in communication properties.

Moreover, most venture capitalists are willing to make substantial loans only with the promise of hefty profits. They usually demand a substantial portion—i.e., between 25 and 75 percent—of a company's equity. Their participation may take several forms, including stock warrants exerciseable at the end of the loan; substantial amounts of preferred stock; and a limited amount of voting stock.

Many venture capital firms also impose conditions which allow them to take control of a company if it does not meet specified gross or net revenue goals. Venture capital firms usually want to participate in the management of a company, and often insist on some measure of control—such as one or more seats on the Board of Directors. Some venture capitalists thus take the place of banks in financing, by having a first position for repayment.

A common venture capital arrangement in recent years is the leveraged buyout (LBO). LBOs increasingly have involved selling some of the acquired stations in a group simultaneously with the LBO purchase to pay off some of the LBO's debt. While bank loans normally are limited to 50–80% of the purchase price, up to 100% is sometimes available in a leveraged buyout. LBO purchasers typically put up relatively little equity; debt-to-equity ratios are 12-to-1 or even higher. Appendix E contains a detailed discussion of the types of stations best suited for a LBO.

e. Public Offerings

The most cost effective means of raising substantial amounts of capital is through an initial public offering (IPO)—that is, a sale of a company's stock to the general public. A public offering can maximize available capital, while leaving the principals of the company in control of their firms.

There are two reasons for this result. First, an IPO almost inevitably results in a large number of shareholders, none of whom has enough stock to exert any real control over the company. Second, if an offering is attractive enough, the company's principals may be able to raise enough capital by offering only a minority interest in their venture.

Despite these attractions, an IPO usually is not a practical means of financing the acquisition of a single station—except for existing media corporations with good financial track records. The basic problem is the speculative nature of investing in a new entrepreneur, no matter how experienced he or she may be as an operation in the industry.

The risk factor of new owners has several consequences. First, it may make it difficult or impossible to find an underwriter—which is essential for a public offering—since its commission on the offering depends upon the success of the offering. Underwriting basically means a guarantee to the offering company that a certain minimum number of shares will be sold. Underwriters' fees range as high as ten percent. Occasionally, stocks in a new company are sold on a "best efforts" basis, with no underwriting commitment. But that is

hardly good assurance of adequate financing of a station acquisition. "Best efforts" offerings are more typical of private placements of stock or securities rather than public offerings.

Second, the Securities and Exchange Commission (SEC) must approve all public offerings, and it closely scrutinizes companies with limited track records. At the very least, the SEC will insist that a new venture load its prospectus with warnings that its offering is "high risk"—a requirement which does not exactly inspire great trust in potential investors. A speculative element in a public offering naturally depresses the stock's selling price.

Third, and this is true of private placements as well as public offerings, a great deal of time is required. In addition to what is referred to as the "due diligence" investigation of the company and its prospects necessary to obtain the underwriting commitment, the SEC approval process can take several additional months.

This does not rule out an IPO for all acquisitions. For a well established company, a public offering is feasible and cost efficient. For totally new entrants to the media marketplace, however, public offerings generally are not productive.

f. Investment Banking Companies

The traditional role of investment bankers is to underwrite securities as well as bond issues, and to arrange mergers between large corporations. Some investment bankers will arrange financing for broadcast station acquisitions priced in excess of $5 to 10,000,000. Investment banking firms typically play an important role in LBOs, where 100 percent external financing requires a mixture of equity, investment and two or more classes of debt. Recently, a few large investment banking companies have invested directly in broadcast ventures. In most instances, an investment banking firm requires a well-regarded management team to operate its properties, in order to assure a successful investment.

Recently, investment banking houses have gained attention with large issues of "junk bond" financing, which has played a significant role in a number of broadcast mergers and takeovers. "Junk bonds" are unsecured or subordinated high-yield debt instruments; the term follows from the risk represented by the bonds to the investors that buy them. They are one type of "mezzanine" financing that investment bankers may be able to raise. Assume, for example, a $20 million transaction in which the entrepreneur brings very little equity to the table. "Senior," or commercial, bank debt will cover $12 million of the price at six times cash flow. The investment banker might raise $5 million in equity through a limited partnership offering and another $6 million in higher-cost mezzanine financing syndicated directly to investors to cover the balance of the acquisition price plus initial working capital requirements.

Factors to remember about investment bank financing are (1) it is usually suitable only for very large transactions (although there are smaller investment banking houses, including some specializing in the broadcasting business); (2) it is very expensive, both in fees and in terms of the rate of return required by investors; and (3) it requires a considerable period of time to put together (four to six months) and is therefore not suited to moving quickly. Appendix F contains a list of investment banking firms which have participated in broadcast acquisitions.

g. Private Placement and Syndication

Another form of equity funding is the limited partnership. In a limited partnership, one or more "general partners" take on all managerial roles and financial obligations. The "limited partners" usually invest most of the capital, but are immune from any of the partnership's liabilities beyond their capital investment.

A tax-oriented limited partnership creates long-term net operating losses as well as future appreciation and income as the station matures. These losses generally can be anticipated during the first three to five years of the investment. They stem from initial net losses, which usually result from the following typical expenses: depreciation, interest, amortization of intangible assets, and recapitalization of plant and equipment to current values. In effect, the partnership "takes down" a very large debt in a very short time, thus creating initial tax deductions and later income.

For the entrepeneur, the principal attraction of the limited partnership is the risk undertaken by the limited partner. Limited partnership investments are paid back only out of profits from station operations. If the station is not profitable, the limited partners have assumed the risk that they will never see a return on their investment. Even in circumstances where limited partner contributions are composed partly of equity and partly of debt, the debt portion is subordinated to senior bank financing and is unsecured. One drawback to this type of financing is that the organization of a limited partnership is often complicated, and can create financing uncertainties until the last minute before closing—particularly if the partnership involves a large group of investors. There are other limitations of limited partner financing that have to be taken into account. In view of the high degree of risk assumed by investors, and to maximize the chances of "selling out" the offering for the full amount, the deal must be structured in a way

that will be very attractive to investors. This means anticipated returns at least on the order demanded by venture capitalists. Moreover, the 1986 Tax Reform Act (TRA) limits the ability of investors to realize tax advantages from losses generated by passive investments. Many pre-TRA limited partnerships were structured to create several years of passive investment losses (principally depreciation and interest charges). Now, however, investors are more likely to be looking for "passive income generators"—PIGS. This has the effect of making only a more limited class of broadcast properties—those where return can be realized in the relatively short term—attractive candidates for limited partner financing. A further and very real drawback to limited partnership financing is the relative difficulty of raising additional capital if the initial offering proves inadequate to meet working capital requirements. Even more so than with other financing arrangements, therefore, the limited partership form places a premium on realistic projections of station performance and adequate budgeting for contingencies.

h. Government-backed Loans

Government-backed loans are available from a variety of sources. These sources can provide guarantees or repayment and/or funds at below prevailing market interest rates.

1. Small Business Investment Companies

Small Business Investment Companies (SBICs) were created by the Small Business Investment Act of 1958 as a vehicle for providing equity capital and long-term loan funds for small businesses. SBICs organized under section 301(d) of the Act specialize in providing equity funds, long-term loans, and management assistance to small business concerns owned by socially or economically disadvantaged persons. These SBICs were at one time called Minority Enterprise Small Business Investment Companies (MESBICs). However, the 1972 amendments to the Small Business Investment Act broadened the term from "minorities" to "disadvantaged Americans" and the official title of a MESBIC is now a Section 301(d) SBIC.

SBICs generally may receive three dollars of government-backed funds for each dollar of private capital; Section 301(d) SBICs generally receive four dollars of long-term subordinated government funds for every dollar of private capital. Because SBICs borrow funds through the government at the rate paid by the government, SBIC loans may be a percentage point or more below the rate charged on commercial bank loans. More typically, however, SBICs function like other venture capital providers and provide funds only at higher rates coupled with features referred to as "equity kickers."

SBIC investments may take any of several forms: for example, loans with warrants (permitting the SBIC to purchase common stock at a specified price at a specified date); convertible debentures and, more infrequently, direct investment in either preferred or common stock, direct loans with no equity features, guarantees, and management and technical assistance. Most Section 301(d) SBICs specialize in investments in a particular line of business.

The investment policy of Section 301(d) SBICs allows for the extension of financial assistance to small business concerns which will contribute to a well-balanced national economy by facilitating ownership in such concerns by persons whose participation in the free enterprise system is hampered because of social or economic disadvantages. Generally, a small business concern which is at least 50 percent owned and managed by individuals from groups that are underrepresented in the free enterprise system will qualify. Such groups include, for example, Blacks, Indians, Eskimos, Aleuts, and Americans of Mexican, Puerto Rican, Cuban, Filipino, or Oriental extraction. Some SBICs with experience in lending for communications properties are listed in Appendix F.

For further information for SBA financing, contact the Office of Business Loans, Finance and Investment, Small Business Administration, 1441 L Street, N.W., Washington, D.C. 20006, (202) 653-6574.

2. Farmers Home Administration (FmHA)

The Farmers Home Administration, a rural credit agency of the U.S. Department of Agriculture, may also assist potential minority broadcast owners to obtain the necessary financing. Any legal entity is eligible for funds. However, the FmHA is primarily concerned with developing rural America and its lending priority is to applications for projects in small towns.

The FmHA assistance ordinarily is provided as a loan guarantee whereby the agency contracts to reimburse the lender up to 90 percent of the principal and interest of the guaranteed note. Applicants apply for the guarantee through their private lenders. In some rare instances, however, FmHA may directly make and service the entire loan.

The FmHA Business and Industrial Loan Program provides for applicants unable to obtain credit through other sources. However, investor equity (ordinarily a minimum of 10 percent) is required to provide reasonable assurance of a successful project. At the present time, the FmHA program has no ceiling, since it is handled by private lenders. However, FmHA is currently

considering adopting regulations to put a cap on the size of loans guaranteed by FmHA.

FmHA loans are available to cover a broadcaster's daily operating costs as well as building, equipment, supplies, research and other nonoperating costs. For guaranteed loans the interest rate will be determined by the lender, consistent with the market rate. For further information, contact the Farmers Home Administration, 1400 Independence Avenue, S.W., Washington, D.C. 20205, (202) 447-4324.

5. Combining Sources of Financing

Loans from banks, insurance companies and pension funds generally are deemed "conventional" financing. In some cases, a station's historical cash flow is sufficient to cover a loan for the full amount of the acquisition. These cases are more the exception than the rule, however, in times of escalating acquisition prices. As an overly simplistic rule, banks usually will not finance an acquisition in an amount greater than about seven times a station's cash flow. As noted before, cash flow multiples for FM or VHF television stations today are running from 10 to 14 times cash flow. Because of legal limits on insurance company investments, ceilings on government-backed and other limitations, it is difficult for new companies to obtain single-source financing, except for properties in small markets. Where historical cash flow is insufficient to repay the loan, additional financing will be necessary.

Combination financing packages have few structural limitations, but share a common objective: providing a cushion for the senior lender in terms of a guaranteed cash flow for interest. A combination of two funding sources can range from all subordinated debt and no equity to the opposite. These financing plans entail considerable risk for the prospective lender or investor, and thus are expensive for the borrower. A borrower thus should attempt to get as much senior debt as possible. A general rule of thumb is two dollars of senior debt for every dollar of equity and/or subordinated debt. The cost of subordinated debt may be reduced, however, by including an equity interest—which gives the lender a stock interest at the loan's maturity—or by using lenders with lower interest rates (e.g., insurance companies). These arrangements improve the viability of different ratios of senior to junior debt.

An example of a combination arrangement may be useful. A buyer wants to buy a radio station in a small market for $1,350,000. In addition to the purchase price, $150,000 of working capital will be required to meet the station's expenses until advertising sales produce revenue, and to promote the station's new "image"—perhaps a format change.

The buyer creates a corporation with $150,000 of capital invested by the common stock owners. A bank makes a $1,050,000 loan, $500,000 or which is guaranteed by the SBA. The remainder—that is, $300,000—of the capital is provided by an equity investor through redeemable preferred stocks with stock warrants and subordinated loans.

A few definitions are necessary in order to understand how this plan will work. Preferred stock pays a fixed dividend and has a fixed dollar value upon liquidation of the corporation. Because preferred stockholders cannot vote on routine corporate business, preferred stock does not dilute the buyer's control of the corporation. On the other hand, the preferred shareholders receive dividends before the common shareholders. With a small property, the dividends to preferred shareholders virtually are de minimis, since most net income is re-invested in the station.

Warrants are options to buy a certain number of shares of stock at a specified price, and generally have a fixed expiration date. These "calls" thus are the mirror image of "puts." Occasionally they also have a fixed option date, on which the option or "call" must be either exercised or relinquished. In the above example, the warrants might give the equity investor an option to acquire 49 percent of the corporation's common stock. If the company prospers, the equity investor can participate if the company goes public or the station is sold at a profit. On the other hand, the corporation can redeem the preferred stock and the attached warrants at an agreed-upon time by paying an agreed-upon price for a "put."

Debentures are long-term debt instruments which are not secured by a lien on any specific property. Debenture holders, however, are next in line after the primary lienholders have been paid. In the above example, the bank is the secured or "senior" lender. If the corporation is liquidated, the equity investor will participate in the proceeds only after the senior lender has been paid back in full. In this example, however, the equity investor is not only a preferred shareholder, but also a junior lender. Its loan is protected at least partially by provisions in the company's articles of incorporation, allowing the preferred shareholder to elect a majority of the board if the corporation is unable to pay dividends on the preferred shares.

Considerations involved in the selection of a particular lending institution involve not just matters such as the interest rate, repayment terms, collateral or the

amount of equity required, but also the lender's capacity to provide financial or management expertise.

6. Negotiating a Loan

a. Convincing the Lender

Before approaching lenders, a borrower should be able to justify and document the merits of his or her financial package.

Once the preliminary structure of the financing has been determined, the appropriate sources of capital must be identified and contacted for indications of interest. In all probability, this will be the most time-consuming activity encountered in arranging financing. The borrower should be prepared for numerous negative or unenthusiastic responses.

For many years the financial community placed broadcasting low on the priority list for favorable loan consideration because of the high degree of leverage, preponderance of intangible assets, volatile earning records and regulatory restrictions associated with such operations. This attitude has changed dramatically during the past few years. Indeed, some money center banks seem to be competing for the opportunity of making broadcast acquisition loans. But many regional and local banks still need to be convinced.

Many objections to broadcast financing proposals can be successfully countered by anticipating them and including information in the presentation. The objection most frequently voiced by lenders relates to the lack of sufficient collateral for the loan. Typically, this results from the lender's shock that a station worth $10 million may have tangible assets of only $500,000.

The concept to be stressed in this situation is that an active market exists for broadcasting licenses—a market in which a fixed number of licenses represents the only means of entry into the industry. Statistical data documenting the increases in station trading activity and average sale prices are readily available and make worthwhile additions to the financing proposal.

If the lender can be convinced that the property in question has a reasonable value and will, therefore, at least retain that value for a reasonable period of time, e.g., five years, market value can be substituted for "hard asset" value. A secured loan reflecting a substantial portion of the purchase price becomes more justifiable to the lender. But a lender still looks primarily at the ability of the station to generate sufficient dollars from operations to pay back the loan, rather than lend on the basis of the station's market value.

Securing (or collateralizing) a loan is another area of concern. The fixed assets (e.g., studio and transmitter) present no obstacle. But a security interest in the most valuable asset—the license—is not permitted under FCC regulations. As a partial alternative, banks often insist on pledges of stock as collateral. There is no legal bar to such a pledge, so long as the bank understands and is willing to observe the FCC's limitations on foreclosure. Before the bank may foreclose on the loan by causing the stock to be registered in its name, or the name of its nominee, the FCC must approve the transfer. Without the FCC's approval, the bank may not sell or control a station.

Concerns about volatile revenue and earnings also can be assuaged to a substantial degree. In what heavy manufacturing industry (favorites of institutional lenders) can overhead be controlled as directly and as quickly as in broadcasting? Massive plant and equipment, which serve as excellent collateral, become a tremendous burden in terms of fixed operating cost in an economic downturn.

Comparisons between publicly-owned broadcasting companies and firms of similar size in other industries can also provide a favorable illustration of value during periods of recession. What was the trend of station values and marketability during these periods? They were generally increasing while the prices at which many industrial companies could be sold, if they could in fact be sold, plummeted drastically.

With these points in mind, the borrower should review the financing proposal to be certain that as many objections as possible have been anticipated and resolved before they can be raised.

b. Rules of the Road

In approaching prospective lenders and in structuring financing,several caveats are in order. Some of the most important are:

- Borrowers should be prepared to spend a great deal of time and effort. The preparation of an effective financing proposal is crucial and can mean the difference between success and failure. The cost of preparing a business plan can run as high as $50,000 from a "Big Eight" accounting firm; an independent consultant, however, can provide a comparable service for far less. An in-person presentation to prospective lenders or investors is much more impressive than dealing exclusively through the mail and over the telephone. A personal presentation helps the lender identify the serious inquiries, and also allows management the opportunity to display its capabilities. After all, broadcasting is a management-intensive industry,

and lenders rely heavily on their evaluation of management in making a loan.

- In proposing and negotiating the terms of a loan, avoidance of overly restrictive covenants is essential. A loan agreement is virtually irrevocable, and five to 15 years is a long time to be bound by restrictions. Some of the terms that require particular attention involve prepayment penalties, acts constituting default, balance sheet maintenance ratios and amounts, disposition of assets, restrictions on future acquisitions, restricted payments, and limitations on additional indebtedness. Onerous or difficult terms may be portents of a strained working relationship or a lack of shared confidence in the acquisition. In some cases, restrictive terms may reflect the lending institution's lack of familiarity with the broadcasting business. It may, therefore, be possible to avoid insertion of such terms with a particularly effective presentation. It is also possible that better terms can be secured by approaching a lending institution with more familiarity with the business. At the least, the borrower should seek to have such restrictions automatically lapse or "self-extinguish" after one or two years. (Some restrictions sought by lending institutions—e.g., requiring lender approval on certain expenditures—also may violate FCC regulations or policies on broadcaster's responsibilities. Again, review of the loan documents by communications counsel is essential.)
- A borrower should take care to ascertain all costs associated with obtaining financing. All financial institutions will charge the borrower for legal fees incurred for preparing loan documents and security agreements. Some financial institutions also require that the borrower pay certain other fees in connection with financing. Some even charge an "origination" fee to review a financing application before making any commitment to provide funds. Examples of other fees charged by lenders include commitment fees, appraisal fees, accounting fees, legal fees and additional life insurance on key officers. A well-informed borrower should be able to keep such expenses to a minimum.
- The Securities Exchange Act of 1934 delineates a fine distinction between public and private offerings of securities. While most financial institutions would be deemed "sophisticated investors" under the Act—and thus capable of making informed decisions—distribution of offering memoranda must be guarded judiciously. Offerings which might be exempt from federal securities regulations nonetheless may be governed by state "Blue Sky" laws. Mass mailings are definitely dangerous.

Even offerings that are exempt from federal or state registration requirements have serious and substantial pitfalls. First but not necessarily the least among them is the procedural requirements necessary to secure and preserve the exemption. Second is the duty to make full disclosure of all material terms and matters affecting the proposed investment. Broker-dealer firms that agree to market such offerings to their customers require a due diligence investigation

TABLE 3
SAMPLE COMBINATION FINANCING

PURCHASE FINANCING		% of Total Financing	DEBT SERVICE TYPICAL TERMS	YEARLY PMTS
Equity—Common Stock	$ 150,000	10%		0
Bank Loan—Direct	550,000	37%	Prime + 2% (= 11% interest) 10 year amortization, due 5 years	$ 90,950
—Guaranteed by SBA	500,000	33%	Prime (= 9% interest) 10 year amortized loan	76,000
Redeemable Preferred Stock	300,000	20%	10% dividend	30,000
TOTAL PURCHASE + W/C FINANCING	$1,500,000	100%	ANNUAL DEBT SERVICE	$196,950

The most important element in combination financing is not being able to "do the deal," but rather the ability to handle the debt service. In this case the station must generate $196,950 in annual cash flow to cover its debt service. If the station can generate the requisite cash flow, the 90% leverage should yield an outstanding capital gain on resale. If it can't, the ability of the entrepreneur to continue owning the station is thrown into doubt.

of the transaction before they will share the risk or liability to investors for *potentially* false or misleading statements. The various state and federal laws regulating securities transactions provide fertile ground for disgruntled investors who have seen their investments evaporate in a puff of unfulfilled anticipations.

- Dealings with so-called "money brokers" also should be undertaken with caution because they often require up-front finder's fees which will not be refunded in the event the financing does not materialize. The state of capital markets within any limited time period actually is quite predictable. Thus, individuals or firms promising unrealistically favorable rates and/or terms for an advance fee with little or no informational requirements on the part of the borrower should be approached with skepticism. Sources of international capital should be especially suspect, because the Communications Act places limits on foreign ownership of broadcast stations.

LAST THOUGHTS ON BROADCAST FINANCING

- The time to talk to a banker is when you don't need the money.
- Everybody wants to be in broadcasting—but not everybody should be.
- If a deal isn't hard to do, it isn't good.
- There is no such thing as an overfinanced purchaser.
- Happiness is positive cash flow.
- Just when you thought the deal was done, you spoke to the venture capitalists.
- Don't expect a lending institution to venture its capital.
- The best form of financing is seller paper.
- The Golden Rule of Broadcast Financing: Whoever has the gold makes the rules.

G. THE CONTRACT

1. Asset Or Stock Transaction

The sale of any business is rarely trouble-free. But the sale of a broadcast station is particularly complex, because it involves many intangibles, such as the license, an audience, advertiser accounts, network affiliation agreements, and the like. A decision should be made early on whether to acquire the assets or stock. The distinction between the two is essentially this: under an asset purchase agreement, the buyer assumes only those assets (and liabilities), including the license, specifically negotiated to be sold. In a stock acquisition, the new stockholders acquire *all* of the assets and *all* of the liabilities (whether or not disclosed) of the corporation, except those which are specifically excluded. The determination may be dependent on tax considerations (e.g., tax loss carried forward, recapture of depreciation and investment credits, and value of current assets above all liabilities). Typically, asset purchases have more favorable tax implications for the buyer, though the TRA of 1986 and IRS rules concerning accounting for asset transactions have made the choice less clear and certain complex mergers/liquidations may accomplish the same tax results. The vast majority of broadcast station sales are pursuant to an asset purchase agreement.

2. The Written Agreement

At the time the buyer and the seller agree upon the general terms of the purchase, these terms should be put in written form. In some cases, a formal option contract is used. But more commonly, a simple letter of intent will suffice. Such a letter states the price and terms for the station and provides that the agreement is subject to the preparation and execution of a formal contract. At this early stage, any written agreement should be fairly general. The fine points can be resolved later on.

The next and possibly most important step is the contract of sale. As a practical matter, there is no such thing as a standard station sales contract. Agreements range from simple eight- or ten-page contracts for the all-cash purchase of a small radio station to detailed 100-page agreements with numerous appendices covering complex purchases of groups of broadcast stations.

The contract not only sets out each party's rights, but also the procedures for the final closing. The contract should be as precise as possible to avoid any misunderstanding. Appendix G contains an outline of typical provisions contained in an asset purchase agreement for the acquisition of a broadcast station.

An absolutely essential provision of the agreement is that the buyer will not participate in the management of the station until after the FCC has approved the sale. (As a practical matter, sellers—who are anxious to see the sale take place—advise the buyer of major business steps that occur during the period prior to FCC approval and the closing. For example, the seller of a television station would normally advise the buyer if there was an opportunity to purchase an expensive, highly-rated, syndicated program series, and take the buyer's reac-

tion into account in deciding whether buy or not to buy.) Where the seller is providing financing by taking back a note or a mortgage, the agreement must be specific on the subject of the seller's rights in the event of default on the debt. Because not only is FCC approval required but outside parties may seek reconsideration or appeal the FCC's decision to the courts, many contracts provide that the closing may take place only after the FCC's approval has become final and is no longer subject to agency or judicial review.

Examples of other contract terms which are important (and, therefore, often the subject of disagreement) include:

- If the accounts receivable are to be assigned, a mechanism is needed to adjust the purchase price to reflect receivables outstanding on the closing date. If the receivables are not to be assigned, the obligation of the buyer to collect outstanding receivables for the benefit of the seller must be defined.
- Obligation of the seller to preserve the business and to continue to operate the station in the normal course of business. (Parties generally agree that the buyer shall not be obliged to assume any contracts, leases or other agreements not specifically listed in an exhibit to the purchase agreement. Preparing a complete list of such agreements, including network affiliation agreements and leases for such items as copiers, the postage meter and office furniture, is a time-consuming but critically important task.)
- Allocation of the purchase price to meet the tax objectives of the buyer and seller. (The seller may benefit by the allocation of a larger share of the purchase price to the station's good will, which minimizes recapture liability on previously depreciated assets. On the other hand, the purchaser cannot deduct, recover or depreciate good will, broadcast license rights, or network affiliation agreements, so he or she would prefer to allocate the purchase price to items such as transmitting equipment, land and buildings, and office furniture, which may be depreciated.)
- The kind of warranty the equipment should carry at closing. (Frequently, the parties agree on language that calls for the equipment to meet FCC standards and be in satisfactory working order.)
- The rights of the buyer and seller in the event of fire or other damage to the facilities prior to closing. (Buyers generally seek the right to choose between terminating the agreement when damage cannot be repaired prior to closing and accepting the facility "as is" together with an assignment of the proceeds of insurance.)

Other provisions generally made part of sales agreements include various representations and warranties of the seller and buyer. Both typically warrant that they are corporations (or partnerships, etc.) duly organized and in good standing and that all actions necessary to enter into and consummate the agreement have been properly taken. The seller typically warrants that it can convey good and marketable title to the property and assets being transferred, that no actions are pending that would impair the ability to transfer the assets and licenses, and that entering into the agreement does not conflict with or result in a breach of any other agreement to which the seller is a party. Typical warranties of the buyer include that he or she has the financial ability to consummate the agreement and that there is no reason to believe that he or she will not be found qualified by the FCC to acquire the licenses. The representations and warranties made by buyer and seller are required to be true and correct as of the closing date, and the obligations of the parties to close are usually conditioned on receiving a certificate (and, as to some of the warranties, a letter of opinion from counsel) to that effect.

These provisions of the agreement serve many important purposes. Through the seller's warranties and representations, the buyer is seeking maximum possible disclosure. The more knowledge the buyer has of the seller's operation, the more tightly the agreement can be worded to assure that the seller will perform as bargained for at closing. By holding its own disclosures to the minimum, the seller is seeking to limit the possibility of technical defaults that might justify the buyer's refusal to follow through with the purchase. Both parties are seeking to minimize the risk of unanticipated future expense or liability to each other and to third parties. Accordingly, both parties typically seek broad indemnification provisions.

3. Between Signing the Agreement and Closing

A point which must be kept in mind is that a station sale can take place only with the consent of the FCC. Thus the period of time involved in the acquisition of a broadcast station is typically much longer than that required for the sale of any other small business. An application for FCC approval must be prepared. Then the parties must wait while the FCC processes the application. Until the FCC grants its approval, the buyer is precluded by law from intervening in the management of the station. Usually, the FCC acts on routine applications within seven or eight weeks after they are received. Occasionally the FCC action is delayed. And, between the time the sale is agreed to and the actual closing, the station's performance often suffers. Key employees may

leave for more secure positions; and advertisers unfamiliar with the new management will defer decisions about long-term advertising commitments. As a result, the purchase of a station may look less advantageous on paper at the time of closing than at the time of initial agreement was reached.

This fact of life may have no direct impact on the valuation of a station. However, it is a focal point in negotiating a final sale agreement as buyers seek provisions that will enable them to walk away from the deal if the station's performance declines precipitously and sellers seek to negotiate terms which will prevent buyers from avoiding their obligations to close. The changes that are likely to take place while the parties await FCC approval are also the cause of much uneasiness among committed lenders, who may see station performance declining below a point where it can be quickly turned around.

H. THE APPLICATION

In the sale of most businesses, a deal is struck, a closing held and the transfer takes place. In broadcasting, the deal is struck and then the parties wait until the FCC processes the applications for approval of the sale. Under the Communications Act, all broadcast station sales are subject to prior FCC approval. For FCC purposes, a purchase of assets including the license is referred to as an assignment of the license. An acquisition by exchange of stock or purchase of the stock of a licensee corporation is referred to as a transfer of control.

1. Timing of FCC Approval

It is impossible to predict how long it will take for an assignment of license or transfer of control application to be prepared, filed, processed and granted as there are many variables and any one may delay the process. One important variable is that any interested person may file a petition to deny the application within 30 days from issuance by the FCC of public notice that the application has been accepted for filing. Another variable is that much of the processing of an application depends on the workload of the Commission and the extent to which the FCC's staff requires that supplemental materials be filed by parties to the sale. Based upon current experience at the FCC, a clean application with no problems and no petitions to deny filed against it can be expected to be granted in about 50–60 days from filing. A non-substantial petition to deny or miscellaneous questions about the application may delay the grant an additional month or two. A substantial petition to deny, raising numerous allegations of fact, could result in delays of up to a year from filing. Because of the many variables which can result in the delay of the grant of an application, many sales agreements provide for a contract expiration date of nine months to one year from the date of the filing of the application and the provision that either party may withdraw if the FCC designates the application for a hearing regardless of the time allowed.

Prior to Commission approval of the application and the consummation of the transaction, buyers and sellers should refrain from actions which could be construed as constituting a premature transfer of control over the operation of the station. Generally, the Commission does not allow a potential buyer, a principal of the buyer or the buyer's proposed manager to assume a managerial position at the station during the pendency of the application. Any such assumption of a managerial position can result in the application being seriously jeopardized. If a potential buyer believes that some unusual circumstances should justify permitting him to assume some position at the station prior to consummation of the transaction, the advice of communications counsel should first be obtained in order to ensure that the application will not be jeopardized by a premature transfer of control.

2. Preparing the Application

Two types of application forms are used—an application for consent to assignment (FCC Form 314), for asset acquisitions, and an application for consent to transfer of control (FCC Form 315) for a purchase of stock. The application consists of two basic parts—the seller's (assignor or transferor) portion and the buyer's (assignee or transferee) portion. If the parties have not already filed the application for FCC approval, the purchase agreement must be filed with the FCC within 30 days after it is signed.

The seller's showing in the application is essentially limited to demonstrating that it has operated the station in a manner satisfactory to the Commission.

The buyer's portion of the application is divided into four sections: legal, financial, programming and equal employment opportunity.

a. Legal Requirements

In the legal section, the buyer must provide detailed information about its legal qualifications, including citizenship, corporate or other business structure and stock interests held and other media interests owned. With respect to the buyer's principals, complete information must be submitted on the other media business activities and interests of each principal. This information enables the FCC to ascertain whether the acquisition will comply with its regulations on ownership of multiple broadcast

facilities and cross-ownership of competing media. Media interests that must be disclosed include direct or fiduciary interests and indirect interests which a principal may have in a broadcast or cable facility or in a newspaper by virtue of the principal being an officer, director or stockholder in a bank, insurance or investment company or other financial institution. For example, if a principal of the buyer is also director of a bank, and the bank, through its trust department or otherwise, votes stock in a company with a broadcast station, that station would be attributed to the principal for purposes of applying the Commission's multiple ownership rules. (See the discussion of the multiple ownership rules in Section II C. 2.)

In all events the multiple ownership rules must be complied with by a potential buyer before the application will be granted.

The application must also provide information concerning lending agreements creating a security interest in or potentially affecting the future ownership of the license, the assets or the stock of the licensee corporation if—as will be true in most cases—a portion of the purchase price will be funded either by the seller or through external financing. Although in most instances the filing of these instruments is not required, buyers who are relying on external financing should be alerted to some general FCC policies in this area and be prepared with an appropriate response if questions are raised by the FCC's staff. For example, sellers taking back notes for deferred payments of the purchase price and institutional lenders usually require security to cover the debt. This can be in the form of a security agreement covering the physical assets of the station or a pledge of the licensee's or buyer's stock. Such security agreements should be filed with the application. Where physical assets are pledged it should be clear in the pledge agreement that upon default the lender or pledgee receives the rights only to the physical assets and no rights to operate the station. (Thus, by foreclosure, the pledgee can seize the assets and force the station to discontinue operations.)

Where the stock is pledged as security, the agreement should provide for the sale of the stock upon default either by public auction or by privately negotiated sale. In the case of the latter, the agreement should specify that the sale must be an arms-length transaction and that the buyer will be sought only after the default. Pledge agreements should stipulate that the licensee maintains full control over the operation of the station. Thus, borrowers must be wary of negative covenants in pledge agreements whereby the licensee must receive the permission of the lender before changing certain facets of the station's operations, or before hiring or firing certain key employees. The pledge agreement must not contain language which restricts the licensee's right to sell the station at any time either by asset sale or by a stock transaction. Such a right of alienability is one of the cardinal elements of control. Of course, the agreement can require that the pledgee be given advance notice of the proposed sale of the station and that such a sale would be an event of default at the option of the pledgee.

Contracts, loans and security agreements must not contain provisions giving the seller of the station any rights to the station upon default or any rights to the use of the station in the future. Such provisions would violate Section 73.1150 of the FCC's Rules prohibiting reversionary interests and reservation of time upon sale of a station.

b. Financial Qualifications

The buyer must certify the availability of sufficient financial resources to purchase and operate the station. To be financially qualified, an applicant must be able to meet the following expenditures:

- cash at closing;
- all principal and interest payments due to seller during the first three months;
- repayment of principal and interest on other loans during the first three months; and,
- projected cash operating losses of the station being acquired over the three-month period following the closing.

Several years ago, the FCC required the buyer to document the availability of funds in the application by submitting loan commitment letters, stock subscription agreements, balance sheets, financial statements, etc. Such information is no longer required to be filed with the application; the buyer is only required to certify that funds will be available. However, the FCC has retained the power to ask the buyer to submit such information about its financial ability. To the extent that responses to other questions on the form reveal details of the buyer's financing plan, or information comes to the FCC from other sources, the Commission's staff has not hesitated to require full details of a financial package and to apply strict standards for establishing financial qualifications.

c. Programming

The FCC requires relatively little information about the buyer's proposed programming. Buyers must submit with the application filing a brief description of how the station's informational programming will be responsive to important issues facing the station's community.

The buyer may determine which problems are sufficiently important to merit treatment in the station's programming by any reasonable means. Applicants should be aware, however, that although a brief description is required, the FCC still requires licensees to provide programming responsive to issues of concern to the licensed community.

I. A WORD OR TWO ABOUT CLOSINGS

As previously noted, many closings are postponed following FCC approval for 40 days, to permit the FCC's order to become final and nonappealable. On the other hand, some closings occur as soon as the FCC issues a public notice approving the sale. FCC approval does not guarantee that there will, in fact, be a closing. That, also as noted, is a major objective of the contract negotiations, as both parties strive for a position in which they can compel the other to close while maintaining some flexibility to avoid what may have become a disadvantageous bargain. (One means by which sellers seek to assure that buyers will fulfill their closing obligations is by insisting on payment of a significant portion of the purchase price—usually five to ten percent on a cash sale—into an escrow account, to be paid to the seller as liquidated damages in the event of the buyer's default.) At many closings, an outside lender will also be a participant. In such cases, the buyer will need to be certain that the necessary steps called for in the loan agreement have been taken to assure that the lender will be present. This means being certain that all of the loan and related agreements with the lender have been agreed to and are ready for execution prior to or simultaneously with the station closing.

J. AFTER THE SALE: SPECIAL RESOURCES FOR MINORITIES

Specific sources of managerial and technical assistance in the communications field available to minorities include:

NAB Minority and Special Services Department

Becoming a successful and productive broadcast station owner requires a great deal of business savvy and knowledge of the industry. Minorities contemplating ownership should become aware of the many nuances and peculiarities they may face. The Department of Minority and Special Services (MSS) of the National Association of Broadcasters (NAB) functions as a resource center to assist minority broadcast entrepreneurs in better understanding many of these factors.

Data ranging from research on minority ownership and employment to marketing trends and minority organizational activities are available from MSS. The Department is in touch with other resource persons and groups throughout the country and conducts seminars, meetings and other forums to keep prospective and existing minority broadcast entrepreneurs apprised of issues, solutions and progress related to minorities in broadcasting. A committee of the NAB, the Minority Executive Committee, comprised of minority broadcasters, meets periodically to advise the Department of Minority and Special Services in its mission to assist minorities in the industry.

For further information and assistance, contact the Department of Minority and Special Services, National Association of Broadcasters, 1771 N Street, N.W., Washington, D.C. 20036, (202) 429-5497.

Minority Business Development Agency (MBDA)

The Minority Business Development Agency is part of the Department of Commerce. It operates approximately 100 Business Development Centers (BDCs) in various cities across the country. These centers, typically private consulting firms, receive grants from the government to provide technical and management assistance to minority businesses in such matters as loan packaging, procurement, expansion and start-up situations, sales and general management techniques. If a BDC does not have in-house expertise in a particular area (for example, radio broadcasting), it nevertheless can subcontract for consulting services from an individual or firm with expertise in the field. Minority broadcasters who want more information about the program and the location of the BDC in their area should contact the nearest MBDA regional office (Atlanta, Chicago, Dallas, New York, San Francisco, or Washington, D.C.).

Native American Economic Stimulus Program (NAESP)

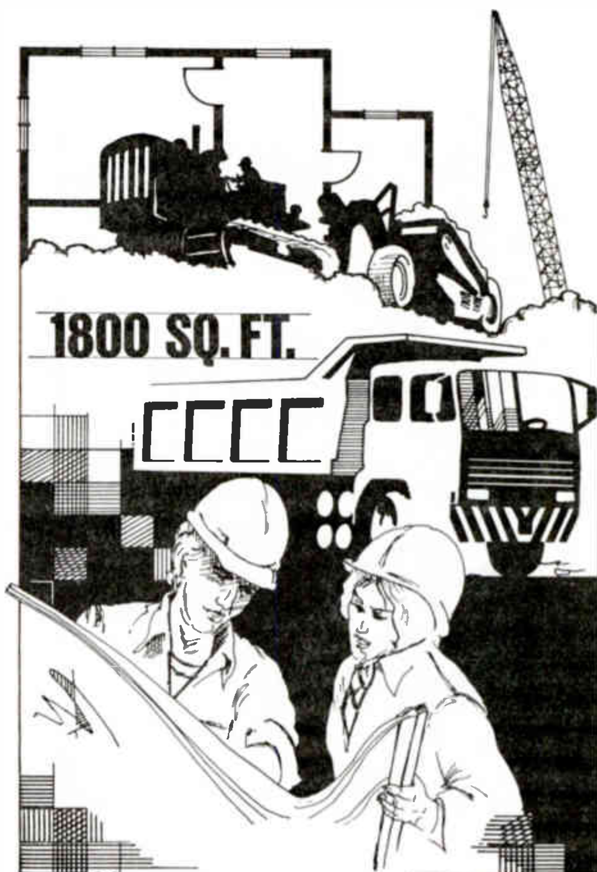
The Native American Economic Stimulus Program of the Department of Labor, 200 Constitution Avenue, N.W., Washington, D.C. 20210, (202) 376-7146, is designated to assist in the economic development of Indian reservations and to provide training programs and additional employment for Native Americans. The Native Americans Telecommunications Training Program, one of the 15 NAESP projects, will offer training and funding assistance to American Indians for existing and new telecommunications facilities.

Federal Communications Commission Consumer Assistance Office

The FCC has established a Consumer Assistance Office, FCC, Room 258, 1919 M Street, N.W., Washington, D.C. 20554, (202) 632-7000, to provide assistance to members of the public in dealing with the Commission. The Office will help individuals in obtaining information and documents from the FCC.

III. APPLYING TO BUILD A BROADCAST STATION

Applying for an FCC permit to build and operate a new broadcast station is a different way of getting into the business of broadcasting. It may sometimes be less expensive because the buyer of a broadcast property is generally paying substantially more than the value of the tangible assets (the studios, offices, equipment, tower and so forth) for the good will of the station—that is, its history of earnings, or, in some cases, the scarcity value of licenses in that particular market.



A. DECIDING WHETHER TO BUILD OR BUY

On one hand, a new broadcast station starts off at a disadvantage. There is no cash flow to meet start-up expenses and interest payments which, at the beginning, must come out of the owner's pocket. As the newcomer to the market, moreover, the owner who builds a station will be looking for revenues which historically have been committed to other stations or prospecting for sources of income the other stations have overlooked or ignored. As a practical matter, there are few opportunities to build new stations in the largest markets. Thus, market size may limit the potential for building a new station.

On the other hand, a new station is not handicapped by the history of inept management, mediocre programming or service of poor technical quality that may accompany a station that is being sold. The person who is considering building a new station may be able to identify a niche in an existing market—a segment of the population which is not served—or a developing community which will profitably support a new broadcast station. In some instances it may be possible to build a new station in a small but profitable market and use that property as an anchor to finance acquisitions in

other markets. In addition, the value of good will and financial performance is higher, and buyers pay dearly for existing stations.

Perhaps the single largest drawback to applying to build a new station is that an applicant cannot always be certain of obtaining what has been applied for. Frequently, others file competing applications for the right to use the same frequency. Where there are competing applications, the FCC holds lengthy and often costly comparative proceedings to determine the best qualified applicant. To reduce the length and cost of these proceedings, Congress has passed legislation authorizing the FCC to conduct some form of lottery among the competitors for a frequency, thereby making the outcome of an application even more difficult to predict. Except in the case of low power television applications, however, the FCC has given no indication that it intends to use this lottery authority for selecting among competing applicants for AM, FM and television stations.

The decision whether to buy or build, then, will depend upon an analysis of a number of factors, among them:

1. The financial resources available to acquire a station;

2. Whether there is a station for sale in the market in which the entrepreneur would prefer to operate, within the applicable price range, which makes good sense on the basis of past earnings or potential for growth and is not encumbered by management, financial or technical problems; or, if not,
   a. whether there is an unoccupied frequency in the market available for application, and there is room in the market for a new competitor to operate profitably; or,
   b. if there is no allocated frequency in the market available for applications, there is a frequency that can be assigned, consistent with the FCC's technical requirements.

3. The entrepreneur's ability to conclude that, if the other factors favor applying for a new station rather than purchasing an existing station,
   a. no one else is likely to apply for the station; or,
   b. if others do apply, they are less likely to be found to be best qualified; or,
   c. where the outcome of competing applications is not capable of being predicted with any degree of certainty, the value of the new station would be worth risking the time and money invested in the application.

B. FINDING A FREQUENCY

1. Assigned Channels for FM and TV Stations

Frequencies for FM and TV stations are listed by community, in Tables of Assignments contained in the FCC's rules. (Section 73.202(b) for FM, Section 73.606(b) for TV). Applications for new stations can be filed only for frequencies listed in these Tables.

For example, the TV Table of Assignments shows that in Des Moines, Iowa, Channels 8, 11, 13, 17, 43, 63 and 69 are assigned. (TV channels 2-13 are referred to as VHF or very high frequency channels; 14 and above are referred to as UHF or Ultra High Frequency channels.)

The FM Table of Assignments is slightly more complex than the TV Table because the FCC has provided for seven different classes of FM stations—Classes A, B, B2, C, C1, C2 and D. Class A stations may operate with power from 100 to 3,000 watts. Class B stations may operate with power of up to 50 kilowatts. Class C stations may operate with power of as much as 100 kilowatts.

Class B1, C1 and C2 stations are subclasses based on lower antenna heights and, in some cases, lower power. Class D stations operate with up to 100 watts of power in a portion of the FM band reserved for noncommercial educational (public) broadcasting.

If the entrepreneur determines that there is no unoccupied channel allocated to the community where he or she would prefer to build an FM or TV station, it may be possible to add a channel through an FCC rulemaking proceeding. A rule-making proceeding begins with a petition which would include a demonstration of need for a channel, and a showing that the proposed assignment is consistent with the Commission's technical requirements. If the petition is in order, the FCC will issue a Notice of Proposed Rule Making and solicit public comments. If no obstacles—especially inconsistencies with the technical rules —arise, the FCC will assign the channel and accept applications.

2. AM Radio Frequencies

Frequencies for AM stations are not assigned to communities in a Table of Assignments the way FM and TV channels are assigned. Rather, applicants for new AM stations must show that there would be no prohibited interference to existing stations. (The FCC has announced that it will no longer accept applications for "daytime only" stations.) The complexities of AM assignments and the various classes of AM stations are impossible to summarize in a few paragraphs. If a person is contemplating building a new AM station, the

only way to determine whether the FCC would entertain such a proposal is to retain the services of a professional consulting engineer or technical consultant.

3. Low-Power Television Stations

More recently the FCC has created the Low Power Television (LPTV) Service. As the name of the new service implies, low power television stations operate with much less power than regular, full power television facilities. This new service also provides for simplified application procedures and relaxed technical and operating rules. The intention of the FCC in providing for low power television has been to bring television service to communities that previously have been underserved or denied service because local television audiences are too small to sustain a full service station. Low power stations can operate at lower cost and with less extensive facilities than full power television stations. As a result, they are more readily available to individuals who are interested in broadcasting but who lack the initial capital necessary to buy a full power television station. LPTV stations are assigned in much the same manner as AM stations.

C. SELECTING THE TRANSMITTER SITE

Hand in hand with finding a frequency, the applicant will need to find a site from which to operate the station's transmitting facilities. The transmitters of FM and television stations must be located so as to meet minimum spacing requirements between stations operating on the same and adjacent channels. (For FM stations, this includes stations on the second and third adjacent channels. UHF television stations must meet not only the minimum separation requirements between stations operating on the same and adjacent channels but also additional separation requirements known as the UHF taboos. By way of example, UHF stations on Channels 14 and 29 must be located at least 75 miles apart under the FCC's rules because of the likelihood that, at a lesser distance, a television receiver turned to the lowest numbered channel would receive the image of the picture transmitted by the high channeled station.) The transmitter location chosen for an AM station will in many cases be crucial to the required showings of non-interference. Another regulatory requirement which will affect the selection of a transmitter site for an AM, FM, or television station is the necessity of providing a signal of the minimum specified strength to the community of license. (As a practical matter, the applicant will usually want to provide a signal much stronger than the minimum required.) The transmitter site must also be chosen so that the transmission tower does not pose a hazard to air navigation as defined by regulations of the Federal Aviation Administration (FAA).

It is not necessary at this point, when only an application is being prepared, to secure the transmitter site by obtaining an option to buy or lease. On the other hand, an applicant must be in a position to certify to the FCC that he or she has a reasonable assurance that the site will be available in the event the application is granted. Reasonable assurance takes into account the willingness of the party who controls the site to sell or lease it to the applicant, and the ability to obtain necessary local approvals, such as zoning variances, to construct a broadcast transmission tower.

D. OBTAINING FINANCING

Sound financing for a new station is just as important as sound financing for an acquisition. On the surface, construction financing seems simple—a large enough loan to build the station, and working capital to operate—but this apparent simplicity is deceptive.

First among the deceptions is the relative ease of obtaining financing for the equipment needed to put a station on the air, which is likely to be the largest single item of expense. For a down payment of from 10 to 25 percent, most broadcast equipment manufacturing companies will sell under a deferred payment plan over three to five years. Interest rates on such sales are typically fixed at 2 1/2 to 3 points over the prime rate at the time of purchase. Usually, no security is required other than the equipment itself. Similarly, most equipment manufacturers will make available open-end lease packages, i.e., leases with an option to buy at the end of three to five years. Current finance charges are built into the monthly lease payments. (Finance charges on an equipment lease are usually expressed as an "add-on" rate, rather than an "annual percentage rate" [APR]. Although an add-on rate of 12 or 13 percent would seem to be less than an APR three points over prime, add-on charges are computed very differently. A 12 or 13 percent add-on amounts to an APR of about 21 or 22 percent.) There are also broadcast equipment sales companies which act as retail outlets for the manufacturers. They, too, commonly offer deferred payment purchase agreements. Bank-controlled leasing companies will purchase equipment packages to order and lease them to their customers. The balance due under the lease will be fully secured by hard assets, i.e., the equipment.

A second deception is the FCC's minimal requirements for new applicants to demonstrate their finan-

cial qualifications. Applications formerly were required to include a demonstration of the availability of funds to put the new station on the air and operate for three months without relying on revenues from the sale of station time. This standard was, itself, likely to reflect a small portion of the applicant's real financing requirements. Now, new broadcast applicants are required only to certify that funds are available. As a consequence, many applicants for new broadcast stations do not seem to give serious thought to their financing needs until *after* they receive an FCC construction permit.

Rather than succumbing to these deceptions, a well thought-out application to build a new station, like a proposal to purchase an existing station, starts with hard, realistic projections of station revenues and expenses.

A common error among construction permit-holders is to overbuild the new station for the size of the market and the revenues that the market will generate. This is not a concern of the equipment manufacturing company. Accordingly, whether the permittee is considering bank financing or a combination of bank financing and equipment credit arrangements, it is important to begin with a budget that realistically estimates the total amount of debt the station will be able to service, based on anticipated revenues.

Given a budget, a broadcast equipment company can prepare an affordable equipment package which meets the FCC's technical requirements (for example, for accuracy and reliability) and the programming objectives for the new station. (Again, for example, an independent UHF television station doing only a few hours a week of local programming will have far different equipment requirements than a station which will be doing local news and sending remote equipment out on a regular basis for taped or live broadcasts of local events. An FM station might require sophisticated studios for locally-originated recorded music programs or, alternatively, an automated programming system.) This type of equipment proposal can be used for purposes of comparison to proposals from other equipment sellers and manufacturers, or as part of a financing proposal to outside investors or lenders.

Just as there is a need to make realistic estimates of the cost of the equipment required for the station, there is a need to make accurate estimates of other costs of applying for the construction permit, building the facility and operating the station. The National Association of Broadcasters (NAB) publishes an annual compilation of financial data for radio and television stations. As noted earlier, James R. Duncan, Jr., Paul Kagan Associates, Inc., ComCapital Group and Broadcast Investment Analysts, Inc. publish booklets containing information which will assist the applicant in making rough estimates of typical revenues and expenses of stations in comparable markets. More refined estimates may require assistance from a consultant with broadcasting experience. Making sound projections of revenues and expenses without the benefit of historical revenue and expense data is a difficult proposition. But, unless the construction permit holder has attempted realistically to arrive at such projections, a proposal will not be seriously entertained by a prospective lending institution.

When cash flow projections have been made, the applicant's financing proposal will be in much the same form as the proposal to purchase a station discussed above and shown in Appendix D. Sources of financing also will be much the same, with the exception of those institutions, such as insurance companies and pension funds, with a clear preference for operating companies.

Negotiation of the financing arrangements will probably follow a course similar to the negotiation of financing to acquire a station, except that the lender will probably withhold final acceptance of a financing proposal until all necessary FCC authorizations have been received and there has been an opportunity to review any changes in the applicant's financial condition or any other aspect of the proposal.

E. PREPARING THE APPLICATION

Notwithstanding the substantial differences between buying an existing station and building a new one, there are great similarities between the FCC application for consent to the sale of a station and the application for permission to construct a new station. The required legal and programming showings, for example, are essentially the same. As previously discussed, the financial section of the construction permit application form FCC (Form 301) requires the applicant to certify that sufficient funds are available to construct the proposed station and meet anticipated operating expenses, including loan payments and/or equipment lease payments, for the first three months of broadcasting. Also, the programming sections of the applications forms are the same.

The application for a new station does contain an engineering section, requiring a full description of the technical details of the proposed station—its location, the channel on which the station will operate, the signal contours of the station, the type of equipment, the transmitter power output, the effective radiated power and the antenna height. Such information is used by the FCC to determine that the proposed facility will not cause interference to existing stations. The surest and safest way of completing the engineering portion of the

application is to have the work performed by a communications consulting engineer.

1. Other Forms and Documents

The applicant may be required to show that construction of the proposed station will not have an adverse impact on the environment. Moreover, agencies other than the FCC may be concerned with activation of a new station. Permits may be required to locate on government land. Applicants frequently must also deal with local zoning authorities, and approval of the Federal Aviation Administration may also be necessary if the station will require construction of a new tower or increase the height of an existing tower.

2. Competing Applications

The biggest distinction between applications for new stations and applications to buy existing stations is that the FCC will accept more than one application to build a new station on the same frequency. (By contrast, when an application is filed to buy a station, the Communications Act prohibits the FCC from considering whether the public interest would be better served by the sale of the station to a different buyer.) If there are no petitions to deny and no competing applications, the FCC— depending on whether additional information is requested by the staff—can usually be expected to grant a construction permit application within approximately six months to a year from the initial filing date. Petitions to deny raising questions which can be resolved without a hearing could add from two to six additional months. However, where there are competing applications—that is, more than one application for the same frequency—the FCC's rules require an evidentiary hearing before an administrative law judge to determine, on a comparative basis, which application should be granted.

3. The Comparative Hearing Process

The FCC uses a "comparative hearing" to choose which competing applicant will receive a license. The process is very much like a civil trial. The hearing is conducted by an administrative law judge who receives evidence on the applicants' characteristics and proposals. The judge issues a written decision which compares all applicants and presents the legal and factual reasons for choosing a particular applicant.

The judge's decision can be appealed to the FCC's internal "appellate court," the Review Board. From the Review Board, a decision can be appealed to the five FCC Commissioners, and ultimately to a federal appeals court or even the Supreme Court. But few decisions are appealed beyond the Commission.

Most applicants hire lawyers to "prosecute" their FCC applications. The lawyers for these cases usually are specialists in the area of communications law. Practice before the FCC is considerably different than it is in local and state courts. Not all of the lawyers in a case represent competing applicants. For example, a lawyer from the FCC's Mass Media Bureau may argue public interest matters. Other lawyers may appear on behalf of administrative agencies such as the Federal Aviation Adminstration, which often is a party to FCC proceedings on issues relating to a proposed tower's effects on the safety of air navigation.

Following is a chronology of the major steps in a comparative hearing.

a. Petitions to Deny

Once an application has passed the processing stage—the "acceptability" phase—the FCC publishes a notice that it has been "accepted for filing." At this point, individuals or groups have 30 days to file a "petition to deny" the application. In order to prevail at this stage, a petitioner must show that the FCC's staff was incorrect in accepting the application. This requires a showing that the application is flawed and unacceptable for filing.

b. Amendments

An application may be amended at any time to remove a conflict. In other words, an amendment which eliminates the need for a comparative hearing may be filed at any time. Applicants have 30 days after the notice that their application has been accepted for tender to make so-called "minor" changes in their applications to improve their comparative positions. These changes are "amendments as of right," since they do not require the FCC's approval. However, if the Commission inadvertently accepts a flawed application for tender, that flaw may not be corrected by an amendment and the application is dismissed as unacceptable for tender. After this 30-day period, applicants may amend their applications only if they can show that there is "good cause" for the proposed amendment. These later amendments may *not* be used to improve an applicant's comparative position.

c. Hearing Designation

At the next stage, the FCC issues a "hearing designation order" which outlines the matters that will be considered by the administrative law judge in choosing an applicant. Under a new FCC requirement, each applicant must pay the FCC $6,000 within 20 days after

the release of a hearing designation order. Shortly after the FCC issues the hearing designation order, it assigns a judge to hear the case. The judge then sets the important dates in the case—including the hearing date, which is usually several months later.

d. Discovery

After the judge has been assigned, the lawyers begin the "discovery process," in which they examine other applicants' cases by requiring them to disclose information regarding their qualifications and proposals. During this process, the lawyers attempt to uncover weaknesses in the proposals of competing applicants. They require competing applicants to answer written questions ("interrogatories") about their applications; require applicants to appear before a court reporter to answer questions ("depositions"); and require applicants to furnish documents not included in the application ("document production requests").

Throughout the hearing process, lawyers can file motions or other pleadings against other applicants or in support of their own cases. Other applicants can oppose all pleadings. Ultimately, the judge grants or denies the motions.

e. The Hearing

Just before the hearing, each lawyer assembles a document describing his or her client's qualifications and characteristics—the written "direct case." After the other lawyers have examined the other parties' direct cases, they can require other applicants to testify at the hearing about the material contained in the direct case and subject them to cross examination. A hearing consists primarily of cross examination. The process resembles a trial without a jury in a civil case. The judge presides over the hearing, which may last for several days. The exact number of days depends on the number of parties and the complexity of the issues. For example, when the technical characteristics of particular applications are at issue, consulting engineers may be called to testify.

f. The Initial Decision

At the conclusion of the hearing, the lawyers prepare "proposed findings of fact and conclusions of law." In these documents, each lawyer presents his or her proposal for the outcome of the case. The lawyers then submit "reply findings" to dispute their opponents' proposed findings.

The complete record of the case thus consists of a transcript of the hearing, the written direct cases, and the proposed findings and reply findings. The judge then prepares an opinion choosing one of the applicants and explaining his or her reasons in an "Initial Decision."

g. Appeals

The Initial Decision becomes final in 30 days, unless appealed to the next level at the FCC—the Review Board. Such appeals are frequent. The Review Board can agree with the judge ("affirming the decision"); disagree with the judge and award the construction permit to another applicant ("overruling the decision"); or send the case back to the judge for additional findings, possibly including another hearing on particular issues ("remanding the case to the judge").

The comparative hearing process thus is complicated, time-consuming and expensive. It becomes all the more complex and costly when cases are appealed to the full Commission and to a federal appellate court.

4. Settlement of a Comparative Case

The comparative hearing process can be expensive. Few applicants escape the comparative hearing process with legal fees of less than $25,000. In a highly complex case with a very large number of applicants, the costs can well exceed $100,000. But there are ways of minimizing delay and expense.

A hearing can be avoided or terminated if the parties settle the case. This may be done in one of several ways:

a. Buy-Outs

Some applicants obtain a construction permit simply by paying all opponents to withdraw from the case. There is no limit on how much money can be paid to other applicants to abandon their applications. But "buy-outs" must be approved by the judge, who must find that the withdrawing applicants did not file their applications only to be bought out.

Sometimes buy-outs are used to remove only some of the applicants from a case. A buy-out can eliminate a particular opponent who is willing to withdraw to end the financial drain of a hearing.

b. Merger

The FCC also allows two or more applicants to merge into a single applicant. If all of the applicants in a case do this, there is a "complete settlement," the case ends, and the construction permit is awarded to the merged entity. If fewer than all of the applicants merge, the case continues, but with fewer parties. It should be noted, however, that individual comparative positions are fixed well before the hearing begins.

Merger does not permit applicants to improve their standing by combining their separate comparative merits. Instead, one application represents the entire merged group. For purposes of comparative credit, the judge will evaluate the "surviving application" as if the merger

never had taken place. A merger thus may hurt the merged parties' comparative standing unless carefully structured.

Variations on the settlement process are possible and frequent. Cases often settle when some applicants are bought out and others merge. Indeed, the FCC encourages settlements. Settlements reduce the FCC's hearing costs, and help expedite new broadcast service to the public. When it becomes apparent that an applicant stands little chance of winning, or when there is no money for further prosecution of the case, settlement is an attractive means of recouping an investment or obtaining a partial ownership interest in a competing application.

5. The FCC's Comparative Criteria

Several factors can influence an applicant's chances of winning. Virtually all of those factors are established by the content of the initial application. Because an applicant's comparative strengths are based almost entirely on its ownership structure, strategy for a comparative case must be planned before the application is filed. This early stage of the process often determines the outcome of a case.

The FCC weighs several major factors in a comparative evaluation, particularly how each proposal will contribute to (a) diversification of control of the media of mass communications and (b) the best practicable service to the public. The factors the Commission takes into account in comparing competing applications and their consequences include:

1. Ownership of other media, especially broadcast properties, results in a comparative demerit.

2. Day-to-day involvement of the owners in the management and operation of the station—known as integration of ownership and management—is a plus.

3. Local ownership and a record of involvement in civic activities is a plus.

4. Minority group and/or female ownership, if involved in management, is a plus. (The FCC is currently examining whether this policy is constitutional or, if found to be constitutional, whether it actually promotes agency objectives.)

5. A good prior broadcast record is a plus.

6. Clear superiority of a technical proposal for station coverage is a plus.

IV. CONCLUDING COMMENTS

The foregoing scarcely scratches the surface of the process of entering the broadcast business. At the end of that process is an opportunity to be part of a challenging, people-oriented business which is at the heart of community life. With a sound analytical foundation and guidance from experienced professionals, the decision to buy or build a broadcast station is likely to lead to an exciting, enjoyable investment with both personal and financial rewards. We wish you well.

APPENDIX A: Glossary of Financing Terms

[Note: To understand the financing market, it is important to understand the jargon of financial transactions. The following list of definitions is not intended to be complete, but to define the terms used in this book.]

AMORTIZATION. The process of retiring the principal of a loan.

CASH FLOW. The actual cash generated from the operation of a business. Generally, this term represents net income plus all expenses not requiring an outlay of cash, such as depreciation. In the broadcasting industry, however, cash flow is usually defined as pre-tax earnings plus depreciation and amortization plus interest expense.

CUMULATIVE CASH FLOW. The addition of each year's cash flow to a running total. Generally, this means projecting cash flow yearly for a period of years. Starting with the first year, each year's cash flow then is added to the running total.

COVENANTS. Specific provisions included in a loan agreement. These provisions usually are the borrower's agreements relating to profitability. Positive covenants state conditions which borrowers must meet to maintain the loan in good standing. Negative covenants specify what the borrower cannot do as long as the loan is outstanding or unpaid.

DEBT SERVICE. The annual payments of both interest and principal required to retire a loan according to the provisions of the loan agreement.

DEFAULT. The inability of a borrower to make interest or principal payments as required by the loan agreement. Default can also occur if the borrower violates any of the covenants included in the loan agreement.

EQUITY. Capital contributed by the owners of a business—both principals and outside investors. The equity interest of the initial investor will fluctuate directly with the profitability of the business, assuming no infusions or withdrawals of capital.

FIXED ASSETS. Generally, those assets which are depreciated for tax purposes such as operating equipment [e.g., tower, transmitter, etc.] but also including land which cannot be depreciated for tax purposes.

FIXED OPERATING COSTS. Those ordinary business expenses which do not vary with sales. An example of a fixed operating expense would be lease payments.

"HARD ASSET" VALUE. The value of a business, taking into consideration only the money that could be realized from the liquidation of its readily salable assets.

INTANGIBLE ASSETS. Those assets which are not fixed and are difficult to value in terms of dollars. Some intangible assets have a determinable life and can be depreciated [film contracts, employment contracts, certain leases, etc.] Other intangible assets do not have a determinable life, notably FCC licenses.

JUNK BONDS. Subordinated loans evidenced by bonds secured only by the performance of the issuer and of a quality considered less than investment grade.

LEVERAGE. The process by which an owner's equity is increased in value through borrowing additional money.

LEVERAGED BUYOUT [LBO]. Financing an acquisition by using the acquired company's assets as collateral to borrow money for the purchase, while at the same time using the assets' cash flow to service debt.

MAINTENANCE RATIOS. Provisions in a loan agreement requiring the borrower to achieve certain measure

of performance, such as: (1) after-tax earnings must be twice the amount of annual interest expense, or (2) total debt cannot exceed 1.5 times the amount of equity in the business; and, (3) level of working capital must be maintained at a certain level (e.g., current assets should exceed current liabilities by 1.5 to 1.).

MEZZANINE FINANCING. Various types of debt—often convertible into common or preferred stock—to bridge a gap between debt and equity financing. Mezzanine financing is appealing to bankers because it can be considered as a form of equity when the lender determines debt-to-equity ratios.

PREPAYMENT PENALTIES. Provisions included in a loan agreement to discourage a borrower from retiring his debt before maturity. Such penalties are usually a factor only in loans of greater than five years' duration, and are ordinarily equal to some portion or even all of one year's interest expense in the early years of the loan (sometimes expressed as a percentage of the outstanding principal balance).

PRIME RATE. The rate of interest charged by commercial banks on loans to their most financially sound corporate borrowers. The prime rate is not necessarily the bank's lowest rate but refers to a rate publicly announced by the bank as its "prime rate" from time to time. It is a base rate upon which the bank adds a markup and is usually one or two percentage points higher than the bank's overall cost of funds.

PRIVATE PLACEMENT. Generally, placement of a debt or equity instrument with one or more knowledgeable investors. Private placements avoid registration and underwriting costs. They are sometimes referred to as "private offerings" or "private syndications."

PRO FORMA. A description provided in advance, often used in connection with financial statments. An estimate of future financial condition or operating performance based on certain specific assumptions.

RECAPTALIZATION. Re-evaluating assets at the time of purchase to reflect the fair market value of the assets at closing. The term also refers to re-restructuring a company's financing.

RESTRICTED PAYMENTS. Certain disbursements of cash which a borrower is prohibited from making without prior approval from the lender. The most common example is dividends to common shareholders in excess of an amount specified in the loan agreement.

SECURED LENDER. A lender who actually holds title or a mortgage to specified assets. This is in contrast to an unsecured lender, who is a general creditor. In liquidation, the proceeds from the sale of assets are used to repay secured lenders in full before unsecured lenders receive any payment.

SENIOR DEBT. Borrowings evidenced by a priority or secured position in liquidation. If liquidation is required, proceeds from the sale of assets are used to repay the senior debt in full before payments can be made to any other creditors.

SUBORDINATED DEBT. Sometimes referred to as junior debt. Lenders of subordinated debt are usually secured creditors, but with a secondary position or interest in the assets in the event of liquidation. That is, senior lenders are repaid first, then subordinate lenders and then unsecured lenders.

VENTURE CAPITAL COMPANY. A company organized to raise risk capital and invest it in other business companies.

WORKING CAPITAL. The amount of current assets—cash, marketable securities or other assets such as accounts receivable, inventory, etc.—that are expected to be converted into cash within the following year. In a startup period, the term working capital is often used to connote funds required to bridge the gap between revenue and cash outflows (expenses, debt service) until the business becomes self-sustaining.

ZERO-COUPON BOND. A debt instrument given to a seller that does not have any cash payments due during the term of the note. Principal and interest are paid in one lump sum at the maturity of the note.

APPENDIX B: Evaluating and Financing the Broadcast Acquisition

by Richard L. Geismar

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Major Market—UHF Independent Television Station

I. INTRODUCTION—General Information

The process involved in acquiring a broadcast property is far more than just a "numbers exercise." The nature of the broadcasting business involves factors that cannot be analyzed solely by numerical processes. Without attempting to become overly mysterious about this industry, philosophical, sociological, and other intangible aspects relating to a buyer and to a specific broadcast property must be taken into account.

With respect to current financial objectives, broadcasting involves maximizing operating profits from day-to-day operations, and then applying these operating profits to service debt, or for reinvestment, expansion, and/or dividends. Broadcasting, being classified as a service business activity, should be viewed primarily as a cash generator; very little of that cash is required to be reinvested in additional tangible physical assets. On the other hand, due to the degree of competition represented by other broadcast stations and non-broadcast

media, frequent promotions needed to maintain and build on an existing audience base may consume a significant part of available cash. The distinction here from other businesses is that promotional expenses are currently deductible rather than capitalized and depreciated.

The second part of the financial objective is to translate this income stream into increased equity, by enhancing the value of the station in the marketplace.

An equally important part of the acquisition exercise is to analyze the buyer's objectives in seeking to acquire a broadcast property. As will be seen, there are numerous alternatives for prospective buyers, who may have a variety of long-range goals; there are a wide range of broadcasting stations available with which he may obtain those goals. It becomes crucial for a potential buyer to recognize his long-term goals since this will, in large measure, determine answers to such questions a "What to buy?" and "How to buy?".

Extending further on the philosophical arguments is a recognition that the operation of broadcast facilities is far different from the operation of a manufacturing or retailing enterprise, or, indeed, involvement in any industry where a tangible product is produced and a significant investment in capital facilities is required. Broadcasting operations are, to a large extent, ephemeral in nature and, while numerous attempts are made to *quantify* the success of broadcast stations from an audience point of view, these are seldom more than guideposts. The measurement of *quality* of service is even harder to measure, even more ephemeral.

Therefore, the owner of a broadcast station must recognize that he is dealing with an industry made up of equal parts of a creative function and a financial function. The successful broadcast operator almost always has to follow the "accordian principle"—on the one side are the highly creative aspects of getting people's attention while on the other side are the hard-nosed "P&L facts of life." If a broadcaster pays too much attention to the creative side, he will probably fail financially in the process. By like token, if, over an extended period of time, he pays attention only to bottom-line dollars, he will also probably be unsuccessful. It is the constant interplay between these two facets of operations which permits a station owner to succeed. And, while an undue aura of mystery should not surround this process, absence of a balance between them will eventually reflect in results unsatisfactory to investors in a station.

In succeeding sections, we will discuss various aspects of *what* and *how* to acquire broadcast stations. The question of *who* should buy is best left to the specific investor who *must*, at the outset, recognize the strengths he brings to the situation, as well as the weaknesses which he will need to bolster from other sources. In most circumstances, he can acquire the backup strength needed to insure successful operation and thus a satisfactory return on his investment. In other circumstances, a broader investment group may provide the answer to that problem. The investor must know that merely acquiring a broadcast license in no way insures that he has found, as the headline of a magazine article once claimed, "another license to print money." On the other hand, it is a unique industry and it can be highly rewarding.

In the historical development of the broadcast industry, there has been strong and steady long-term revenue and profit growth. As might be expected, in some years the rate of increase has exceeded the long-term growth rate while in other years it has been less. For the past several years, both revenues and profits have grown at a rate exceeding the secular long-term growth rate; as a result, there has been an influx of many new investors who formerly had no exposure to the broadcast industry. The world of electronic communications will probably be one of the faster-growing areas of commerce in the world for the next 25 years. But it is important for prospective investors to realize that short-run spurts of growth should not be extrapolated into a long-term operating forecast. The ramifications of these comments will be discussed later in this section.

II. OBJECTIVE FACTORS—What to Buy?

Market Analysis

Broadcast stations, by FCC definition, as well as from advertising considerations, exist to serve specific markets. The first step in appraising a potential acquisition is to understand all of the relevant factors about the market in which it operates. A buyer must be able to determine the extent of sales potential and, therefore, profit potential of the station. Obviously, the size of the market is important, which will relate to the number of people to be served as well as the consumer disposable income generated by that population. These are the principal measures commonly used in appraising the size of the market. There are several studies which attempt to quantify the relationship of consumer disposable income to both total advertising revenue as well as to potential broadcasting revenues in any market. While there do not appear to be any hard rules of thumb as a result of such analyses, it is fair to state that a market in which consumer disposable income is advancing rapidly will probably reflect a strong growth pattern in its media spending, and particularly in its broadcast advertising.

Concurrent with analyzing the size and growth characteristics of a market, it is imperative to understand the economy, habit patterns, and general philosophical makeup of the market; this will have a direct bearing on the type of broadcast service which would be best received by potential viewers of, or listeners to, a station. Attention must be paid to competitive stations in the market, their strengths, and their success in garnering revenues and capturing audience; in addition, the importance of other media in the market should be studied. The newspaper medium continues to be the largest recipient of advertising dollars in the U.S. and its major advertisers probably provide the greatest potential source for broadcast industry growth in the foreseeable future.

The development of sophisticated marketing techniques during the past ten years requires far greater attention to the demographic makeup of the population in the market. Greater attention to lifestyle and to psychographic analysis has been made possible by significant improvements in research techniques. Radio stations have long ceased attempting to be all things to all people. Successful radio station operators attempt to identify the specific target audience whom they wish to attract, and then to structure and program their operations toward that audience. The television industry is only now beginning to address the audience fragmentation which exists. Significant increases in research expense will continue to be incurred by station operators, but valid research is a necessary prerequisite to successful station operation.

Technical Considerations

The next important factor in appraising a broadcast facility is the nature of its technical facilities. Without the ability to deliver a signal to the market, the efforts of a broadcaster to attract large audiences may be severely limited. It should be emphasized at the same time, however, that the existence of a strong signal, per se, does not guarantee that listeners or viewers will be readily attracted. The subject of programming to attract that audience is a complex subject. However, even the most successful programming will be jeopardized if technical capability to deliver it does not exist.

Radio

The AM radio spectrum is located between 540 kilohertz and 1600 kilohertz, and the FM spectrum is located between 88.1 megahertz and 107.9 megahertz. While there appears to be little difference in the quality of signal output at the various ends of the FM spectrum, there is a significant one in the AM spectrum. The technical nature of the AM spectrum provides stations at the lower end (toward 540 kilohertz) with significantly more definitive spacing between stations. In addition, the FCC has allocated a much greater number of stations, albeit in most instances with lower power, at the upper end of the spectrum. As a result, it is usually more difficult to tune to an AM station located at the upper end of the band. There are exceptions to this general statement, but they are relatively few.

The power output of a station can have a major effect on its ability to attract listeners, in that such a station is easier for a listener to find, particularly when considering the large number of transistor radios in use today. In the FM spectrum such differences are less critical, since the FCC has provided only three classes of maximum effective radiated power output:

Class A — 3 kw — ERP
Class B — 50 kw — ERP
Class C — 100 kw — ERP

Class A stations are low power local facilities; Class B stations are licensed to the northeastern quadrant of the U.S.; Class C stations are licensed to markets in the rest of the country.

The FCC has recently acted to expand usage of the FM broadcast spectrum. It has provided for facilities in Class B and Class C areas which operate at less than the maximum allowable power presently enjoyed by Class B and Class C stations. These new licenses are designated Class Bl, Cl and C2.

A third technical aspect of a station relates to its antenna—in AM, a low, watery area providing good ground conductivity for the signal is important; for FM, an antenna height which provides line-of-sight transmission to the entire coverage area is important.

The fourth significant technical factor is the allowable broadcast time of the station—in order to eliminate objectionable interference between stations, the FCC has required certain AM stations to reduce, directionalize, or to eliminate their signal at varying parts of the day (before sunrise and after sunset). Such actions can reduce the effectiveness of a radio station in its attempt to provide full service to a market. In recent years, there has been an increase in the number of applications from AM stations wishing to increase their power, by designing highly directional signal patterns which avoid signal overlap on a particular frequency. This method may provide a station coverage of a portion of its market which was not previously possible.

Finally, the subject of stereo capability requires consideration. During the past 30 years, development of the FM spectrum has occurred based on the higher quality stereo provided for broadcast signals. This technology

has now been made available to stations broadcasting in the AM spectrum. While the number of stereo-type receivers available for receiving these signals will be limited at first, their growth will probably significantly exceed the early growth rate of FM stereo receivers, since the quality it provides is now so widely accepted. It is possible to speculate that AM stations, broadcasting in the stereo mode, may eventually be more effective than their FM counterparts, since the coverage area of medium and high-power AM stations typically exceeds that of the highest-power FM stations.

Television

The critical technical factor in examining television stations is whether they operate in the VHF spectrum (Channels 2 to 13), or UHF (Channels 14-69). While the FCC has attempted to equalize the effectiveness of VHF and UHF signals, it has generally been unable to do so. The major technical factors mitigating against successful UHF operation remain the extremely high cost of power needed to cover an area which is also served by a competitive VHF signal and the difficulty (until recently) of tuning television receivers to UHF stations. In addition, the technical characteristics of the UHF signal itself, which is more adversely affected by solid objects in the transmission path to homes in the market, make fully competitive signal coverage more difficult to achieve.

Another important technical item relates to location of the transmitter. In most markets, communities with more than one television station are serviced by an "antenna farm," an area in which all of the local broadcasters have built their transmitters. If a station's transmitter is located outside of this transmitter farm area, the odds are increased that viewers in the area will require an additional receiving element on their home antennas; failure to do this will reflect adversely on the quality of the reception of the station located outside of the antenna farm area. This problem is diminishing, since in recent years antenna farms, or joint antennas, appear to be more the industry norm. Major exceptions occur in smaller and medium-sized markets where one or more stations may be located away from the primary market in order to provide television coverage to a smaller adjacent area. In such circumstances, the revenue potential for the outlying station would most likely be restricted.

In markets in which cable television (CATV) system density is very high, this problem is also reduced since the CATV system will attempt to maximize clear reception from all channels in the area. Up to 1985, CATV systems were obligated to carry all local stations in their primary coverage areas, but the FCC's newly promulgated regulations may create dramatic changes in the foreseeable future. The FCC's new regulations specifying the number of local television stations a CATV system must carry are in effect for only five years and will sunset in 1992.

In many areas, the growth of CATV systems has presented both problems and opportunities for television station operators. For UHF stations, it has meant an approach to parity with their VHF competitors. For all local stations in a given market, it means increased competition from signals brought in from outside the local area. It is becoming a factor which must be analyzed when examining the coverage pattern of a contemplated station acquisition.

Until recently, power output comparisons of television stations have been significant only when comparing VHF to UHF, since for the most part, television broadcasters attempt to operate at the maximum allowable limits for their stations.

However, the FCC has recently created an entirely new class of television stations (LPTV). These stations operate at low power and are dropped into the present allocation tables, but are designed to avoid interference with existing stations. The intention of the new class of stations is to provide programming service to small segments of the population with specialized interests. Up until very recently, the FCC had been inundated with applications for such services, and was able to issue only a relative handful of construction permits in a number of smaller markets.

In most markets, a number of competitive applicants filed for each available LPTV facility. In order to expedite issuance of new licenses, the FCC was required to use a lottery procedure to break the logjam. Prior FCC philosophy was that these stations would be owned and operated by "minority groups" but, in fact a significant number of applications were submitted by non-minority enterprises.

It is difficult at this time to foresee the rapid development of low-power television stations as a significant factor in the communications landscape, primarily because of a lack of program material which is practical and economical for them.

Studio Facilities—Radio and Television

It has been axiomatic in the broadcast industry that a listener or viewer didn't care whether programming originated from a barn or from a palace. From an operations point of view, as long as the studio facilities were efficient to provide the level of programming quality required to serve the community, they were adequate for the purpose. While the foregoing may be a bit of

oversimplification, a prospective buyer should make sure that studio facilities are indeed adequate, and capable of being efficiently operated.

Capital Requirements

A prospective broadcast station owner should understand that some capital expenditures will be required during the period of his ownership. Most electronic facilities used in broadcasting do have a history of long, useful life but innovations have occurred from time to time which make it desirable to replace existing hardware. For example, the advent of solid state equipment to replace tube-type gear, microphones with broader sensitivity ranges, video electronic news-gathering equipment and advanced video and audio recorders have provided useful means to reduce station operating overhead and to improve the quality of programming. A station owner must recognize the improvements that can be obtained by acquiring such equipment and, therefore, must have some understanding of the need and timing for capital expenditures which may be expended for a station.

It is not implied that every new technical innovation should immediately be installed in every station. An owner should observe the results of a new technical product at other stations to assure himself that it is truly workable and does indeed provide a cost benefit. But it is most important to recognize that there will be some capital expenditures which must be made to sustain successful broadcast operations.

Programming

The subject of programming is probably the most complex factor in understanding and structuring a broadcast station. This is particularly true in radio and is becoming increasingly pertinent in television.

During the industry's first twenty years, radio stations attempted to serve the largest number of persons covered by their signals, with little effort in attempting to attract a specific segment of the market. With the proliferation of radio stations which have been authorized since the end of World War II, radio station owners have had to increasingly target their programming efforts toward specific demographic groups. Typically, the targets involve men and women in varying age brackets; in many markets target audiences are reached by formats aimed at relatively small ethnic groups whose interests are not being served by other media. A prospective owner must understand to whom a station is presently aimed and what changes might be made if he expects to reap financial rewards from his investment.

Programming is the single most ephemeral factor referred to earlier in this discussion. Conceptually and in execution, it is an art more than a science. It is a subject which must be successfully dealt with by every station owner.

The development of the television industry is following lines similar to those of radio following World War II. During its first twenty years of commercial operation, with a relatively small number of commercial stations in most markets, little effort was made to attract specific demographic segments. In some of the larger markets, where four or more commercial stations have operated, economic factors have made it necessary for the independent stations to seek out smaller target audiences, in order to survive financially.

However, we are now witnessing the emergence of an increasing number of non-network affiliated television stations. The existence of these stations has provided viable alternatives to the three-network structure which previously existed. This probably means that the audience size for each of the old-line stations will be fragmented as these new stations seek out successful programming alternatives, just as has happened in the radio industry.

The programming of these newly-created, independent stations will vary. Some will offer entertainment programming of a generalized nature, such as network reruns. Some may have a specific flavor as exists on those stations emphasizing a religious format or ethnic attraction.

In several large markets, subscription television was attempted, whereby subscribers would directly pay for the product they received from a specific station. The majority of these efforts proved to be uneconomical, and most of these stations have changed their operating mode. As CATV systems expanded, additional programming sources were offered to their subscribers, and it is now possible for viewers to receive well in excess of the three channels which were typically available in most markets. It is the expansion of CATV multi-channel programming services that has provided the major problem for subscription television, which can only deliver one program per station.

The most recent innovation is stations devoted to selling products directly to the home, such as Home Shopping Network. It is too early to assess the economic viability of this concept, but its emergence has provided a source of capital for a number of independent stations. It is reasonable to assume that other consumer-type activities will attempt to use over-the-air television as their medium.

For most affiliated stations, it is the quality of the network affiliation which is the most cogent factor in

appraising its basic programming—these stations attempt to attract maximum audience shares in the market. However, the major networks provide only a portion of the total broadcast day of their affiliates, and an even smaller portion of the station's revenues. The network typically provides the framework around which the affiliate's programming is built. It is the success of the television station owner in developing non-network programming in time periods which he controls that can provide significant sales and profit returns. In this area may lie significant profit potential for a prospective purchaser.

The entire subject of program concepts is too intricate to be covered in this discussion but, together with the considerations of the market and technical facilities, they form the triumvirate of basic decisions which must be made by a prospective broadcaster.

Operating History

It is most important to analyze the historic operating and financial results of a station in its marketplace.

A buyer must understand the underlying facts behind the earnings and cash flow statement. For example, he must recognize how station revenues have been generated out of the total dollars available in the market, which in turn derive from the rates which the station has been able to charge. Comparisons with other markets are useful in such analyses.

An understanding of the ratings history of the station is necessary, ephemeral as such reports may be. Although good management can improve the audience position of a station, there are many instances where a station which has achieved an excellent reputation over a period of years will benefit from this reputation when current rating reports no longer compare favorably to competitive stations. The carry-over effect in increased audience for a long-time successful radio or television station should not be ignored.

Evaluating the ratio of operating profit to net revenues provides one of the best tests of management efficiency in a station, especially when measuring a station's results against industry norms. Since certain operating costs are basic to all stations, it is expected that stations in larger markets should produce higher operating profit margins than do smaller ones.

In television, it is not uncommon to find network-affiliated stations in major markets reporting operating profit margins in excess of 50%, while 35% may be more appropriate in markets of a lesser size.

In radio, a few stations in major markets may produce operating margins of up to 45%, but 35% is more likely to be the norm for well-managed stations which are plowing back some earnings into improved program quality. For successful stations in small markets, a margin of 15% to 20% is a practical expectation.

In situations in which a station's margins exceed these norms, there should be concern that the present owner is not sufficiently reinvesting funds to maintain the quality of his service and his position in the market.

Personnel

The success of a station invariably stems from the quality of its leadership at the top. An ability to appraise the attributes of the existing or proposed general manager of a station is critical. In addition to structuring the operations of the station, a successful general manager will insure that the personnel reporting to him are capable and successfully motivated, and that the station will perform to the requirements of the investor or investor group. It is not implied that every owner will want, or indeed need, to make dramatic personnel changes in the operation of his newly-acquired facility. While he should be prepared to make changes if needed, his most important concern is to see that the individual in charge of that facility has the knowledge and the sensitivity to successfully discharge that function.

A comment is in order on the subject of employees who are covered by collective bargaining agreements. In large markets, and particularly where television stations are concerned, past operating experience has given rise to the unionization of a portion of the work force, particularly in the technical and talent areas. The presence of a union organization is less likely to occur in small and medium-sized stations, if for no other reason that it has not proved fruitful or cost-efficient for labor unions to attempt to organize these small groups of employees. The most significant objective from an owner's point of view when dealing with a union contract is to attempt to acquire maximum flexibility of assignments and workloads in day-to-day operations. In a well-managed broadcast facility, the presence or absence of a union bargaining group should not generally have a significant impact on the profitability of the stations, as long as management does have the flexibility to insure that the quality of the air product is sustainable at all times.

New Competitive Factors

In conjunction with the analysis of specific stations or specific markets, it is becoming more important to understand the newly-created sources of program availability. We have already mentioned CATV, which can provide a very wide selection of product.

Subscription television has probably failed in its attempt to be a significant factor, but multipoint distribution service (MDS) and satellite-to-home transmission (DBS) are projected as alternative video sources. Another significant competitor will be video cassette recorders (VCR) in the home. While some of these alternative forms of product distribution are still in early stages of development, it will be important for a station owner to understand their potential impact.

For example, an area of current concern relates to national and international news coverage and presentation. Dramatic improvements in both hardware and software must be assayed by all station operators.

If past experience is any guide, the development of these new program sources will extend over a period of several decades. While hardware has been invented and is reasonably operational, a significant amount of experimentation will be required to determine what types of services are economically viable. In the area of software development, we expect numerous opportunities for investment, although not without considerable risk.

Investment Capabilities

Concurrent with all of the foregoing objective factors, the financial condition of the purchaser must be related to the contemplated acquisition. The availability of investor capital fairly well determines the size of the total commitment which can be assumed. While financial structures to maximize the use of this capital can be created, the investor must know his financial limitations in undertaking a prospective acquisition.

These factors will be discussed next.

III. FINANCING CONSIDERATIONS—How to Buy?

General Objectives

As previously stated, the financial objective in acquiring broadcast properties is to create a stream of income —or cash—and to apply this income to satisfy a desired investment program. A private investor hopes to shelter this stream of income from taxation and to use the cash generated to reduce debt—and the interest charges associated with it—as soon as possible, in order to provide maximum return on the original investment. A public corporate investor will apply this income stream in a manner which will relate to his overall reported earnings picture. It will typically attempt to minimize interest and depreciation charges on the consolidated financial statement in order to maximize reported earnings to shareholders.

The Goal—An Increase in Market Values

When observed over the past fifty years, income generated by broadcast stations, and therefore the market values of those stations, has, at the least, kept pace with the growth of the general economy. This is particularly true of the long-established radio medium, in spite of a dip which occurred in the early 1950's when "television was going to make radio obsolete." It is the continued marketability of broadcast properties, based on their success in providing service to their communities at a profit, that has been demonstrated repeatedly. It is this factor which has provided security to prospective investors, as well as to lenders, who are aware of the equity value a stream of income can create.

Obviously, there is a caveat to the foregoing. An assumption is made that the operations of a station continue to provide a valuable service to the community and that financial support, in the form of advertising, will be forthcoming from the community to continue and to improve that service. In instances in which the quality of service has not been sustained, the market value of a station may decline until improved management and programming techniques are applied. Again, there is no guaranteed "pot of gold" at the end of the broadcasting license rainbow.

The second item relating to the market values is the matter of supply versus demand. For many years, prices of broadcast properties tended to keep pace with the general inflation level of the economy. During the past several years, we have witnessed a very strong increase in the level of buying interest for broadcast properties, the result of which has been to increase station prices at a rate faster than the general inflation rate. Whether the level of sales prices will be justified for these recent investors is yet to be demonstrated.

The third factor affecting market values relates to the cost and availability of outside funds. Since broadcast stations are primarily regarded as cash generators, the level of funding which they are able to support will vary inversely to the cost of financing. Stated another way, the ratio of station prices to operating profits, which would be satisfactory to an investor, will be proportional to the cost of funds in inverse ratio.

Measuring Criteria

Operating Profit Benchmarks

Operating profit (income from operations before charges for depreciation, amortization, interest and taxes) is the single most meaningful measure of the value of a broadcast station. The rate of growth of operating profit, as well as changes in the cost of funds needed to accomplish acquisition, is reflected in changes in "target" operating profit ratios.

In the 1960s television stations were selling at ratios of 10, 15 and 20-times current operating profits, while radio stations, often sold in the 10 to 15-times range. In the early 1970s, ratios approximated 6 to 8-times for radio stations and 7 to 9-times for VHF television stations. In recent years, several transactions involving television stations and FM radio stations have taken place at a 15-times multiple, indicating the increased demand for certain properties.

As might have been expected during the 1982 recession, we observed radio stations trading in a 5 to 8-times operating profit range and television stations at 10-times operating profits, or even less. During that period, a major factor in pricing related to the method of financing which was being employed by the purchaser. In such a financial environment, purchasers who had cash available were able to acquire stations at the lower end of the range of price to operating profit multiples. Conversely, transactions involving seller financing typically reflect a higher price and a lower interest cost.

In the present general economic climate, we find AM radio stations priced in a 6 to 9-times operating profit range, FM radio stations in an 8 to 10-times range and profitable television stations in a 10 to 15-times range. These are generalized ratios, and there are notable exceptions, some of which occur because of supply and demand factors which will be discussed later.

In addition to evaluating a station's present operating profit, detailed study must be made of its probable future rate of growth. In the case of a new station or more likely one which has been doing poorly and which is in the process of being restructured, a higher growth rate of operating profit will be reported than will likely be the case in a mature property. Typically, this growth rate will slow as a station matures, although the station will continue to improve its absolute profit. In such instances, the "target" ratios mentioned above may not apply.

Secondly, the introduction of better management and programming techniques, particularly involving format changes in radio and independent television stations, may cause a new owner to modify the "mature station" guidelines shown above. In part, a station purchaser is betting that he will improve a station's profits over what the former owner has been able to accomplish; a buyer should be sophisticated enough to recognize that broadcasting is a somewhat fluid business, that events may occur which can be rapidly reflected in his station.

Cost of Funds

The cost and availability of funds will directly impact on the net investment return which originated with the cash generated from operations. Questions relating to current needs, long-term needs, and the extent of seasonal revenue fluctuations must be analyzed. While reasonably well-managed broadcast stations should always generate cash in excess of their financial needs there will be times in a station's operating cycle, particularly at the beginning of a new management team or programming format, where adequate operating profit may not be available.

Investor Objectives

Concurrent with a prospective investor's subjective desire to enter the broadcast industry, and his objective evaluation of the properties available for purchase, is, obviously, consideration of his financial status. An investor whose initial objective is to reap current income with a secondary objective of creating future capital gains will attempt to minimize his own investment and use leverage (the application of as much debt as the situation will warrant) to complete his financial package. The investor will wish to insure that he has sufficient capital to meet the apparent needs of the newly-acquired station as well as have a sufficient cushion in the event that Murphy's law—what can go wrong will go wrong, and at a time when least opportune to do so—takes effect. "Leverage" has been described as a wonderful servant but a terrible master.

A buyer should build in a safety factor so that he is not forced to seek additional capital or subject himself to the stringencies imposed by unhappy lenders. Illustrations of various financial approaches will be described later, but the formation of a financial package should obviously balance the upside potential of a broadcast investment against its downside exposure.

There have been several instances in which investors attempted to structure a broadcast investment as a tax shelter against their other investments. There was a philosophical fallacy here, in that the operating objective in acquiring a broadcast station is to build its income stream as fast as possible, thus eliminating in as short a time period as possible any losses generated from the operation. Additionally, recent federal legislation has eliminated reasonable consideration of this form of financial structure.

In the case of a large corporate investor wishing to become a station or group owner, the corporation is likely to have significant funds available from its general corporate resources. In this instance, the buyer will most likely desire to maximize reported net earnings by keeping interest and depreciation charges to a minimum. A corporate investor may hope to be able to use its equity securities to induce owners to part with their stations—this again will tend to maximize reported earnings from

the broadcast properties since depreciation and interest charges will be minimized.

There were occasions during the past twenty years when corporations used their equity securities as an acquisition vehicle for broadcast properties. The general economic difficulties of the early 1970s and 1980s, and the concurrent dramatic reductions in corporate equity prices limited the desire of most corporations to follow this route. However, the 1986 Tax Reform Act will probably accelerate this type of transaction, as opposed to sales of assets which will create significant seller tax liabilities. This method utilizes a tax-free exchange of securities which will avoid or at least minimize the tax implications of the sale.

As was previously mentioned, a new type of corporate investor has recently emerged. Increased interest by investment-syndicate organizations has provided an opportunity for individual investors to invest in broadcast properties on a "corporate" basis. This is probably the most significant investment innovation which has arisen within the broadcast industry in recent years.

Another significant change for investors was the elimination of the FCC "three-year rule," whereby a station owner was obligated to hold his investment for at least three years. With the elimination of this rule, the broadcasting industry becomes a much more competitive investment vehicle for non-operating investors.

Lender Objectives

The objectives of a typical lender to a broadcast station purchase, as with any other financing involving the acquisition of a business, are: (a) to insure that his loan is adequately secured; (b) that he is receiving an adequate interest rate; and (c) that the loan principal will be repaid when due.

The subject of security is critical in the decision of knowledgeable lenders and it is important to understand that after 50 years of broadcast operations in the United States, only a relatively small percentage of sophisticated lenders understand the nature of this industry.

The single most important asset of a broadcast station is its license, which is granted to it by the FCC. This is not an asset which is owned by the station operator. It is a franchise which is granted to him for a five- or seven-year period and which is typically renewed, barring unethical practices by the licensee, in the normal course of events. Therefore, a sophisticated lender will look to the quality of a broadcaster's operations in appraising his risk exposure in a broadcast station loan.

The remaining assets of a typical broadcast station represent a small portion of the total investment in that station, and these assets generally have a greater value "in place" than would be true if they had to be repossessed in a foreclosure situation. Therefore, a lender will typically take back a pledge of stock of the corporation which owns the station, and in the event of default, will attempt to take control of the property, in toto, in a normal foreclosure proceeding. While approval is required by the FCC for the transfer of a license to an owner who is a successful bidder at a foreclosure proceeding, the FCC has usually been cooperative with lenders as long as the prospective purchaser of the foreclosed assets meets Commission standards of character and financial reliability.

Finally, a lender will appraise the safety of his loan by attempting to assure that the station's cash flow adequately covers annual debt service (principal and interest). A conservative rule of thumb in a typical loan would suggest that if annual cash flow is at least double the annual debt service requirements, the loan is adequately covered. This is the critical measure for a lender, far more important than the classic debt-equity ratio referred to in other industries. Variations in this cash-flow to debt-service ratio will arise depending on the size, stability and growth factors involved in the station under consideration; it is reasonable to presume a ratio as low as 1.5-to-1 for some long-term multiple-station loans. The 2-to-1 ratio is a desirable one, however, because if this coverage rate begins to slip, a lender would have sufficient time to attempt to work with the borrower before the loan gets into difficulty.

Balance Sheet Structure

One of the most difficult factors for non-broadcasters to understand is the nature of the balance sheet normally associated with broadcast properties. Since broadcasting is essentially a cash business, tangible assets represent a small portion of the total asset value of the station. Lenders and investors must satisfy themselves that the intangible asset known as "station license" or good will has significant value in the vast majority of situations.

In structuring the balance sheet of a broadcast station acquisition, a purchaser will first retain a qualified appraiser to provide him with detailed current values of the tangible assets which he plans to acquire. An appraisal should also be made of the value of the license, again by qualified personnel. The balance of the assets will then be assigned to accounts known as intangibles, including good will. Again, the 1986 Tax Reform Act has modified earlier guidelines, but the principle remains intact.

The most important items in a broadcast balance sheet relate to cash and therefore to working capital.

Again, broadcasting is essentially a cash-generating business, with little in the way of inventory or capital expenditure requirements and a reasonably fast turnover of receivables. Working capital ratios of 1-to-1 and even less are not unreasonable for many broadcasting stations. However, during the past ten years, most businesses have experienced a slowdown in the collection of their accounts receivable and thus a safer current ratio today would approximate 1.25-to-1 for the typical broadcast property. A ratio much less than this will impede the station's ability to maximize the use of its cash in the operation of its business.

The subject of amortization of the intangible items on the balance sheet does deserve consideration, however. Prior to 1971, generally accepted accounting practice was to treat a station's intangibles as a non-deteriorating asset. This was based on the fact that in the vast majority of circumstances, stations were sold for higher prices than at which they were originally purchased and, rather than being a wasting asset, the license and good will increased in value over a period of years.

In 1970, the accounting profession and the SEC instituted new regulations, whereby all intangibles were to be amortized over their useful lives, such life not to exceed 40 years. Obviously, such a charge is deducted from the station's net earnings and what is worse, a station owner is unable to include this charge as a deduction from his federal income taxes. The subject of "amortization of intangibles" presents one of the most serious inconsistencies for broadcasters under federal regulation—the SEC insists on such amortization as a deduction from earnings while the IRS refuses to allow it as normal business expense and, therefore, deductible from pre-tax earnings. There are some industry groups who have been attempting to rectify this anomaly, but its presence provides a serious problem for prospective publicly-owned purchasers of broadcast stations.

In the case of large broadcast properties, a privately-owned buyer, who is less interested in reported net income and more interested in cash flow, will be able to justify paying a higher price for a broadcast station than would a publicly-owned corporation whose stockholders may not be aware of the nuances of broadcast accounting and who are only interested in reported net income.

One final note about broadcast balance sheets is in order. Some broadcast companies may report debt-to-equity ratios which may run 2-to-1, 4-to-1, or even more. To repeat, it is more important to know the repayment timing of that indebtedness since, as stated previously, it is the ratio of cash flow to debt service that basically determines whether a broadcast company is financially sound.

Timing Requirements

A potential station purchaser must justify his financial solidity to his investors, to his lenders, and to the FCC. The FCC is basically interested to know that a purchaser is financially able to complete the contemplated transaction and that during the ensuing 3 months he will have adequate funds available from internal and external sources to operate the station. Therefore, a purchaser's financial plan must be well conceived prior to the time he files with the FCC for transfer of license. If a loan is involved, detailed loan documents are usually not completed until shortly before the closing of a station transaction, an event which typically occurs four to twelve months following execution of a purchase contract. It is important, therefore, for a purchaser to deal with a knowledgeable lending institution which will feel secure in issuing a commitment letter, or "letter of intent," in advance of formal documentation of the loan.

Non-Cash Transactions

The 1986 Tax Reform Act will enhance non-cash transactions because (1) it minimizes the tax consequences for the seller, and (2) encourages swaps of similar types of stations. From the point of valuation of the property or properties involved, there is no difference in the analytical process that is used from that of a cash transaction. The non-operating considerations will solely depend on the financial position of the buyer and seller.

Historically, there have been few major acquisition transactions involving the use of the purchaser's equity securities. This type of transaction fell out of favor in the early 1970s and 1980s because of the decline in prices of equity securities of many major corporations. In addition, there was an adequate supply of capital to fund acquisitions on a cash basis. Tax reform should favor transactions.

From time to time in recent years, discussions have been held between owners proposing to swap one station for another, and, in fact, several such transactions have occurred in recent years. The practical problem seems to be that most broadcast owners view their assets on one level when selling them and on another level when wishing to purchase them. Agreement on satisfactory values to accomplish swaps has proven difficult to achieve.

"Creative Financing"

Included in the rash of broadcast transactions which have recently occurred are several which involve the issuance of "junk bonds." These are debt instruments

which typically defer the payment of interest until later in their term, and offer supposed tax benefits to their purchasers. In short, their value depends on the distant future ability of a borrower to meet his repayment schedule. They are often secured only by the "asset value" of the stations being financed and have no security position in the "hard" assets or other collateral that could be easily sold or liquidated. Both rising interest rates and declining equity markets put a "squeeze" on payments to holders of junk bonds. Either or both conditions will put a damper on junk bond financing.

The earlier comments about leverage are particularly pertinent here. From the viewpoint of a prospective purchaser of junk bonds, any appropriate debt instrument should relate to the realistic ability of the borrower to meet its terms. Purchasers of unusual forms of debt will be looking through the supposed tax benefits, the implied asset values and the issuers' selling efforts to ascertain that adequate cash flow exists to service them. So, in structuring an offering to purchase broadcast properties, a buyer intending to rely on junk bond financing must be cognizant of trends in the wider financial markets and confident of the cash flow assumptions underlying his debt service ability.

IV. POTENTIAL EQUITY INVESTORS

Historically, the number of potential investors in the broadcast industry has been limited by a lack of understanding of broadcast financing and broadcast operations. As recently as twenty-five years ago, there was only one significant publicly-owned company which operated broadcast stations. The major source of investors has been those who understood the nature of cash flow and the capital gains potential available from broadcast operations.

Thus, private owner-investors have historically provided the largest pool of investment capital in the broadcast industry, particularly so in the case of radio stations. The increase in profit levels of television has tended to increase corporate forms of ownership of these stations, but in most cases these corporations arose from the early efforts of individuals who then expanded their holdings. Until the mid-1970s, the majority of corporate investors in broadcasting were relatively small and closely held organizations, with some obvious exceptions, such as Taft, Capital Cities, Storer and Metromedia (each of which started out as a closely-held company).

During the past several years, there has been a significant expansion of interest on the part of corporate investors. Some of these corporations have achieved success in other lines of commerce and have now directed their attention to the broadcast industry as a viable investment opportunity. The favorable public exposure that such an investment can attract provides an additional reason for such investment. Expansion of corporate interest has been provided by companies already involved in other segments of communications operations, such as newspapers and magazines, which now perceive the potential of electronic communications. At this time, more than twenty-five of the 500 largest U.S. companies and almost equal number of the second 500 largest companies are significantly involved in the broadcast industry.

Another significant equity source has been companies licensed by the Small Business Administration which have been formed to provide venture capital to new enterprises. These organizations provide funds, either in the form of equity or as debt with a related equity involvement. Institutions of this type have been very active in the financing of small broadcasting groups.

The seller of a broadcast property who takes back equity securities as a part or all of his payment for the transfer of a station is another potential equity source. This type of investor has not been a significant player in the transfer of broadcast stations in prior years, but recent tax changes will make this type of transaction more appealing than was true in the past.

As indicated earlier, the most significant innovation in broadcast investing is the formation of a number of new broadcast entities which are being formed by syndication organizations. Investors in those new companies anticipate the future sale of company assets, which would provide them with a significant capital gain over a three- to five-year period, reflecting the typical financial picture of broadcast station ownership over the past 50 years. It is reasonable to anticipate the creation of an increasing number of syndication projects, resulting from the wider knowledge of potential profits which typically are generated in the broadcast industry.

Investment bankers such as Kohlberg, Kravis & Roberts; Smith, Barney; L.F. Rothschild and a number of other organizations are leaders in attracting this new equity capital to the broadcast industry. In most cases, the investment banker obtains well-regarded operating management to assure success of the investment, and it is crucial for investor participants to satisfy themselves as to this management capability.

V. LENDING SOURCES

As has been the case with investors in broadcast stations, the number of knowledgeable lenders is relatively small.

The number of banks which are knowledgeable about the broadcast industry is limited, although there is usually at least one banking institution in each major market that will have developed a specialized knowledge in this area. The Bank of Boston, First National Bank of Chicago, Citibank and Security Pacific National Bank are among those banking institutions which have, over a period of years, had successful experience with loans to the broadcast industry. With the increasing attention on the part of individual and corporate interests, there has been an expansion in the number of banks that have taken the trouble to learn about broadcast industry financing. This number is likely to increase significantly during the next several years.

While the number of sophisticated banks is limited, the number of sophisticated institutional lenders (insurance companies) has been even more so. There is now a growing awareness on the part of institutional lenders that they can be adequately secured and receive a satisfactory rate of return on loans to the broadcast industry, but only a relatively small percentage of them have made an effort to understand the possibilities that are available. A partial list of significant institutional lenders to the broadcast industry includes Home Life, Teachers Insurance and Prudential. The list is not meant to be all-inclusive by any means, but it is intended to show the reticence of institutional lenders to finance broadcast acquisitions. We are aware that an increasing number of major lending institutions have made loans for the first time to station owners, and we anticipate this list to expand in future years.

Other sources of broadcast loans are finance companies such as Barclay's American/Business Credit, Firstmark Financial and Heller Financial. These companies are categorized as "fully secured lenders" since their loans are based on the value of the station's tangible and intangible assets. Loans from such lenders are typically based on the value of these assets, rather than on the net earnings which are generated.

Parenthetically, it should be observed that traditional earnings-oriented lenders such as banks are beginning to pay more attention to the value of the underlying assets than was typically the case in the past, instead of relying solely on earnings projections.

The loan formats of each of these three types of institutions will typically vary along the following lines:

- Banks are primarily interested in loans which mature within a five-year period and which carry interest rates running between 1/2 and 3 points over the prime rate.
- Finance companies are interested in loans in the 5- to 10-year range, and the interest rate charged more typically is 3 to 5 points over the prime rate.
- Insurance company loans usually mature in 12 to 15 years and, for the most part, seem to be available only to larger, broadly-based corporate owners. While interest rates will normally compare favorably to long-term rates of medium quality loans in the general market, these lenders have often looked for a portion of their return in the form of warrants exercisable in common stock of the borrower.

The foregoing discussion of generally available terms is in no way meant to depict the exact status of financial markets at every point in time, but rather to illustrate the nature of terms which are likely to be available to borrowers in the broadcast industry.

As mentioned earlier, SBIC's are also potential lenders since their loans are often tied in some way to an equity position. The total rate of return is more nearly that sought by an equity investor.

Two other lending sources should be mentioned. Suppliers of broadcast equipment are frequently anxious to make attractive financing terms available to enhance the sale of their products. Stations which are operating with limited cash flow may require equipment at a time when they are less able to pay cash. Under such circumstances, leading equipment suppliers will often make arrangements to finance these purchases.

Finally, the most significant group of lenders to station purchasers are former owners of stations. Their objective in becoming a lender is twofold: (1) to get the maximum price for their station, bearing in mind that if the purchaser defaults on his note the seller will probably regain control of his former property; and (2) to mitigate the income tax effects of a sale in accordance with his overall financial planning. It is important to recognize that the 1986 Tax Reform Act will affect the shape of such transactions. Rules relating to installment sales have changed significantly and now offer fewer benefits for tax deferral.

During the economic stringencies of 1974 and 1975, and again in 1981-1982, when external financing was scarce, seller-financing was the most significant industry source of borrowed funds.

Seller financing, although currently not as prevalent as heretofore, will continue to be a significant source of funds, particularly for purchasers of smaller stations.

VI. SITUATION ANALYSIS— What Can Be Done!

The preceding discussion has intended to describe the philosophical, operational, and financial aspects of

acquiring broadcast properties. It is useful to analyze these factors in the light of real-world situations. In the discussion which follows, an attempt is made to describe actual situations, the rationale that went behind both the buyer's and the seller's decisions, and the practical aspects of the activities of each. No two acquisitions present the same opportunities or the same problems, but these examples will illustrate a broad spectrum of each.

Radio:

Medium Market—FM Radio Acquisition

This situation presents an ideal opportunity to examine what could be described as a textbook case. The station in question was privately-owned in a medium-sized market. From a technical standpoint, its transmitting and studio facilities were the best in the market and it had a long history of successful operation. The former majority owner had reached retirement age, was in failing health, and at a point in time when he felt it undesirable to draw more cash out of the operation to satisfy his personal needs; the tax impact of additional cash payout was unfavorable to him. Table 4 is the audited balance sheet of the former owner's company at about the time he entered negotiations to sell the station.

Included in the assets, in addition to the radio station itself, were a small two-way communications business and some excess cash and real estate. The seller and the purchaser agreed on a price of $2,250,000 for 100% of the stock of the selling company. The first point to be made is that the balance sheet does not reflect what turned out to be the "fair market value" of the station.

Table 5 summarizes the operations of the station during the last years of prior ownership. Detailed analysis by the purchaser involved an appraisal of the total market, the station's audience share in that market, and the rates at which it sold air time. Also involved was a detailed analysis of the cost structure of the station and estimates of changes that would realistically occur under a change of ownership.

On the surface, it would appear that the purchaser was willing to pay 9.8-times current operating profit in order to acquire the station. In reality, the purchaser observed that the assets to be acquired included approximately $450,000 of cash and other items which would not be needed for the ongoing operations of the station; this brought his actual net effective purchase price down to $1.8 million, or a multiple of 7.8 times current operating profit.

The next step in the buyer's analysis was to anticipate what would happen to the station under his ownership and management. Estimates of market growth, as well

TABLE 4
Medium Market—FM Radio Acquisition
Balance Sheet—Prior Owner
($000)

Assets	
Cash	261
Accounts Receivable	134
Total Current Assets	395
Fixed Assets—Net of Depreciation	266
Cash Surrender Value of Insurance Policies on Lives of Officers	8
Total Assets	669
Liabilities and Capital	
Accounts Payable	14
Accrued Taxes	28
Accrued Expenses	26
Total Current Liabilities	68
Capital Stock	262
Earned Surplus	497
Less Treasury Stock	(158)
Total Capital	601
Total Liabilities & Capital	669

TABLE 5
Medium Market—FM Radio Acquisition
Summary of Operating Results
Prior Owner
($000)

	Year Prior To Sale	Year of Sale
Net Revenue	1,085	1,055
Operating Expense	835	825
Operating Profit	250	230
Depreciation	30	30
Interest Expense	0	0
Net Income Pre-Tax	220	200
Taxes	110	100
Net Income	110	100
Operating Profit Margin	23.0%	21.8%

as of station growth, were made in detailed fashion, as were the previously mentioned changes in operating and financial structure.

Included in the new financial structure was a recasting of the fixed assets to be acquired. Table 6 illustrates, in outline form, a summary of this analysis. Purchasers should be aware of Sections 1245 and 1250 of the Internal Revenue Code which, in general terms, have the effect of eliminating prior years, depreciation charges and causing the income thus generated to be taxed at ordinary income tax rates. (In the instant case, the additional income liability was offset against the purchaser's other available tax losses.)

It should be recognized that either purchaser or seller would have had an additional $100,000 federal income tax liability at such time as the fixed assets were revalued in some form of corporate reorganization. Part of any negotiation must resolve which party will be liable. And as stated earlier, the impact of the 1986 Tax Reform Act should be analyzed to structure a contract most favorably to seller and to purchaser.

The next step in the purchaser's analysis was to prepare an income and excess cash projection. Table 7 is a summary of that projection, which was used in conjunction with the application to a bank for financing. In this instance, the purchaser provided one-third of the net purchase price in the form of equity and the bank provided the remainder in the form of a five-year term loan, with partial repayment scheduled for the first five years plus a balloon payment at the end of the five-year period. This was, and continues to be, an acceptable financing mode. Alternatively, banks have been known to extend the repayment period to seven or eight years, depending on general economic conditions.

Since this transaction occurred some time ago, it is possible to examine what actually did happen. Table 8

TABLE 6
Medium Market—FM Radio
Fixed Asset Analysis
($000)

	Cost	Deprec. Recap. (Est.)	New Value (Est.)	Life	New Deprec.* (Est.)
Real Estate					
Land	51	0	300	--	0
Land Improvements	41	16	100	20	5
Service Buildings	70	11	130	30	4
Building Improvements	8	5	20	15	1
Studio Building	164	48	350	30	12
TOTAL	334	80	900		22
Technical Equipment					
Antenna	26	0	100	20	5
Transmitter	36	32	50	6	8
Studio-Technical	49	37	80	6	15
Mobile	12	8	20	6	3
TOTAL	123	77	250		31
Other Equipment					
Furniture & Fixtures	46	32	20	5	4
Air Conditioning	2	2	2	5	1
Autos	23	17	6	4	1
Miscellaneous	26	8	20	6	3
GRAND TOTAL	554	216	1,198		62

*—Straight Line Basis

TABLE 7
Medium Market—FM Radio Acquisition
Projected Income and Excess Cash
($000)

Year	1	2	3	4
Net Revenue	1,160	1,220	1,300	1,400
Operating Expense	810	770	750	770
Operating Profit	350	450	550	630
Depreciation	60	60	60	60
Interest Expense	100	90	80	70
Net Income Pre-Tax	190	300	410	500
Taxes	90	150	200	250
Net Income	100	150	210	250
Add: Depreciation	60	60	60	60
Excess Cash	160	210	270	310
Operating Profit Margin	30.2%	36.9%	42.3%	45.0%

TABLE 8
Medium Market—FM Radio Acquisition
Summary of Operating Results
New Owner
($000)

Year	1	2	3	4	5
Net Revenue	1,326	1,354	1,459	1,447	1,530
Operating Expense	901	804	871	929	950
Operating Profit	425	550	589	518	580
Operating Profit Margin	32.1%	40.6%	40.4%	35.8%	37.0%

illustrates, in summary form, the growth in operating profit of this radio station. While a recession had an adverse effect on the station's profits in the fourth year, it regained its momentum and continued to grow beyond its original projections.

It is useful to observe at this point that the broadcast industry has sometimes been categorized as recession-proof. This is not quite true, but it is recession-resistant, and since, as stated earlier, its financial results will tend to follow the trend of the general economy, an inflation hedge is attainable for a successful broadcast owner.

It is most important to examine the improvements in the equity position of the new owner. If he were to choose to sell this station, and his current operating profit approximated $600,000, he could reasonably apply a multiple of 7-times that profit and expect to achieve a sale price in excess of $4 million. His initial investment was $600,000, and he probably has no more than $500,000 debt outstanding against the property. This represents a 42% annual return on his investment, in what could not be described as a "glamorous" opportunity. This gain occurred during a time period when the general economy was suffering extreme financial malaise.

These results were achieved through a combination of good operating management and creative financing techniques, but this example should not be considered a unique experience in the broadcast industry. By like token, ownership of the station was not, again to quote, "another license to print money." It reflects the results

of considerable effort based on prior experience within the broadcast industry.

Medium Market Stations—Superior Technical Facilities

This situation depicts an AM/FM combination which was owned for many years by a multi-media, multi-station operator. For a number of reasons, it decided to sell these properties, and the purchaser was an organization with little prior experience in broadcasting.

Table 9 describes, in summary form, the operating results of the stations. The AM station has long been the ratings and revenue leader in the market, but over the period shown has suffered deterioration in both categories. Its operating profit also declined significantly.

The prior owner did put more emphasis on the potential of the FM station, but its growth was not sufficient to offset the decline in AM station profit. Nevertheless, the stations offered apparent profit potential to others, and it should again be recognized that broadcast station prices generally follow the expectations of the potential purchaser.

The purchase price of more than $3 million far exceeded any reasonable relationship to accepted operating earnings multiples, although the purchaser did acquire some valuable real estate along with the stations.

TABLE 9
Medium Market Stations—
Superior Technical Facilities
Summary of Operating Results
Prior Owner
($000)

	Year 1	Year 2	Year 3
Station Share of Market Revenue	31.8%	28.2%	24.5%
Net Revenue	1,113	1,238	1,184
Operating Expense	926	1,044	1,060
Operating Profit	187	194	124
Operating Profit Margin	16.8%	15.7%	10.5%

Parenthetically, the presence of valuable land in a broadcast acquisition must be weighed against the technical needs of the stations. In many larger markets, replacement real estate on which to locate transmitters is in short supply, and the existing site may not be appropriate for disposal if the station is to operate effectively.

The analysis of a station's operations, its position in the market, and the major factors affecting its existence can be assisted by several accepted sources. Material furnished by the local Chamber of Commerce is useful, as is market data published by the Census Bureau and by *Sales Marketing and Management* magazine. In many markets, the station operators have banded together to produce market revenue estimates, and it is often possible to gain access to them. Organizations such as the National Association of Broadcasters, Television Bureau of Advertising and Radio Advertising Bureau are extremely helpful.

The most useful publications which have emerged in recent years are those published by the National Association of Broadcasters, by James Duncan for radio and by Broadcast Investment Analysts for television. They provide data relating to market size and other relevant statistics, and compile audience position standings based on Arbitron and Nielsen ratings.

Table 10 describes the operating results from the new owner's management practices. In fact, he was not able to improve either station's position in the market, and more importantly, their profit levels.

At this point, he has two major alternatives. The market, and his technical facilities, are still attractive to prospective purchasers; financing costs are less than at the time of his original purchase, so that he can anticipate a sale price which would cover his cost and the losses to date.

TABLE 10
Medium Market Stations—
Superior Technical Facilities
Summary of Operating Results
Present Owner
($000)

	Year 1	Year 2
Station Share of Market Revenue	21.3%	19.3%
Net Revenue	1,244	1,300
Operating Expense	1,416	1,320
Operating Profit	(172)	(20)
Operating Profit Margin	--	--

TABLE 11
Medium Market Stations—Superior Technical Facilities
Projected Operating Results
($000)

	Year 1	Year 2	Year 3	Year 4
Station Share of Market Revenue	21.0%	21.5%	22.1%	22.7%
Net Revenue	1,584	1,822	2,095	2,409
Operating Expense	1,200	1,284	1,374	1,470
Operating Profit	384	538	721	939
Operating Profit Margin	24.2%	29.5%	34.4%	39.0%

TABLE 12
Major Market—Excellent Facility (1)
Summary of Operating Results
Prior Owner
($000)

Year	1	2	3	4
Net Revenue	2,490	2,690	2,790	3,040
Operating Expense	1,490	1,590	1,710	1,860
Operating Profit	1,000	1,100	1,080	1,180
Operating Profit Margin	40.2%	40.4%	38.7%	38.8%

His other choice would be to attract new management personnel, most likely using an incentive based on improved performance, to get the stations to profit levels which more nearly reflect industry expectations. Table 11, in our opinion, is a reasonable expectation for these facilities in the market environment in which they operate.

Major Market—Excellent Facility (1)

This situation reflects a large station with a solid track record of earnings. It has been well-managed, although it is likely that in this type of situation operating expenses have been allowed to rise above their optimum levels. Nevertheless, the former owner enjoyed significant earnings, as described in Table 12, from an investment made many years earlier. Coincidentally, the net asset value of his facilities had been almost completely depreciated. This station was sold for approximately 7-times its operating profit.

This situation will illustrate the difficulty on the part of a corporate purchaser who wishes to improve his reported net earnings by acquiring a station. It is reasonable to assume that of the total purchase price, a maximum of $1,000,000 could be assigned to depreciable and non-depreciable tangible assets. The balance of the purchase price must therefore be allocated to intangibles which must be amortized, although not deductible from taxable earnings, over 40 years. Again, the impact of the 1986 Tax Reform Act will probably affect the form of acquisition which any type of purchaser might select.

The alternate effects on two types of purchasers, private and publicly-owned, is demonstrated in Table 13, which is a simplified five-year projection of what might be expected from this station. It is assumed that both purchasers would create financing packages using $2.5 million of equity and $6.5 million of debt, which will provide $500,000 of working capital in addition to the $8.5 million purchase price. It is also assumed that the purchasers use the same depreciation rates.

The private investor is generating an 18% return on his capital in the first year and a 28% return in the fifth year. At the end of five years, the equity value would be in excess of $7.5 million, if valued at 7-times operating profit and deducting the outstanding debt. This represents a 25% annual return on the original investment.

The publicly-owned company, however, is reporting a return on its investment which is disappointingly low. In the first year, it will only earn 1.8% on its total investment, or 6.4% on the capital it has invested. At the end of the fifth year, these returns will only have risen to 4.8% on total assets and 16.4% on invested capital. What is more, there is no reflection on the public corporation's books of the increased station value that has been obtained, unless it is sold.

This problem becomes even more acute when television stations are involved, although it is true that a television station would have earnings and tangible fixed assets considerably in excess of those of a radio station. Nevertheless, the problem is a real one for publicly-owned corporations desiring to make broadcast acquisitions. There are a number of corporate owners who have elected to sell their stations in order to improve their overall financial position.

A useful approach for an acquiring corporation might be to finance its broadcast acquisitions on a basis which would not require them to be consolidated, for earnings purposes, on the parent company's financial statements. This can be accomplished by limiting the current equity involvement of the corporation to a level of less than 20%. The use of subordinated convertible securities or stock warrants might be considered, which securities would be converted at such time as the earnings level of the broadcasting subsidiary would not cause a diminution of the parent company's reported earnings. In other words, the development of the broadcasting subsidiary would take place in an "off balance sheet mode," to be brought in on a fully integrated basis at such time as the subsidiary attained some degree of maturity.

As was mentioned earlier, a significant change has occurred in the attitude of public investors toward broadcasting investments. More attention is being paid to the "asset values" of stations as opposed to the net income that they generate. As recently as five years ago, publicly-owned broadcast stocks typically sold at about 50% of the fair-market value of the assets of the company. Because of this change in public perception, it is fair to state that publicly-owned broadcasting stocks sell more nearly at 80% of the market value of their assets. This factor has undoubtedly made broadcasting stations, as investments, more attractive to publicly-owned corporations.

Major Market—Excellent Facility (2)

As further evidence that ownership of a broadcast property is not "an automatic license to print money,"

TABLE 13
Major Market—Excellent Facility (1)
Projected Income and Excess Cash
($000)

Year	1	2	3	4	5
Net Revenue	3,300	3,450	3,600	3,800	4,000
Operating Expense	2,000	2,050	2,100	2,250	2,350
Operating Profit	1,300	1,400	1,500	1,550	1,650
Interest Expense	500	480	440	400	350
Gross Cash Flow	800	920	1,060	1,150	1,300
Depreciation	100	100	100	100	100
Amortization (Non-Tax Deductible)	190	190	190	190	190
Net Income Pre-Tax	510	630	770	860	1,010
Taxes	350	410	480	525	600
Net Income	160	220	290	335	410
Add: Depreciation & Amortization	290	290	290	290	290
Excess Cash	450	510	580	625	700
Operating Profit Margin	39.4%	40.6%	41.7%	40.8%	41.3%

TABLE 14
Major Market—Excellent Facility (2)
Summary of Operating Results
Prior Owner
($000)

Year	1	2	3	4
Net Revenue	2,400	2,400	2,500	2,350
Operating Expense	1,600	1,800	2,000	1,950
Operating Profit	800	600	500	400
Operating Profit Margin	33.3%	25.0%	20.0%	17.0%

the next example is a major market, top facility radio station which has suffered from a number of adverse circumstances. In the first place, the former owner of this station was not basically attuned to maximizing its profit potential. The station represented a relatively minor investment of a large corporation and the owner was content to bask in the reflected image of the well-established call letters. Table 14 reflects the shrinkage in operating profit margins which arose from a combination of weakened sales and programming efforts, while also allowing operating expenses to get out of control. A purchaser of this station would assume that he can operate more effectively than the former owner, and that in a reasonably short period of time he will be able to turn the situation around.

Without intending to be obvious, it should be stressed that there are no magic buttons that can be pushed to reshape the operating results of a broadcast station. It is hard work and generally follows an established pattern which requires a period of time for each of the rebuilding steps to be fully reflected in improved operating results.

Assuming the technical facilities are in reasonably good condition, the first objective is to define what target audience the station will attempt to reach and, following that, what programming would most suitably attract that audience. Next, audience promotion to attract new listeners is mandatory since in most markets, with the exception of teen-age audiences, listening habits are relatively fixed. Successful programming and promotion will then be reflected in higher program ratings, as well as in retail sales activity for satisfied advertisers who have purchased time on the station. The final step is then an increased level of air-time sales and an increase in spot rates. As in all service businesses, so it is in broadcasting—after the operating breakeven point is attained, an increasing percentage of incremental revenue flows through to the operating profit line. With the exception of sales-related expenses, basic station costs are relatively fixed.

Getting back to this situation, a buyer would face the problems of increased expense which is needed to revitalize the station, while at the same time trying to generate sufficient operating profit to service his debt. In this specific situation, the buyer agreed to a price which was more than 15-times the current operating profit level, on the assumption that he could rapidly increase his operating profits. Assuming a money cost of only 10%, it would appear to be difficult to generate sufficient cash to service a highly-leveraged financial structure, much less to expend funds to improve station operations.

And, in fact, this is exactly what happened—the new owner was in a position of having to play "catch-up". His options were to make an additional investment or liquidate his interests in the station at a loss.

A useful method to raise equity in this situation might well be in the form of preferred stock. While the holder of such a security would have a prior position, the original investors would hopefully be provided with sufficient capital to cover the time needed to rebuild the station and eventually receive some return on their investment. The alternative might be a forced liquidation.

The infusion of additional capital plus good management provided the ingredients whereby the station did become profitable over a period of time. It is seldom possible to achieve fast turnarounds of mature broadcasting properties.

Major Market—Excellent Facility (3)

Table 15 again describes the danger signals that must be observed in appraising a potential broadcast investment.

TABLE 15
Major Market—Excellent Facility (3)
Summary of Operating Results
($000)

Year	1	2	3	4	5	6	7
Station Share of Market Revenue	16%	14%	10%	11%	8%	5%	5%
Net Revenue	2,845	2,756	1,987	2,393	2,219	1,529	1,762
Operating Expense	1,167	1,282	1,402	1,282	1,445	1,720	2,184
Operating Profit	1,678	1,474	585	1,111	765	(191)	(422)
Operating Profit Margin	59.0%	53.5%	29.4%	46.4%	34.6%	--	--

This station, in the year in which it was acquired by its new owner, was a dominant factor in its market. In addition to excellent financial results, it enjoyed an excellent reputation in the community. It was purchased by a non-experienced buyer for what seemed to be a reasonable price of 7-times operating profit.

The questions that should have been asked at the time of purchase was whether or not the operating profit margin was realistic and projectable at that level into the future. In all likelihood, the owner of this station should have been re-investing heavily into improved programming and promotion to attempt to maintain the significant market share he enjoyed.

During the ownership period covered by Table 15 there were several management changes and format changes imposed on the station, strong new competition entered the market, and the station's income and reputation were badly affected.

The station was disposed of at the end of this time, for a price of about 40% of the original purchase price, to a broadcast operator who felt that the market and the station's technical facility offered a profit opportunity. As indicated earlier, such turnarounds are expensive to effect—we anticipate more than $2 million in turnaround costs were incurred.

Such projects should only be undertaken by experienced and well-financed organizations. The results of this latest chapter in the station's history are yet to be recorded.

Raw Start-up, FM Facility

During the past ten years, there has been extensive growth of stations operating in the FM spectrum. The ability of new owners to make minimum financial investments to achieve quick financial rewards has been widely reported in trade publications. As has also been reported, not all of these situations worked out to investors' expectations.

The three key factors of market, technical facility, and management must be dealt with in any start-up, since a significant cash operating drain is the normal expectation for a period of time.

In this example, an individual with extensive successful broadcast experience perceived the potential of a medium-sized market which was undergoing major, positive changes in its outlook. He obtained a construction permit for a new station to operate at the maximum power allowed in that market.

He obtained a transmitter site equal to or better than any of his competitors. He acquired state-of-the-art equipment to provide top-quality sound along with minimum maintenance expense. He retained a program specialist to find the "program hole" in the market for maximum impact of the new station. He retained strong, recognized local management personnel to gain immediate acceptance into the marketplace. In short, he went first class.

The result of this effort exceeded expectations. The new station's signal was unexcelled in the market. The programming, aided by a successful promotion campaign, attracted some of the largest audiences in both major ratings services. And the station's operating profit reached a breakeven point in six months.

Assuming that a knowledgeable purchaser would pay a minimum of 7-times succeeding years' anticipated operating profit of more than $200,000 for the station, the investor could anticipate a seven-fold return on his $200,000 investment.

To reiterate, this type of situation does not guarantee automatic results. It does demonstrate what professional investment and management techniques can attain.

Major Market—AM Rebirth

It is accepted wisdom that AM radio stations no longer offer acceptable returns on investment, because of the development of FM radio. Varied reasons have been offered for this development, while at the same time, it appears that many AM radio stations remain in strong hands and are prospering.

The three factors of market, technical facility and management are being applied in a number of current situations, and this example describes such an opportunity.

In this case, the market ranks in the top twenty-five. Further, after years of desultory growth, or even economic slippage, it has been awakened by a combination of strong political and economic leadership, reinforced by an uplift in the general economy.

The station occupies a frequency at the low end of the AM spectrum, the most favorable position. Although presently operating with one kilowatt power output which gives it excellent market coverage, it expects to increase to five kilowatts in the near future. This, combined with top-quality stereo sound, will produce a signal second to none in the market.

Both the equipment and the programming had badly deteriorated under prior ownership, and the station's audience and revenue positions reflected this. So, too, did the station's market value; it was acquired for an effective price of about $500,000 by an experienced broadcaster supported by a knowledgeable investor.

TABLE 16
Major Market Station—AM Rebirth
Balance Sheet—Prior Owner
($000)

Cash	11
Accounts Receivable	45
Total Current Assets	56
Fixed Assets—net	38
Total Assets	94
Accounts Payable	31
Accrued Expenses	4
Total Current Liabilities	35
Loans Payable	161
Shareholders Equity	(102)
Total Liabilities & Equity	94

TABLE 17
Major Market Station—AM Rebirth
Prior Operating History
($000)

	Year 1	Year 2	Year 3
Station Share of Market Revenue	1.7%	2.0%	1.7%
Net Revenue	239	298	301
Operating Expense	268	294	311
Operating Profit	(29)	4	(10)
Operating Profit Margin	--	1.3%	--

TABLE 18
Major Market Station—AM Rebirth
Projected Operating Results
($000)

	Year 1	Year 2	Year 3	Year 4
Station Share of Market Revenue	1.9%	3.7%	3.8%	4.2%
Net Revenue	426	900	1,040	1,250
Operating Expense	595	798	859	941
Operating Profit	(169)	102	181	309
Operating Profit Margin	--	11.3%	17.4%	24.7%

Table 16 is the prior owner's balance sheet prior to the sale. Table 17 is the station's operating record for the three years prior to sale.

No suggestion is made that this type of turnaround is easy. The first step is to define the "program hole" and at the same time to repair or replace the major equipment items. A change in the station's call letters is sometimes desirable.

The most important financial factor is to assure that sufficient working capital exists to fund the changeover of station operations. Turnarounds are seldom accomplished in less than a year, and often take longer. In this case, the station met its first year targets, and Table 18 projects its future growth. Note that a large audience share is not required to make the investment viable, since the initial investment was not large.

Looking forward several years, it is not difficult to anticipate such stations as viable competitors to the highest-rated FM stations in the market. Their high quality signal will reach a significantly larger audience when enough AM stereo receivers are acquired in the future. In the meantime, AM stations can provide an acceptable return on investment for knowledgeable owners.

TELEVISION:

Major Market Television Station—Network Affiliate

This situation is a television station which had suffered from a number of problems over a period of five years. It had been the third-rated station in its market, competition was weak—which means that air-time rates were below those which would be expected in a market of this size—and the station's owners had been unable or unwilling to install adequate management to take advantage of their investment.

A sophisticated purchaser, when examining this property, would make detailed analyses to determine what the station could earn, and then base his offer on a multiple in excess of 7-times the depressed level of present operating income. This, in fact, is what happened, although the owner rejected that offer as being too low.

He then decided to rebuild the station with outside assistance, and the results of his efforts are reflected in the fifth year of Table 19. It so happens that this year was extremely profitable for the television industry, but the results demonstrate profit margins which well-run stations should generate. Further, if a trend line was extended over the five years covered by the Table, the reasonable rate of growth that should have been generated by the station would be depicted. The improvements which were introduced at the end of the fourth year, therefore, were not unusual or unique.

This situation also illustrates the difficulty in dealing with inexperienced investors in attempting to structure financial arrangements to purchase such a station. Although attempts were made to attract private investors as buyers of this station at the asking price of $13 million, the eventual purchaser turned out to be a knowledgeable, privately-owned group broadcaster who recognized the potential of the station and the market. As a matter of fact, the eventual purchase price turned out to be 5.8-times current operating profit, probably one of the lower multiples for the purchase of a major market, network affiliated television station in recent years. The purchaser recognized his opportunity and moved quickly—while at the same time the seller achieved his objective of eliminating from his corporation an

TABLE 19
Major Market Television Station—Network Affiliate
Summary of Operating Results
Prior Owner
($000)

Year	1	2	3	4	5
Net Revenue	4,000	4,500	4,250	4,500	6,000
Operating Expense	2,700	3,000	3,450	3,750	3,750
Operating Profit	1,300	1,500	800	750	2,250
Operating Profit Margin	32.5%	33.3%	18.8%	16.7%	37.5%

activity in which he had no continuing interest and little expertise.

It is interesting to examine the return that a private investor group could have achieved by acquiring this station at its asking price of $13 million. Assuming an original equity investment of $3 million, a very conservative forecast of operating earnings growth, as well as a 7-times multiple at the time of a possible sale five years hence, Table 20 demonstrates that the investors would have had a 38.5% annual return on their investment. There would be very little downside exposure, since the station is located in a market which does display growth characteristics and is one of only three VHF stations allocated to that market. The station was actually sold for about $40 million five years later which provided the investor with a 63% compounded annual growth rate on his investment.

The profit potential from this type of station, if purchased at a reasonable price, has been recognized by numerous sophisticated operators, but they have been followed by purchasers who believed that almost any price could be paid for such a station. This supply/demand factor has resulted in transactions with price-to-operating profit multiples in the range of 15–20 times.

In the present financial environment, we observe VHF network-affiliated television stations trading in a 10 to 15-times operating profit range. Higher multiples generally apply to stations in the top twenty markets.

As for UHF stations, there is a wide range of pricing. Major determinants include the question of affiliated or independent station status, and if the latter, how may other stations populate the market.

In the last analysis, the multiple relating to the sale price will be based on the new owner's estimates of the future of the station. It should be recognized that "multiples" are a reflection of the transaction, not the determining factor in setting the price of the station.

Major Market VHF-Affiliated Television Station

In spite of popular conception, all major markets, all VHF stations, all network affiliates, all station technical facilities and finally, all station managements are *not* alike.

Table 21 describes a station facing a number of problems. The station and its owners have been well-regarded for many years. It has maintained a large market share of available revenues, but it does not deliver a profit level normally anticipated for such a station.

It is axiomatic that almost any broadcast property which has operated for a long period of time under a

TABLE 20
Major Market Television Station—Network Affiliate
Projected Income and Excess Cash
($000)

Year	1	2	3	4	5
Net Revenue	6,850	7,300	7,800	8,300	8,700
Operating Expense	4,590	4,880	5,180	5,540	5,800
Operating Profit	2,260	2,420	2,620	2,760	2,900
Interest Expense	990	930	850	770	720
Gross Cash Flow	1,270	1,490	1,770	1,990	2,180
Depreciation	930	930	930	930	930
Amortization	110	110	110	110	110
Net Income Pre-Tax	230	450	730	950	1,140
Taxes	170	280	420	530	625
Net Income	60	170	310	420	515
Add: Depreciation & Amortization	1,040	1,040	1,040	1,040	1,040
Excess Cash	1,100	1,210	1,350	1,460	1,555
Operating Profit Margin	33.0%	33.2%	33.6%	33.3%	33.3%

TABLE 21
Major Market VHF-Affiliated Television Station
Summary of Operating Results
($000)

	Year 1	Year 2	Year 3	Year 4
Station Share of Market Revenue	36.4%	37.5%	36.3%	36.0%
Net Revenue	12,294	14,403	15,279	16,550
Operating Expense	9,004	10,532	11,023	12,188
Operating Profit	3,290	3,871	4,256	4,361
Operating Profit Margin	26.8%	26.9%	27.9%	26.4%

single owner will provide cost-reduction opportunities for a purchaser. At the least, personal relations with key employees often retard efficiency-producing changes which might be in order. In this case, a knowledgeable purchaser paid about 18-times operating profit for the station.

The problems are three-fold. The market has not displayed growth characteristics, relative to the rest of the country, and in fact has been lowered in market ranking. Second, there appears to be a serious threat that stations in nearby markets might be able to attract audience shares from this market. Finally, the station's present technical facilities must be improved, at a significant cost. These problems overlay the obviously out-of-line expense levels which the purchaser inherits.

This example illustrates several considerations for a purchaser. The stated price may indeed be less than the total consideration paid by the purchaser. As was illustrated earlier, it is difficult to define the precise moment when a station's problems can be remedied and profit levels restored to more normal expectations.

Finally, it demonstrates that different purchasers have different objectives, and will be more or less willing (and able) to reach out to acquire specific stations. A purchaser's goals and objectives must be established before he goes into the marketplace.

Major Market—UHF Independent Television Station

Until 1977, it was an axiom of television broadcasting that it was almost impossible to generate operating profits from an independent television station which operates in the UHF spectrum, and which directly competes with several VHF stations. In prior years, there has been isolated exceptions. The continued growth of total television revenues has provided an increasing number of UHF independents with the capability of showing a significant and increasing level of profit.

During the past five years, the profit potential of operating non-network affiliates in many markets became apparent, and many applications were filed to activate the UHF stations which had been allocated many years earlier.

In a number of instances, the original grantees of new UHF licenses only intended to sell out, at significant profit, to organizations planning to provide competitive services to their markets. Several such transactions still occur each year.

More importantly, some of these new stations now provide viable alternative programming to that available on the older-established network affiliates. The major problem these stations face is in obtaining programming at a cost which will allow them to earn a profit, and yet be able to attract a significant audience. The problem is magnified when more than one, or at most two, independent stations are established in a market.

Pricing and valuation of these new stations is extremely difficult. Revenue and expense projections require considerably greater analysis, and the resultant profit projections must be laid against a financial package which provides a higher degree of safety than would be prudent in acquiring a VHF station. It should be noted that the license for a UHF independent station in a major market was recently turned back to the FCC, after the owner could neither operate profitably nor find a buyer on reasonable terms.

Eventually, it is reasonable to suspect that the same operating profit multiples will apply to UHF stations as apply to their VHF counterparts—it is reasonable to expect that the forces of supply and demand will even-

TABLE 22
Major Market UHF Independent Television Station
Summary of Operating Results
Prior Owner
($000)

Year	1	2	3	4	5
Net Revenue	5,400	5,500	5,100	5,400	8,600
Operating Expense	6,110	5,960	5,910	6,390	8,050
Operating Profit	(710)	(460)	(810)	(990)	550
Operating Profit Margin	--	--	--	--	6.4%

tually create such an environment. One of the most important decisions for an owner of a UHF independent television station is to determine what niche he can profitably fill within the marketplace. We have discussed earlier the fact that CATV, MDS and DBS will increase the number of available video signals in various markets. A proper decision as to the form of service to be delivered to the specific market will be paramount to success.

In Table 22, we have illustrated the track record of a UHF television station which was purchased for $11 million. There is no formula that we can apply which would justify this purchase price other than the optimism of the purchaser and the belief that he is knowledgeable about his financial affairs. Again, only time will determine what a true value of this property will be.

In this market, we are aware that one UHF competitor disappeared, while another is probably worth over $100 million. It is the projection of the future growth of operating profit which is the basic determinant as to what a prospective purchaser will pay for such stations.

SUMMARY

The continuing development of electronic communications—to provide a broader range of information, education and entertainment services to the general public—offers attractive opportunities in the broadcast industry.

A potential station owner must undertake a detailed examination as to the basic tenets of what and how to buy stations. He must also consider his own individual creativity and his own commitment to accept certain risks.

It is the commercial success of the existing media, the existing communications forms, that has permitted new competition to appear, such as CATV, VCR, multipoint distribution and satellite-to-home service; these are nothing more than new distribution forms of audiovisual signals. Because there are not enough VHF outlets in many cities to service the volume of advertising that is placed, UHF stations in many markets have finally become profitable. It is the demand for additional video services that over-the-air television has not provided, or cannot provide, that is allowing CATV to become economically viable.

These new communications forms should serve to reinforce and enhance existing broadcast properties. There will undoubtedly be changes in the nature of the services being provided, however, as each segment of the industry seeks its most viable and most profitable function.

Also observe that the emergence of new communications forms does not render obsolete existing services, but it does force them to seek their most economical operating format in order to remain viable as an investment.

Broadcasting isn't "another license to print money," but it can prove to be an exciting and rewarding enterprise to a knowledgeable investor.

APPENDIX C: Station and Market Review Check Lists

I. STATION REVIEW CHECKLIST

STATION CHARACTERISTICS—Identify station power, frequency, location of studios and offices, transmitter tower and city of license. Check the station's gross revenues, cash flow, depreciable items, real estate and non-recurring expenses. Analyze the immediately previous three years' [five years if possible] financial reports including station operating statements and balance sheets. Determine if the bookkeeping has been consistently accurate, because a history of accurate bookkeeping is essential if future projections, comparisons and recommendations are to be useful. If possible, work with review or audit reports and the station's accountant.

OWNERSHIP AND HISTORY—Establish the date the station originally went on the air, its current ownership, business form of ownership (sole proprietor, partnership or corporation), names of the principals, amount of ownership each has and whether the ownership is public or private. Determine how long the present owners have owned the station and how long each previous owner owned the station.

GROSS REVENUES—Find out what the cash revenues and collections are. Check trade and promotion deals for anything that might misleadingly inflate income figures or understate expenses. Find out what the sources of income and sales are and the percentage from each source such as network, national and local, as well as other sources of income. Where necessary, adjust figures to determine cash revenues. Set up a separate column entry on the financial analysis report for adjusted income.

DIRECT SALES EXPENSES—Determine if sales and agency commissions are common, then relate this to the percentage of network, national and local revenues. Where possible adjust these figures to establish net sales revenues.

OPERATING EXPENSES—Look for any non-recurring or inflated department expenses, particularly in the technical, program and administrative departments. These may reveal operating expenses such as payments to a home office or consulting fees which offer an opportunity for substantial savings. Where possible adjust these expenses so as to get an accurate cash flow figure.

DEPRECIATION—Review current schedule of depreciation. Determine if all depreciation allowed by IRS has been used. Set up a new depreciation schedule for depreciable items. Consult an accountant or tax attorney for the latest Treasury Department rulings and case histories. Your new depreciation schedule may depend to some extent on the needs of your investors and the advice of your accountant.

CONTRACT COMMITMENTS—When the financial analysis is completed, obtain copies of all the station's contractual commitments and check these against your financial review. Determine the beginning and end dates and details of the contracts, leases and licenses. Principal contracts to look for are land and building leases, trade deals, syndicated programming, transcription, news, advertising, trade memberships, equipment, sales representation and union contracts. Contracts can sometimes be rewritten before acquisition of the station to provide savings and possibly new depreciation opportunities for the new owners.

INCOME CONTRACTS— Examine time sales or other income-producing contracts. Determine the type of spot advertisers purchasing time, both national and local.

Review the number of long-term advertisers, their longevity and their dollar totals and relate this to total sales. Repeat this for the ten largest-spending clients. Obtain the total number of national and local contracts annually to determine their average length and revenue. Compute network and other income and relate this to total sales. Look for other sources of income either undeveloped or not being charged, such as remotes, use of studio facilities and tower space, talent fees. Observe any unusual seasonal sales trends for future attention.

LEGAL AND FCC—Ascertain whether there are legal actions pending against the station. Check whether the station license is in effect and that there are no FCC actions pending or anticipated which directly or indirectly involve the facility. Review also the station's past FCC license history.

With this part of your evaluation completed, you have accurate knowledge of the station's financial track record of sales, expenses, depreciation, cash flow and contract commitments. These are the financial facts you will later compare to the total market advertising expenditures, the market radio revenues and other media income. At the same time, you have made an adjusted financial assessment of the station corrected to reflect true cash flow and non-recurring expenses applicable to the new ownership. You have been able to pinpoint possible areas for further examination to reduce expenses, increase depreciation, increase sources of income and determine from whom, where and when sales may be increased. These findings will be the basis for future financial planning.

RATE STRUCTURES—Evaluate past, current and projected rate card pricing for network, national and local, also day-part share point averages and cost per thousand compared with other stations. Review station logs for unsold or oversold areas and for unrealistically priced day-parts. At all times compare to similar competitors to estimate past losses of sales income and projections of future sales revenues. Current sales and projections should be compared to available data on market broadcast sales to arrive at the station's market share.

PROGRAM CHARACTERISTICS—Analyze the station's program format, affiliation, news service, local production and public service in addition to client, press and public attitudes. Listen to the station and all competitors before initial program evaluation. Look for program preferences of the audience in the market which are not being met commercially, as well as news, public service or technical weaknesses.

COVERAGE AND AUDIENCE—Research the station's greater coverage and marketing area for total audience characteristics, number of households and their composition. Compare with other stations for relative market share and percent of total audience. Watch carefully for the audience trends of each station. Compare these results with the percent of market broadcast revenues. Check to see if there are any applications filed or construction permits granted for additional facilities serving the market.

Station Inspection

PERSONAL INSPECTION—Conduct a personal inspection of the offices, studios and engineering facilities. Determine whether there is adequate space for your operations, with an atmosphere conducive to the comfort and effectiveness of the station employees. Physical inspection of facilities is almost always permitted before contract signing.

ENGINEERING INSPECTION—All engineering equipment should be inspected by a broadcast consulting engineer. This includes transmitter, tower, remote units, consoles, recorders, turntables, wiring and control rooms. He should report on the age and condition, type, location, FCC specifications, needed replacements and possible engineering improvements. This engineering inspection could reveal conditions that would affect the amount of operating capital you would need and the amount of depreciation you could deduct. If the transmitter site, studio or property is being leased from someone else, check the terms of the lease.

PERSONNEL POLICES—Review with the station owner the number of employees, their length of employment, responsiblities, profit-sharing plans, vacation polices and any other employee benefits. This will provide you with a look at the physical property and a feeling of station-employee relations.

II. MARKET REVIEW CHECKLIST

STATISTICAL DATA, SIZE AND NATURE OF THE MARKET

Research the market and coverage area to determine the following:

a. Population
b. Households
c. Consumer spendable dollars per capita, per household and total
d. Retail sales per capita, per household and total
e. National rankings of population, households, income and retail sales

f. Growth trends, past and future, of population, households, income and retail sales.
g. Principal employers and other industries

From these basic factors for measuring market strength, look for upward or downward trends that indicate future market shifts of population, income and retail sales.

ADVERTISING DATA—TOTAL MARKET

Research the station's market and coverage area to determine the following:

a. Market's total annual advertising volume. Break down total to determine amount of national and local (if available)
b. List all major media in market
c. Break down all major media to include annual dollar volume and then determine the amount each received of national and local expenditures (if available)
d. Break down all major media to include circulation, rates and cost per thousand

From the above information, determine each medium's percentage of the market. Look for market trends in total advertising dollars and any medium which dominates. Observe carefully the broadcast and radio shares.

BROADCASTING DATA—SPECIFIC STATIONS

Determine or estimate the following data for each broadcast station:

a. Revenues (network, national, local)
b. Audience size and composition
c. Time listening
d. New stations—available, applications pending, granted applications
e. Coverage, power, frequency
f. Programming
g. Rate card
h. Affiliation and representative
i. Local public and client opinion of station

APPENDIX D: A Model Financing Proposal

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II. POINT-BY-POINT COMMENTARY ON THE MODEL PROPOSAL

III. AN ILLUSTRATIVE PROPOSAL

The prospective broadcasting station owner faces a series of demanding and important tasks associated with locating, purchasing and operating a radio or television station. How well those tasks are accomplished will determine, in large part, whether a station is successfully acquired and whether the newly purchased station can be profitably operated.

An increasing number of resources is available to aid the broadcast newcomer in successfully completing the necessary tasks. The National Association of Broadcasters (NAB) and the Federal Communications Commission (FCC) both provide variety of publications and individual counseling services to prospective station owners. In addition, acquisition consultants, brokers, and some investment bankers serve first-time broadcast buyers.

THE FINANCING PROPOSAL: ITS NATURE AND USES

What is a financing proposal? In essence, it is a complete description of a business—in business terms—compiled by the owner or prospective owner and supplied to prospective lenders and investors. The lender uses the data in the proposal to help make the financing decision. As a working document, the proposal supplies evidence to the lender that the borrower has fully analyzed the business he or she wants to purchase.

What does a financing proposal do for those who want to buy a broadcast station? First, it shows what kind of business broadcasting is. Second, it suggests the

skills a station owner should possess to be successful. A careful analysis of the proposal will help the entrepreneur answer two very important questions: "Do I really want to be in the broadcasting business?" and "Do I have the skills and experience necessary for success?" After understanding what the proposal is, it is important to recognize some of the things it is not.

PROPOSALS IN THEMSELVES DO NOT CREATE FINANCING OPPORTUNITIES

Even when highly organized and thorough, a proposal provides only a vehicle for discussion about identified opportunities. An activity separate from the proposal, but important to its success, is for the future station owner to learn as much as possible about the prospective investor or lender. It is particularly valuable to know, for example, whether the people to be contacted have had previous experience in such financing and what they expect. Preliminary contacts with these individuals can help a prospective borrower determine which aspects of a proposal will be most important and who will play a key role in making the loan. The proposal itself will not create these relationships or ensure success.

THE PROCESS IS MORE IMPORTANT THAN THE PRODUCT

Since both the buyer and some lenders may well have limited experience in broadcast financing, preparing and analyzing a detailed proposal are likely to be educational experiences for all parties. The preparation of a thorough proposal improves the ability of the financial institution to ask meaningful questions and enhances the prospective buyer's ability to answer those questions. Anything that facilitates this educational task and improves the quality of discussions is viewed as more important than just a well-written proposal. Organizing it in a useful and meaningful way will produce a valuable document, a knowledgeable buyer and will facilitate informed reviews of the proposal.

The Model Financing Proposal

The model financing proposal will be useful to the prospective station owner in a number of different ways as he or she moves through the process of deciding to purchase a station, locating a station, developing a financing plan and finally taking over operation of the station. The next several paragraphs illustrate some of the ways the proposal can be used.

Deciding to Purchase A Station

Regardless of the motives and personal goals of the prospective station owner, it must be remembered that a broadcasting station is a business—an economic entity. Operating the station will consume funds and those funds must, in most cases, be generated by the station itself. And because broadcasting is a relatively complex business, broadcast managers must be very good business people. Using the model proposal presented here as a guide, the entrepreneur will be able to produce a sound financing proposal—a critical first step in demonstrating business skills.

Looking for a Station to Purchase

Prospective station buyers look for stations in many different ways. Some respond to "Station for Sale" advertisements in trade magazines. Others deal with station brokers. Those who are already active in the broadcasting business or who have acquaintances in the business may follow up leads they get from other broadcasters, advertising agencies, communications lawyers and others. Many simply select stations that interest them and contact the owners directly with an offer to purchase.

Regardless of the method used to locate a station, it is necessary to get the specific information required to make informed decisions about: (1) whether to purchase the station at all and (2) how much to pay for it. Again, the model financing proposal describes in detail the types of elements that must be considered, including the size of the market, the condition of the station equipment, the station's ratings history and so on. These are the qualities of a station that determine its business value, both as it stands and as it will develop under new ownership. The decision to purchase should be made only after the purchaser has balanced the station's cost against its value, in the context of the market, and the audience and sales potential.

Developing a Financing Plan

When the prospective buyer has located a station to purchase and is seeking sources of outside financing, the model financing proposal can be used as a blueprint for creating a financing proposal for the specific station under consideration and for determining the individual financing sources that appear most appropriate. Because this is the way most people will use the model, the next section deals in greater depth with the development and use of a formal financing proposal.

Planning Station Operations

The model can be effectively used as a framework for planning the management and operation of the station the entrepreneur wants to purchase. As noted earlier, a commercial broadcasting station is a business and must be operated in a businesslike manner. The broadcaster must have a clear understanding of the relationships among the audience in the market, programming

availability and cost, sales revenues and expenses, operating and financing costs and other variables involved in running a broadcast station.

While each of these variables will be different for specific markets, stations and management plans, the general relationships will remain the same. In this way the sample proposal can be extremely useful in providing guidelines and checkpoints for the entrepreneur's planning process.

Sources of Financing and Information

During the process of locating a station, negotiating with the station owner, arranging for license transfer and finding sources of financing to purchase the station, the entrepreneur will come in contact with a number of individuals, organizations and agencies that can provide information about either the financing process or financing itself. For the entrepreneur to take advantage of these opportunities, he or she should understand the role each individual, organization or agency plays and the contributions each can make to the development of a workable financing package. Appendix E of this book is a Financial Resource Index, listing many leading lenders and investors to the broadcast industry.

Station Brokers

Station brokers earn their income, in most cases, by representing the station seller in much the same manner that a real estate broker represents the seller of a house. They are paid a commission on the station's selling price after the sale is completed. It is therefore in the broker's interest to complete a successful sale negotiation as fast as possible.

Because the sale is not assured until financing is arranged, many brokers will help the prospective buyer arrange a financing package. Often they can assist a buyer in developing a financing proposal. Sometimes they can provide leads to lenders they know are interested in financing broadcasting stations. In some cases they can actually arrange the necessary financing themselves for which they may charge the buyer a fee.

In situations where a sale is taking place directly between buyer and seller, with no broker involved, some buyers choose to retain a broker to represent their interests.

Regardless of any sources of financing available through a broker, the buyer should always investigate other potential lenders to make sure of getting the best available terms.

Acquisition Consultants

Acquisition consultants and investment bankers work on behalf of the buyer to assist in the analysis, legal and financial structuring and financing of an acquisition. An acquisition consultant assists buyers with all levels of educational and preparatory needs. The business of buying a station demands different skills than those required in the business of operating a station. Both the investment banker and acquisition consultant help bridge the gap between the operator/buyer and the funding sources in terms of understanding each other. Investment bankers generally will not work on smaller transactions unless their fees are guaranteed or they are confident of a successful financing.

Acquisition consultants are usually paid an hourly fee, sometimes with a small percentage fee based on the station's purchase price or the funding obtained. They assist buyers in finding stations through brokers, writing financing presentations and structuring and securing financing.

Investment bankers generally are paid a fee based on a percentage of the funds raised. Since equity financing is the most difficult to raise, it commands the highest fee, while senior debt is the least difficult to secure and, therefore, commands the lowest fee. Investment bankers usually will want to see a buyer's financing proposal before they accept the assignment. A buyer must be well prepared before the first meeting with an investment banker.

Communications Lawyers

To oversee the process of license transfer, the station buyer will, in all likelihood, retain a Washington-based communications law firm that specializes in working with the FCC. Such law firms, because they represent a number of different stations, are frequently aware of lenders with interest in financing communications properties. In many cases communications lawyers will represent buyers to lenders as the financing is finalized.

Station Sellers

The individual or organization selling the station is in a position to provide not only information about financing, but also financing itself. First, the seller can supply much of the information for a financing proposal, including historical ratings and financial reports. Second, the seller, because of his or her position in the broadcasting community, may know of organizations and institutions with experience and interest in station financing. In some cases the purchaser may be able to assume

the financing arrangements made by the previous owners when the station was purchased.

Finally, the seller may be in a position to finance a part of the sales transition. There are three reasons why the previous owner might be willing to take a note, non-competition agreement or consulting agreement for part of the purchase price.

1. If the seller takes less than the full purchase price in cash, the Internal Revenue Code in some cases allows delayed payment of a portion of the taxes on the income from the sale until the year the funds are actually received. Depending on the taxes owed and the seller's financial position, this may be highly desirable.
2. By personally providing a portion of the financing the seller may be able to arrange a sale to the purchaser who is willing to pay a premium price but is unable to locate financing to support that price.
3. The seller may be able to command a higher yield interest rate on the funds he or she lends to the buyer that is greater than the rate available if invested elsewhere.

The willingness of the seller to finance a portion of the purchase price frequently depends on the experience the buyer has in operating a broadcast station. Further, the buyer may have to agree to operate the station in much the same way the seller did. Because the seller understands the broadcasting business and the particular station and market involved in the transaction, frequently he or she will require a much less detailed financing proposal from the buyer.

Banks

The buyer may deal with several different types of banks in locating financing. Lending policies can differ substantially from one bank to another. The following paragraphs describe generally the needs and interests of three principal categories of banks.

Local Banks

Local banks serve a very limited market area—often a single town or county. These banks generally know very little about the broadcasting business. Their preference will be for lending on the basis of hard assets rather than potential cash flows. Because only a small portion of the value of most stations is represented by such assets, local banks will be exceedingly cautious about lending large sums to finance station purchases. The prospective buyer should therefore anticipate spending substantial amounts of time and energy explaining the broadcasting business to local banks, and should probably not expect to finance most of the purchase price through such institutions.

On the other hand, a financial partnership with a local bank can be extremely productive for the buyer. First, such a relationship can provide seed money to begin the process of station acquisition. Second, local banks can provide the short-term financing to cover seasonal fluctuations in station income. Third, a strong relationship with a local bank can provide a new station owner with an entree to the local business community.

Regional Banks

Regional banks serve one or more states but are not national in scope. The station buyer is much more likely to find experience with, and understanding of, the broadcasting business among regional banks. At the same time such banks may be more amenable to lending amounts large enough to cover a substantial portion of the station's purchase price.

Because regional bank offices are frequently located at some distance from the station, and because regional bank loans may be made on the basis of cash flows from operations, lending officers in these banks will wish to see very complete financing proposals, with exhaustive descriptions of the station and its market and a detailed operating and financial plan for the life of the loan.

Money Center Banks

Money center banks are located in very large cities and have a national clientele. Some money center banks have made a number of broadcast property loans and have developed a significant level of expertise in broadcast financing. Because of this, it would seem that such banks would represent likely sources of financing for the broadcast entrepreneur. However, banks of this size tend to make loans of relatively large size to established entities and the entrepreneur purchasing a single station may fall outside the boundaries within which these banks conduct most lending activities. Money center banks, like regional banks, require a very detailed financing proposal.

Two characteristics apply to banks of any size. First, they prefer to lend money for relatively short periods, frequently for no longer than five to seven years. Given the limited cash flows generated by a broadcasting station for payment of interest and principal, this is a short period for most new station owners. Second, most banks will base their decision to lend upon the applicant's character, management experience and knowledge of broadcasting. The financing proposal is an excellent vehicle for demonstrating these qualities.

At some large local banks, and at many regional and money center banks, entrepreneurs from a minority

group will be directed to a minority loan officer or department. While these officers may be helpful in explaining bank procedures and lending policies, they frequently do not have the authority to lend an amount large enough to meet the station buyer's needs. In such cases it will be necessary to work with the bank's regular financial officers.

Insurance Companies

A number of insurance companies have financed broadcasting station purchases. In general, these companies' lending policies are similar to those of money center banks, with two exceptions. First, insurance companies generally are willing to lend for periods of ten to fifteen years. Second, the minimum amounts lent are normally far larger than the amount necessary to purchase a single station. Therefore, most insurance company-financed purchases have been of station groups.

Small Business Investment Companies (SBICs)

SBICs are investment companies set up to finance small businesses. As such, they are potential sources of station financing. Unfortunately, only a few SBICs have experience in communications financing, so the entrepreneur should anticipate spending some time educating the SBIC about broadcasting. In addition, SBICs will require either a direct equity in the station or the guaranteed option to convert the loan to station ownership.

DEVELOPING THE PROPOSAL

The Important Questions

The model proposal outlined here is a tool for preparing a flexible reference work to help obtain financing. Underlying the actual data and organization is a series of general questions reminiscent of a dialogue between two entrepreneurs: "Is this a good business to be in and a good way to enter such a business?" "What are the opportunities and the potential problems?" "Who will provide the financial integrity and the management ability necessary for a healthy business of this type?" "What's in it for me and what do you expect me to do?" "What happens if something goes wrong?" The model is a formal way of providing information to answer these questions. The prospective buyer should ask these questions and be prepared to answer them in meetings with others, both with and without reference to the formal proposal.

Style

The way in which the proposal is written—that is, the word choices—should reflect a number of important characteristics. According to many sources, the proposal must have a strong financial tone. It is not a mechanism for presenting a treatise on advertising or sales, the broadcast industry, technical nuance or social responsibility. Its job is to present a description of a business in terms familiar to most business professionals. For the same reason, the document needs to be concise. Lengthy descriptions or detailed data should be referenced and provided in appendices or separately. Above all, the presentation needs to have a realistic quality. It must be believable not only in terms of the facts presented, but also in terms of the means described for running the business in a prudent, profitable fashion.

Organization and Flexibility

The format reflects professional judgment about an order of presentation that would be useful to most people. A particular format may not be the right way to present every proposal. Proposals must convince other individuals about the worth of the business opportunity. Therefore, while honesty, accuracy and completeness are required, a proposal may be better presented by reorganizing various elements to accent those opportunities and problems (with solutions) that describe the venture in the most relevant (and therefore favorable) light. This may be especially true if different types of institutions will be contacted. For example, a bank or insurance company may be particularly interested in the property and financing plan, while a foundation or seller may be interested in how the proposal fits with its efforts in the community.

THE MODEL AND ITS ELEMENTS

An outline of the model financing proposal is presented in its entirety below. Each of its elements will again be presented in the commentary on the model.

I. **Overview**

   A. Identify buyer and seller
   B. Identify property
   C. Statement of current station format and proposed changes,if any
   D. Outline performance improvement opportunities
   E. State purchase price
   F. Identify financing required
   G. State financing terms being sought

II. The Property Today

A. Station description
B. Station audience
C. Current programming
D. Current staffing
E. Present owners
F. Community reputation of station
G. Assets and contracts

III. Market Profile and Analysis

A. Audience analysis
   1. Size and composition of overall market
   2. Define potential audience in overall market that is within reach
   3. Specify proposed target audience
   4. Apparent broadcasting competition
   5. Total advertising dollars in geographic area
   6. Percentage of advertising dollars devoted to target audience
   7. Seasonal or yearly fluctuations in advertising dollars
B. Market Opportunity

IV. Description of Buyer

A. Principals (owners)
B. Legal structure
C. Financial structure
D. Organization and management
   1. Key positions and individuals to be employed
   2. Outside consultants or other management resources
   3. Plans for employee and management development

V. Operating Strategy

A. Revenue strategies
   1. Audience development
   2. Pricing approach
   3. Sales development
B. Expense strategies
   1. Salaries and other compensation
   2. Other expenses
C. Capital strategy
D. Management strategy
   1. Staffing plans
   2. Controls on business activities
   3. Community involvement
E. Financial policies
   1. Collections
   2. Promotion
   3. Trade/barter
   4. Controls
   5. Incentives, deferred income, etc.

VI. Financial Information

A. Current
   1. Seller's balance sheet
   2. Market value balance sheet
   3. Statements of income and cash flow of seller
   4. Management analysis of operating results
   5. Short-term, seasonal financing requirements
   6. Banking relationships
B. Historical Review of Performance (3 years)
   1. Revenues by source
   2. Operating costs
   3. Profitability and cash flow
C. Projected Performance Under New Ownership (5 years)
   1. Assumptions
   2. Profit and loss statement
   3. Balance sheet
   4. Sources and uses of funds
   5. Debt service coverage

VII. Purchase Price Rationale

A. Independent appraisals
B. Comparison to other station selling prices
C. Relationship of price to key financial data
D. Special analyses

VIII. Financing Plan

A. Description of total package
B. Equity financing plan
C. Debt financing plan
D. Additional funding resources

II. POINT-BY-POINT COMMENTARY ON THE MODEL PROPOSAL

I. Overview

All of the items in the overview are intended to give only a quick presentation of the salient points of the proposal. Since each is described in greater depth in the proposal, the entire overview should amount to only a few paragraphs of facts with no defense of these facts. Its purpose is to capture interest and to demonstrate that the prospective buyer knows what is important.

A. Identify Buyer and Seller

Who are the legal participants, individuals or corporations? For the buyer, a sentence can be included demonstrating why he or she is uniquely qualified to own or manage a broadcast property.

B. Identify Property

In a sentence or two state the call letters, frequency, wattage and station location. (BROADCASTING YEARBOOK may help.)

C. State the Station's Current Format and Proposed Changes

If the intention is to convert the format to better serve the community, state that here.

D. Outline Performance Improvement Opportunities

In two or three sentences, discuss the major opportunities for increasing market share of audience, advertising revenues and any other enhancements to improve cash flow, including expense reductions.

E. State Purchase Price

Simply cite the dollar amount of what will be paid to the seller and any special payment mechanisms to be used. Do not defend either the price or mechanisms at this point in the proposal.

F. Identify the Financing Required

Here one would briefly state the amount sought from the potential lender and, if the sum is less than the purchase price, the sources and amounts to be used from other participants.

G. State Financing Terms Sought

What interest rate,duration of loan, and repayment schedule does the buyer desire? Also state any special provisions sought or offered such as a moratorium guarantee or freedom from prepayment penalties. (Discussions with brokers, the lending institutions and acquisition consultants will help on this.)

II. The Property Today

Basically this is an expansion of Section I.B., above. However, it is still mainly a narrative in which brief descriptions and data tables are appropriate. Lengthy supporting documents or information should be referenced or appended.

A. Station Description

In what kind of building is the station housed and where is it located? Where is the tower located and how tall is it? Is there more than one tower, studio or office? What is the signal strength and does it change during day or night under its current license? Is it subject to interference? Will improvements to the facility be necessary or beneficial? Is FCC approval needed for such changes? Include a coverage map with local communities clearly marked.

B. Station Audience

What audiences currently typify the community? What formats are offered by competing stations? What are their ratings? (Obtain rating service data from the services or, with the permission of the services, use the reports purchased by ad agencies or the stations. Alternately a special study could be commissioned.)

C. Current Programming

Describe the current programming of the station under review, its target audience and share data.

D. Current Staffing

What are the primary jobs in the current station's organization? Cite any key individuals currently employed, their skills and experience and the importance they will have in the station's success, if appropriate. Will they be retained or replaced? Also cite any turnover problems.

E. Present Owners

A legal description of the current owners, their roles and a brief history of ownership is appropriate here.

F. Community Reputation

Does the station currently serve a key role in the community? How is it perceived by the financial and social groups in the community? Interview appropriate representatives of the community. Also, newspaper accounts may be useful. The FCC may have complaints on file. Station representatives are another source of opinions.

G. Assets and Contracts

A description of the major assets of the station should be provided here. Vehicles, furniture, equipment and other major tangibles can be cited. Attach a full list in an appendix. Describe important contracts or leases to be assumed.

III. Market Profile and Analysis

In this section the prospective buyer fully defines the station's current market position and how any changes will affect both the market position and related advertising revenues. It builds on the information in Part II.B. Advertising agencies, station representatives and some

associations may be able to help. Regular rating data or special study data should be used.

A. Audience Analysis

In this section (the following seven items), complete data should be presented on the existing market. Shares of listenership and advertising revenues should be compared to illustrate potential improvement in sales performance.

1. SIZE AND COMPOSITION OF OVERALL MARKET. Provide all instructive demographic data, such as age, sex, race, income and purchasing power for the communities in the station's market. Also indicate important trends and projections in the statistics. (The Census Bureau, state and city agencies and the Chamber of Commerce are good sources and much of their information may be in a large local library. Trade publications may help as well.)

2. DEFINE POTENTIAL AUDIENCE IN OVERALL MARKET THAT IS WITHIN REACH. The objective is to indicate who in the communities described above can effectively be reached by the station. If only half of a large, growing and prosperous younger community lives inside the signal area, this clearly needs to be stated for a music-format station.

3. SPECIFY PROPOSED TARGET AUDIENCE. Compared to the statistics of the reachable audience, what groups of listeners is the station proposing to target? Describe them in terms of their demographic characteristics, programming preferences and purchasing power.

4. APPARENT BROADCASTING COMPETITION. What other stations currently compete for the groups within reach and the target audience groups of the station? What are the trends in this competition?

5. TOTAL ADVERTISING DOLLARS IN GEOGRAPHIC AREA. In terms of radio station advertising dollars, how much is spent in the market containing the station? National and local data should be reported, separately if possible. What is the station's current share of this advertising? (This may be hard to find. Advertising agencies and commerce statistics may be helpful. For a new station venture, stations in comparable markets may have to be used.)

6. PERCENT OF THESE ADVERTISING DOLLARS DEVOTED TO THE TARGET AUDIENCE. This could be little more than a guessing game, but good data, if available, really completes the advertising revenue analysis.

7. SEASONAL OR YEARLY FLUCTUATION IN ADVERTISING DOLLARS. If, for example, the station depends heavily on Christmas advertising or advertising during the baseball season, these factors need to be presented.

B. Market Opportunity

In this part of the market profile and analysis, the entrepreneur should provide a convincing discussion of how the future strategy of the station relates to the market described above. Will there be a continuation of the previous market strategy? If there are changes, why will these be effective in terms of listenership and advertising revenues? Contrast the proposed data with the data in the previous section. Furthermore, what are the favorable economic trends in the community and how will these be tapped? Other items for possible inclusion here are: underutilized technical capabilities; advertising voids in the market; and weak marketing capabilities of the station or its competitors. (Be careful not to duplicate unnecessary information which may be more suitable to other sections of the proposal, such as the operating strategy in Section V, below.)

IV. Description of the Buyer

Basically this is an expansion of Part I.A., with the addition of how the proposed venture will be organized.

A. Principals (Owners)

Again, identify the individuals and/or legal entities involved. Full descriptions of the legal entities and detailed resumes of the individuals can be provided in an appendix, so the objective here is to describe how the experience and credentials of the people involved, especially the owner and operating partners, will assure a successful station.

B. Legal Structure

Where is it incorporated? Or, is it some other form of business such as a partnership or non-profit organization?

C. Financial Structure

What is the debt and equity position of the firm and the disposition of partnership interests or stock? How is the ownership distributed?

D. Organization and Management

As discussed in the three following elements:

1. KEY POSITIONS AND INDIVIDUALS TO BE EMPLOYED. These include the general manager, sales manager, business manager and program director. What experience and qualifications are required in the key

jobs? Who is to be retained and who is to be hired? (Resumes and job descriptions in an appendix may be appropriate. Salaries will be listed later.)

2. OUTSIDE CONSULTANTS AND/OR MANAGEMENT RESOURCES. If special assistance is anticipated for either near-term or long-run operations, what will be the functions, responsibilities and authorities for these people? (Fees would be listed later.)

3. PLANS FOR EMPLOYEE AND MANAGEMENT DEVELOPMENT. If there are gaps in expertise, can these be filled through certain development efforts? Also, is there a management succession plan to insure operating continuity?

V. Operating Strategy

In this section the entrepreneur would describe basic elements of how the business will be run. Differences between the proposed venture and the station's current activities should be cited.

A. Revenue Strageties

How will income be generated?

1. AUDIENCE DEVELOPMENT. Will new demographic targets be sought or will existing audiences be further developed? Based on Section III and proposed changes, what are the projected revenues? Also, will new audiences be reached under planned changes in the signal? With what revenue effects?

2. PRICING APPROACH. Is there a potential for increasing the advertising rates? Will a discounting policy be used?

3. SALES DEVELOPMENT. What selling efforts will be used and who will implement them? Are there specific, untapped sales opportunities?

B. Expense Strategies

How will revenues and income be spent?

1. SALARIES AND OTHER COMPENSATION. Provide a breakdown of salaries for the operation as well as other forms of compensation and benefits.

2. OTHER EXPENSES. What will be budgeted for promotion efforts by the station? What are other major fixed or variable expenses?

C. Capital Investment Strategy

Will an investment program be necessary to upgrade the equipment or facilities? Will equipment be leased or purchased?

D. Management Strategy

Explain how the less tangible aspects of the business will be handled in terms of the following three items:

1. STAFFING PLANS. Plans for eventual changes in the number or character of the operating staff should be discussed here.

2. CONTROLS ON BUSINESS ACTIVITIES. Who has control over day-to-day decisions affecting operations? What safeguards will be used to protect the station's reputation and its financial integrity? What management reports will be utilized? Who has the authority to spend money for various purposes?

3. COMMUNITY INVOLVEMENT. Here one would describe concerns or planned activities which could affect or improve the roles of the station in the eyes of the community.

E. Financial Policies

This would be a description of the factors affecting the financial and management accounting aspects of the business. Cite any improvements over the existing operation and policies for working capital requirements current ratios, discounting of paybles and receivables, etc.

1. COLLECTIONS. What will the collection policies of the station be?

2. PROMOTIONS. How will the promotion monies and selling expense described earlier be controlled?

3. TRADE/BARTER. Will mechanisms for payment of station time sold include the receipt of goods or services from the advertisers? How will these be valued, accounted for and controlled?

4. CONTROLS. When will audits be performed and by whom? What financial reports will be prepared? How often and for whom?

5. INCENTIVES, DEFERRED INCOME, ETC. Describe any special programs for rewarding management or staff which will have financial implications for the firm, such as deferred income and stock options.

VI. Financial Information

A. Current

What is the current position of the station as described

by the most recent fiscal year financial statements of the station? If a start-up situation, a pro-forma approach for the first year of operation should be utilized. (Accounting assistance and the cooperation of the seller would be advisable for this section.)

1. SELLER'S BALANCE SHEET. Self-explanatory.

2. MARKET VALUE BALANCE SHEET. This can be difficult to prepare. Typically, it requires objective valuations of the tangible and intangible assets of the station. It also involves negotiation between the buyer and seller on what items have appreciated and depreciated because of the tax effects on the two parties. (Use appraiser's report, if available.)

3. STATEMENTS OF INCOME AND CASH FLOW. Make sure your and the seller's definitions and calculation of cash flow are consistent and also are identical to the lender's concept of cash flow.

4. MANAGEMENT ANALYSIS OF OPERATING RESULTS. Here a description should be provided that explains key items in the financial reports and what causes, good and bad, produced those financial results. Indicated how unfavorable causes will be eliminated by new management.

5. SHORT-TERM, SEASONAL FINANCING REQUIREMENTS. Regardless of the year-end financial position, how much financing was utilized during the year and was paid back? Is this unusual?

6. BANKING RELATIONSHIPS. With whom does the station currently bank and what comments have these institutions with regard to the station?

B. Historic

A three-year retrospective set of financial statements that can be compared with the current financial data should be provided here. The following three items will be of particular interest and any changes or trends should be noted. Statements should be prepared by an outside accounting firm.

1. REVENUES BY SOURCE. Self-explanatory.

2. OPERATING COSTS. Self-explanatory.

3. PROFITABILITY AND CASH FLOW. Self-explanatory.

C. Projected

A five-year pro-forma analysis of the proposed venture should be provided in this section.

1. ASSUMPTIONS. A brief restatement of key factors described earlier about the financial and social environment of this station can be provided here. The objective is to note those assumptions which can most affect financial performance.

2. PROFIT AND LOSS STATEMENTS. Pro-forma income statements.

3. BALANCE SHEET. Self-explanatory.

4. SOURCES AND USES OF FUNDS. Self-explanatory.

5. DEBT SERVICE COVERAGE. How will debt be repaid, especially for the funds currently sought? How will other infusions of debt money during the next five years, if any, be repaid?

VII. Purchase Price Rationale

In this section the entrepreneur defends the total price to be paid for the station in the acquisition deal. The exact information to be used and its organization will depend on the negotiations between buyer and seller. The objective is to describe to the lending institution how you arrived at the valuation and why it is reasonable.

A. Independent Appraisals

Brokers can make arrangements for such appraisals. as can acquisition consultants.

B. Comparison to Other Station Selling Prices

Industry publications on station transfer and the FCC files are sources for comparative data.

C. Relationship of Price to Key Financial Data

All of the applicable multiples can be presented at this point, such as price to sales or price to cash flow.

D. Special Analyses

Are there special elements that affect the price? Also, one could include illustrative calculations, such as the price compared to the net present value of future income or cash flows.

VIII. Financing Plan

This is a detailed expansion of Section I, items E and F.

A. Description of the Total Package

Use few sentences to recap the financing sought.

B. Equity Financing Plan

How much money will beinvested by the primary owner and others? In what form is the equity—e.g., cash or stock from another corporation, personal savings or assets? Will the current owner retain an interest?

C. Debt Financing Plan

How much financing is to come from the lender, in what form and over what period? Who else will hold debt instruments in the venture and for how much? What security is available to the lender?

D. Additional Funding Sources

Sources of funding not described in the previous two elements should be addressed here. Additional investors, for example, might be a factor. Also, plans could be described for obtaining funds from another institution (such as an insurance company) based on the agreement of the institution now being sought (a bank, for instance).

III. AN ILLUSTRATIVE PROPOSAL

The following document is a hypothetical proposal for the acquisition of a radio station by a first-time buyer. It closely follows the model financing proposal presented earlier, and therefore illustrates the type of information appropriate to a proposal and a workable style of presentation. However, the reader must be cautioned that this is not a real proposal. All the information and data are completely fabricated, and while it may resemble the kind of information a good proposal would contain, the relationships within the data are not necessarily those one would find in an actual financing proposal. The reader will also note that the appendices referenced in the document have not been provided.

A Proposal For Participation by the Southern National Bank in the Financing of WTXA Radio, Bellville, Texarkana

I. Overview

A. The Buyer and Seller

THE BUYER—The proposed buyer of WTXA is Bellville Radio, Incorporated, a Texarkana corporation owned principally by Mr. William C. Johnson Sr. (42%), Mr. William C. Johnson Jr. (21%), and Mrs. Janet Wellman (16%). Mr. Johnson Sr., who will serve as president of Bellville Radio, Inc., is the owner and proprietor of Johnson Funeral Service, 215 Southern Avenue, Bellville. Mr. Johnson Jr., who will serve as vice president of the corporation and general manager of WTXA, is currently general sales manager of WXYL radio, Center City, Texarkana. Dr. McCrae, who will serve as treasurer of the corporation, is a physician in private practice in Bellville. Mrs. Wellman, who is the sister of Mr. Johnson Sr., is a retired Bellville school teacher. The secretary of the corporation is Mr. Alan King, Esq., of the Bellville law firm of Simpson, King & Saunders, Attorneys at Law.

THE SELLER—WTXA is currently owned by Texarkana Communications Corporation which, in turn, is part of the estates of Lawrence and Elizabeth Newell, recently of Center City. The Center City Trust Company is the executor of the Newell estates.

B. The Property

The subject of the proposed purchase is WTXA, an FM radio station, located in and licensed to Bellville, Texarkana. WTXA, one of the six radio stations in the market (3 AM, 3 FM), broadcasts on a frequency of 100.9 megahertz with a power of 3 kilowatts.

C. Current and Proposed Station Format

The current programming of the station, a mixture of music and "personality" disc jockeys, is designed for adult listenership. The station has, during the past 3 years, averaged fourth or fifth in overall Bellville listening. It is the intention of Bellville Radio, Inc., to reprogram WTXA with the specific aim of serving the black population of Bellville and the surrounding communities, and to meet the needs of advertisers wishing to address that population.

D. The Purchase Price

The agreed-on purchase price for WTXA radio, and associated assets, is $450,000, cash. This amount is approximately equal to nine times the station's cash flow from last year.

E. Financing Required

Bellville Radio, Inc. seeks from Southern National Bank an unsubordinated loan in the amount of $380,000, secured by the assets of the corporation, to finance purchase of the station and to meet working capital needs of $44,000. The Texarkana Bank has agreed to provide regular short-term financing and is willing to provide $15,000 initially (to aid start-up operations) on a line of credit not to exceed $20,000.

F. Financing Terms Sought

Bellville Radio, Inc., seeks the following terms: an eight-year note with interest of 9.5% on the unpaid principal, payable quarterly; repayment of principal to begin 1 year from the date of purchase and to be at the rate of $52,000 per year, also payable quarterly, with a final

payment of $68,000 due seven years from the date payments commence.

II. The Property Today

A. Station Description

Radio station WTXA is licensed by the Federal Communications Commission to broadcast non-directionally on FM frequency 100.9 megahertz with power of 3 kilowatts. The station is licensed to the city of Bellville, Texarkana, and its studios and transmitter are located 4 miles east of the city center, approximately 1/2 mile outside the city limits, on Texarkana Route 21. The station's broadcast license was last renewed for a period of seven years. A copy of that renewal is included as Section X of Appendix X. WTXA began broadcasting on October 10, 1948.

The WTXA signal provides excellent reception in all of Coleman County and portions of Jefferson and Elk Counties. Section X of Appendix X includes coverage maps of the WTXA signals as determined by the consulting engineering firm of Doehrn and Greene. The WTXA antenna is located on a 410-foot guyed tower (460 feet above average terrain, 760 feet above sea level) immediately adjacent to the station offices and studios. Primary and standby transmitters are located in the main studio building.

B. Station Audience

WTXA currently is programmed to appeal to a broad and diversified audience. The station's ratings during the past several years have tended to cut across several demographic categories, with greatest relative and absolute listenership among women 35 to 49, men 35 to 49, and women 50+, in descending order of magnitude. Within these demographic groups, the station has generally ranked third or fourth in the market in terms of popularity.

Listenership to WTXA has typically peaked during morning drivetime, thanks in part to the presence from 6:00 to 10:00 a.m. of a well-known area personality, and in the early afternoon hours. Music selection and announcer presentation in the early and middle evening hours have, during the past two years, been skewed toward more current music in an as-yet unsuccessful attempt to draw the attention of teenage audiences. The 5-minute hourly news breaks are based on news feeds from UPI Audio, the UPI National and Regional wires and stories drawn from local print and broadcast media.

The ratings of WTXA for the past 5 years, along with ratings of all competing stations, are included as Section X of Appendix X.

C. Current Programming

The majority of WTXA programming is currently in an adult contemporary format, utilizing live announcers and original versions of relatively recent popular music. In addition to musical material, the station presents 5 minutes of local and national news every hour on the hour and 3 hours of public affairs and farm programs each week. Section X of Appendix X is a schedule of current WTXA programming.

D. Current Staffing Pattern

The WTXA full-time staff numbers 12. This includes a general manager and a sales manager, both of whom perform some sales duties; 4 announcers, who also perform limited news duties, and one of whom functions as the program director; 3 sales persons; a traffic manager; a business manager; and one clerical and secretarial person. Total station payroll, including commissions on sales, is $212,000 per annum. While these individuals have been important to WTXA's performance, several key managers will be replaced to accommodate the new programming and operating strategies (see Section IV.D.). Engineering duties are performed by an outside engineer under contract.

E. Present Owners

WTXA is currently owned and operated by Texarkana Communications Corporation, which, in turn, is part of the estates of Lawrence and Elizabeth Newell. Mr. Newell was the original licensee of WTXA when it first went on the air on October 10, 1948. On July 22, 1956, he sold 100% of his interest in the station to Texarkana Communications Corporation, of which he was president and majority stockholder. Other properties owned by Texarkana Communications Corporation include WGLP AM-FM in Gulfport, WCPT AM-FM-TV in Center City, and three cable TV systems in Center City, Ridge and Gulfport. The Center City Trust Company, as executor of the Newell estates, is in the process of disposing of all Texarkana Communications Corporation properties.

F. Community Reputation of the Station

WTXA has been a relatively minor influence in its service area. Although the station's signal is competitive with most other signals in the market, promotion and programming have not been carried on in an aggressive manner, due, in part, to Mr. Newell's failing health over the past several years.

Thus, several other radio stations in the community have achieved dominance in listenership through programming, community affairs and news leadership. Although WTXA has not been active in programming for minorities, station management did, prior to the

station's last license renewal, agree to work with a committee of local black spokespersons in an effort to better serve the minority community of Bellville. To date, however, no specific changes have been instituted.

G. Assets and Contracts

The property to be purchased by Bellville Radio, Inc., from Texarkana Communications Corporation is composed of the following elements:

- The operating entity of WTXA radio, including its Federal Communications Commission license to broadcast.
- Electronic equipment incidental to radio broadcasting, including studio equipment, amplifiers, transmitters and antenna, valued at $105,000. Included as Section X of Appendix X is a complete inventory of station equipment, with valuation as appraised by William L. Greene, P.E., of the engineering firm of Doehrn & Greene.
- Land (6.6 acres), zoned C (commercial), located on Texarkana Route 21, approximately 4 miles east of the center of Bellville. All WTXA facilities, including studios, transmitter and tower are located on this parcel, and the combined assessed value of the land and buildings is $48,000. Registered survey drawings of the parcel, copied from the Coleman County Plotbook, page 314, are included as Section X of Appendix X. Drawings to scale of the WTXA studios and offices are included as Section X of Appendix X.
- Two automobiles, a Ford LTD and a Buick Skylark, and one van, a Dodge Tradesman, used incidentally to station operations and having a total value of $17,220.

III. Market Profile and Analysis

A. Audience Analysis

1. THE BELLVILLE MARKET—The Bellville market consists of the city of Bellville, a major retail and trade center for the southeast corner of Texarkana and the county seat of Coleman County, with a population of 185,000; Louisburg, the county seat of adjoining Jefferson County, located 26 miles to the west of Bellville and having a population of 32,000; Nestor, a small manufacturing and mining center located 18 miles north of Bellville and having a population of 26,000; 18 smaller incorporated and unincorporated towns and communities located within 45 miles of Bellville with a total population of 38,000; and rural areas consisting of all of Coleman and Jefferson counties, the northern half of Elk County and the southern third of Adams county, with a total population of 26,000.

2. WTXA POTENTIAL AUDIENCES—The total population of WTXA's service area is 307,000. Of this number approximately 225,000 individuals reside in areas definable as the Bellville market. This includes all residents of Coleman County, the portion of those living in Jefferson County whose orientation is toward the Bellville market, and all residents of the northern half of Elk County. Of this 225,000, residents of Bellville or its suburbs number 185,000 and are seen as the station's primary market; the remainder is essentially a rural population, served by largely rural media, and it constitutes a secondary market.

Table 23 presents the significant demographic characteristics of the primary and secondary markets. Population trends in the Bellville market have mirrored U.S. trends, but at a slightly accelerated rate. Total Bellville population is increasing at 3.2% per year, versus 2.9% per year for the entire United States. Consequently, the

TABLE 23
The Bellville Radio Market

	Primary Area	Secondary Area	Total
Total Population	185,000	40,000	225,000
Male	91,200	19,800	111,000
Female	93,800	20,200	114,000
White	153,200	33,800	187,000
Black	31,000	6,000	37,000
Other	800	200	1,000
Under 18	51,800	10,000	61,800
18-24	27,800	6,000	33,800
25-34	31,400	6,800	38,200
35-50	29,600	6,800	36,400
Over 50	44,400	10,400	54,800
Total Families	65,800	13,500	79,300

TABLE 24
Estimated Populations of the Bellville Black Community

	Primary Area	Secondary Area	Total
Male	15,300	3,000	18,300
Female	15,800	3,000	18,800
Under 18	8,700	1,500	10,200
18-24	4,700	900	5,600
25-34	5,300	1,000	6,300
35-50	5,000	1,000	6,000
Over 50	7,400	1,600	9,000

average age of Bellville residents is younger than the average age of all U.S. residents.

Although income levels are slightly below U.S. averages, they are higher than regional averages and are increasing at a faster rate than either. At the same time, due to the relatively low cost of living in the Bellville area, disposable personal income per household is extremely close to the U.S. average.

3. THE PROPOSED TARGET AUDIENCE—WTXA will be programmed to meet the entertainment, public affairs and educational needs of two easily identified and relatively profitable audience groups—blacks and young people regardless of race. Black people will be the primary target audience, and their needs will be served through a diverse mixture of black-oriented music, news, and public affairs programs. Because, however, the musical tastes of all contemporary teenage and young adult audiences skew heavily toward music written and performed by black artists, substantial listenership can be anticipated among this overall group.

Because no other radio station primarily identified as black-oriented currently services the Bellville market, WTXA may be expected to develop extremely high listenership among the black community. (Black-formatted stations in Center City and Northern Falls both report substantial listenership among blacks in Bellville, despite relatively poor reception and lack of any orientation to the Bellville community.) The population of non-black teenagers and young adults from which WTXA might reasonably expect to draw listeners is 66,200.

While it is impossible to estimate precisely potential listenership among this group, in some larger markets black-oriented stations have been able to reach in excess of 30% of all listeners in the under-25 category. If a target figure of 15% of all teenagers and young adults in the station's primary service area were achieved, the additional non-black audience would amount to 9,900. Based on the assumption that per capita income of blacks in the Bellville area approximates 80% of that of the general population, and that per capita disposable income of teenagers and young adults is similar to national averages, the estimates presented in Table 25 were developed.

TABLE 25
Estimated Disposable Income of WTXA Audience in Dollars and as a Percentage of All Bellville Disposable Income

	Dollars	% of all Bellville Disposable Income
Black	$117 Million	13%
Non-Black (under 25)	$ 42 Million	5%
Total	$159 Million	18%

4. BROADCASTING COMPETITION—The population groups proposed as WTXA target audiences currently listen to radio stations falling into three general categories: (1) black-oriented stations in neighboring cities; (2) teen-oriented stations; and (3) contemporary stations. With regard to black audiences, about 20% of listenership is to black-oriented stations, about 25% is to teen-oriented stations, and about 45% is to stations programmed for contemporary audiences. Competing stations are shown in Table 26. Section X of Appendix X shows the approximate listenership for each of the competing stations by each of the targeted groups during the last 3 years.

5. ADVERTISING REVENUES—For many communities larger than Bellville, independent radio database companies estimate radio revenues expended in the market. Some markets have information gathered directly from participating stations by accounting firms hired to perform this function, and for other markets, the estimates are based on historical financial ratios supplemented by data from people knowledgeable about the market.

For Bellville, no independent firm collects radio revenue data. Therefore, estimates must be made from other data. In surrounding markets for which information is available, radio revenues expressed as a percentage of local retail sales are consistently in the 0.35% range. It is possible then to approximate Bellville's total radio dollars by multiplying the retail sales estimates for the Bellville market (available from many different government and not-for-profit sources) times 0.35%.

Because the Bellville newspapers, The Chronicle and The Bulletin, are both privately owned, no data on advertising revenues are available. Members of the Bellville advertising community suggest, however, that newspaper revenues have grown at about the same rate as those of radio.

6. ADVERTISING DOLLARS DEVOTED TO TARGET AUDIENCE—Because there are no significant black media in the Bellville market, it is impossible to estimate the amount of funds directly employed in reaching black consumers. Bellville advertising execu-

TABLE 26
Stations Listened to By the Target Audiences

Station	Service	Location	Format	Frequency	Power
WAAA	AM	Bellville	Middle of the road—talk	790 kHz	500 W
WBBB	FM	Bellville	Beautiful Music	99.1kHz	100 kW
WCCC	AM	Bellville	Adult Contemporary	890 kHz	1 kW
WDDD	FM	Bellville	Rock	106.3 kHz	100 kW
WEEE	AM	Bellville	Rock	1490 kHz	1 kW
WFFF	AM	Northern Falls	Black	1000 kHz	1 kW/250W
WGGG	AM	Center City	Black	600 kHz	1 kW

tives point out that they currently use general appeal advertising media to reach minority consumers. However, given the development of a medium directed toward the black community, experience in other markets suggests that only a portion of the market's advertising funds, generally up to 80% of the minority-group buying power, will be channeled into the black media.

Three factors will impact the proportion of all radio advertising funds that are devoted to WTXA target audience's: (1) the proportion of those audiences buying power to total market buying power; (2) any under- or over-attention paid to those audiences by the advertising community; and (3) the total radio spending in the market. It should be noted that the revenues discussed above only reflect radio spending in the Bellville market. While it is reasonable to assume that the programming of WTXA to attract teenage and young adults will not greatly enlarge total advertising, it is also reasonable to assume that the creation of the area's first significant black medium will attract black-targeted funds currently being spent in other general appeal media.

7. FLUCTUATIONS IN ADVERTISING DOLLARS—General growth in the Bellville economy, and in local advertising revenues, has been relatively consistent during the past decade, even during periods of national recession; this immunity to national economic downturns has generally characterized Sunbelt markets and there is no obvious reason to assume that it will not continue.

Seasonal fluctuations in radio advertising in Bellville, as in all major markets, are relatively significant. On average, during the past five years, first- and third-quarter revenues have run slightly over 30% below second- and fourth-quarter revenues. Although these fluctuations could lead to some difficulty in covering fixed expenses, their occurrence is shown and understood by the local lending community, and short-term financing has been available.

B. Market Opportunity

The opportunity presented by WTXA radio is a function of several factors: the Bellville market, the target audiences for the station and the broadcast facility itself.

Bellville is a classic Sunbelt market. It is growing at greater-than-national rates; incomes are rising faster than national averages. The results of this economic activity are particularly favorable for local media:

- New industry and new work forces are being attracted, which in turn fuel additional growth.
- The attention and funds of regional advertisers are increasingly attracted to the market.
- The local retail market and local retail advertising are expanding rapidly.

The WTXA target audience groups comprise significant subgroups of the Bellville community, each developing in terms of population and disposable income at rates greater than those of the market as a whole. Each group is self-defined, with relatively clear-cut cultures and needs which can be appealed to through easily defined programming. One group, the black community, currently has no major medium dedicated to its service, and experience has shown that when one media channel is so dedicated, its circulation among blacks grows extremely quickly.

The WTXA facility is a well-maintained and modern one, capable of competing with any of the Bellville stations. Its dial position, signal strength, antenna height and location and studio facilities are all highly desirable. Because stations are valued more on the basis of cash flow than assets, and because the station has not been operated in a particularly profitable manner, the facili-

ties are available at a price that effectively discounts their value.

IV. Description of the Buyer: Bellville Radio, Inc.

A. Principals

1. MR. WILLIAM C. JOHNSON, SR., PRESIDENT —Mr. Johnson is the owner and operator of Johnson Funeral Services, a sole proprietorship which has served the South Bellville community from its Southern Avenue location for nearly 30 years. Mr. Johnson is 63 years old, was born and raised in Bellville, is a graduate of Southern Agricultural and Technical Institute (1946) and the Melrose School of Mortuary Sciences (1951). Mr. Johnson also owns a minority interest (25%) of Bellville Take-Out Corporation, which owns and operates three Kentucky Fried Chicken franchises in the Bellville area. For a number of years Mr. Johnson was a partner, with his wife, in Bridal Designs, a South Bellville bridal salon. Mr. Johnson's resume is included in Section X of Appendix X.

2. MR. WILLIAM C. JOHNSON, JR., VICE-PRESIDENT—Mr. Johnson is the general sales manager of WXYL, the black-oriented radio station located in Center City. Prior to joining WXYL in 1981, Mr. Johnson served on the sales staffs of WTXN, Natchez, Mississippi, WSOA, Louisville, Kentucky, and completed an 18-month management internship with WLML, World Broadcasting Corporation's Houston station.

Mr. Johnson is 36 years old and is a 1974 graduate (B.S.) of Texarkana State University where he majored in Business Administration and minored in Broadcasting. He has been active in a number of civic and professional organizations in the Center City area, including the Red Cross, the Advertising Club and the Business and Professional Association. In 1986 he served as Media Coordinator for the United Fund Appeal. Mr. Johnson's resume is included in Section X of Appendix X.

3. DR. GEORGE McCRAE, M.D., TREASURER— Dr. McCrae is a physician in private practice in South Bellville. He is active in a variety of Bellville area associations and holds equity positions in several Bellville institutions and businesses. Dr. McCrae's resume is included in Section X of Appendix X.

4. MRS. JANET WELLMAN, PRINCIPAL—Mrs. Wellman is a retired Bellville school teacher. She continues to be active in Bellville civic and political organizations. She holds no other business interests. Mrs. Wellman's resume is included in Section X of Appendix X.

B. Legal Structure

Bellville Radio, Inc., is a duly chartered corporation under the Texarkana general code, and was incorporated on March 2, 1988. The bylaws of the corporation and the identity of its officers and board members are registered with the Texarkana Department of Corporations and are included as Section X of Appendix X. The officers of the corporation are William C. Johnson, Sr., President; William C. Johnson, Jr. Vice President; George McCrae, M.D., Treasurer; and Alan King, Esq., Secretary. The members of the Board of Directors are:

William C. Johnson, Sr., Chairman	Mortician
William C. Johnson, Jr., Chairman	Radio Broadcaster
George McCrae, M.D.	Physician
Alan King, Esq.	Attorney
Janet Wellman	Retired Teacher
Ronald A. Clark	Banker
Edward O. Meare	College Professor
L.W. Edmonds	CPA

The current mailing address and location of operations of the corporation is 1990 Southern Avenue, Bellville, Texarkana. The fiscal year of the corporation is January 1 to December 31. The next annual meeting is scheduled for March 20, 1989.

C. Financial Structure

Bellville Radio, Inc., is capitalized in the amount of $125,000. The corporation is authorized to issue 200,000 shares of common stock with a par value of $.01 per share. Of this amount, 125,000 shares have been issued on a one-for-one basis for each dollar of equity capital contributed by the principals. The remaining 75,000 shares of unissued stock will be reserved for further equity contributors, should such contributors prove necessary, and for use in future employee stock option motivation plans. Other than occasional short-term borrowing to cover seasonal fluctuations in revenue, no obligations besides that currently sought from Southern National Bank are anticipated.

Assuming that the corporation receives the applied-for funding, the debt-to-equity ratio at the date of station purchase will be 3.0 to 1.

D. Organization and Management

1. KEY MANAGEMENT POSITIONS—Four key management positions at WTXA will be filled with new personnel immediately upon station purchase. These positions and the personnel who will fill them are:

General Manager: William C. Johnson, Jr.
General Sales Manager: Lawrence Mayfield

Business Manager: Jordan Brooks
Program Director: James Cower

Mr. Johnson, whose background and achievements are described above, brings to his position long-time understanding of the needs and goals of the black community and broad and deep skills in broadcast marketing and management.

Mr. Mayfield, whose resume is attached as Section X of Appendix X, has served as an account representative and/or sales manager at three southern radio stations, two of which have been black-oriented. His principal efforts and achievements have been in the development of new retail accounts. At his current station, Mr. Mayfield was responsible for the development, in two consecutive years, of over $80,000 in new business.

Mr. Brooks has broad experience in general accounting, broadcast accounting and administration. As a native of the Bellville area, he is also knowledgeable of and involved in community activities. His resume is included as Section X of Appendix X.

Mr. Cower, who will serve as both program director and on-air personality, has compiled an outstanding record of ratings successes in both roles. At his current station, during his first 6 months of employment, he affected a 40% across-the-board improvement in ratings and audience share. His resume is included as Section X of Appendix X.

2. OUTSIDE CONSULTANTS—Other than accounting services, the services of a local contract engineer, and assistance and guidance from the members of the Board of Directors, no use is anticipated of outside consultants.

3. EMPLOYEE AND MANAGEMENT DEVELOPMENT—A rigorous and extensive program of internal employee development is planned by the principals of Bellville Radio, Inc. All department heads bring to their positions broad understanding of their areas of responsibility and a commitment to communication of that understanding to their employees. Management compensation will be partially tied to the effectiveness of in-house training programs.

In addition, selective use will be made of the texts, programs, seminars and workshops of industry professional organizations, including the National Association of Broadcasters, the Radio Advertising Bureau, the Broadcast Financial Management Association, etc.

V. Operating Strategy

A. Revenue Strategies

1. AUDIENCE DEVELOPMENT—The thrust of the WTXA audience development program will be in two areas: programming and promotion. In each of these areas, because of its primary commitment to serving the black community, the station will enjoy a significant advantage.

Because the station faces no local competition in providing black-oriented programming, WTXA will be able to take a broad approach in programming for black listeners. Specifically, this will involve programming each day-part to meet the needs of the most attractive available demographic group within the black community, and reliance on the overall black image of the station to hold the attention of other black listeners. In practice, this will mean programming morning drive-time for young and middle-aged adults of either sex, programming weekdays 10 to 3 for young and middle-aged females, and programming later afternoon, evening, and night for progressively heavier proportions of teen-age and young adult audiences.

Personalities and musical material in each day-part will be tailored to the needs of that day-part's target audience. Thus, morning drive-time will see a personality-type announcer, somewhat less music, and more news, commentary and general "talk"; nighttime programming will involve a younger, up-beat announcer and extremely current music.

Less emphasis will be placed on hard news, with more emphasis on announcements of particular interest to the black community, programmed to correspond to the interests of the day-part target audience. A single UPI news wire will be used to provide brief 1- to 2-minute hourly updates on world and national news.

Promotion of the station will also be simplified by the lack of local competition. Essentially, the station will be positioned as the black medium, with the black sound. It will not be necessary to differentiate it from other media with similar content. Because other media, principally television and press, are also interested in increasing circulation among black consumers, and because these media are not seen as significantly diminishing radio listening, heavy use of traded promotional ads on TV and in the newspapers is anticipated. Exploratory discussions with these media indicated that they are interested in such trades.

A secondary promotional thrust will be through generation of, and involvement in, community-oriented activities. The station will sponsor and promote clean-up campaigns, block parties, concerts and similar social, entertainment and civic programs with immediate relevance to the black community. The effect of this effort will be to further strengthen the station's image as a black media channel.

The experience of the Bellville Radio management team is that the transition of the station from its current format to a black format should be accomplished quite quickly, rather than being phased in over a period of months, and should be supported by a sizable promotional expenditure ($20,000) concentrated in print and billboards. Section X of Appendix X outlines the planned timetable and expenditures for reformatting the station.

2. PRICING APPROACH—Pricing of the newly formatted WTXA will be structured in three tiers, responding directly to the needs of the three principal buying groups.

National and regional sales will be priced on the basis of future projections of the cost per-thousand for the station's key demographics.

Local spot sales to experienced advertisers and agencies will be based on the current spot prices level of competitive Bellville radio stations, which regularly run approximately 30% below national spot rates.

Local spot sales to newly developed local accounts, consisting principally of advertisers who can, because of the existence of a medium focused on the black community, economically promote their business on a "mass medium," will be priced on an investment basis. Under this method, the new advertiser will receive substantial aid in marketing strategy, campaign development and merchandising as part of the WTXA advertising package. Although such sales will require a substantial investment in sales staff time, the incremental revenues received, when seen as part of a continuing stream, as well as future potential from these advertisers, will more than underwrite the incremental sales costs.

3. SALES DEVELOPMENT—Sales development, like pricing, will be carried on at three levels—national and regional spot levels; local spot level with experienced advertisers; and local spot level with inexperienced advertisers.

At the national and regional spot level, a national representative firm, the Thompson-Ritchie Company, will be retained. This firm is the most experienced of all representative firms in handling the sales of black-formatted stations and has been extremely successful in bringing national business to smaller-market stations. Based on their experience with stations similar to WTXA and upon audience projections developed by Bellville Radio, Thompson-Ritchie suggests that a doubling of current station national spot revenues is achievable within one year. Section X of Appendix X lists Thompson-Ritchie's experience with a number of black-formatted stations in markets similar to Bellville. At the local spot level, when dealing with experienced advertisers and agencies, station sales personnel will work to affect a smooth transition to selling WTXA time on the basis of its unique access to black and teenage and young adult audiences. Research to support the viability of advertising to these audiences, some of which is included in this proposal, already has been gathered. The image of the station will be thoroughly professional, and the basic selling proposition will be based on the cost-effectiveness of marketing to minority audiences and the unique capacity of WTXA to reach those audiences. The goal of this selling effort will be to bring to the station that amount of local radio advertising revenues that is proportionate to the WTXA audience buying power.

Based on calculations made earlier in this proposal, the estimated total of Bellville radio advertising funds spent on black audiences last year was $310,577. Assuming an 8% annual increase, next year's figure will be $335,423. A reasonable WTXA target share of these funds, after the initial reformatting period, is 65% or $218,024 ($18,168 per month). Assuming a further 8% increase this year and a similar target share, WTXA can budget for $235,466 ($19,622 per month) in the first year of ownership.

Similar calculations on advertising revenues directed at teenagers and young adults, assuming an 8% increase in year one and a 20% target share, suggest monthly revenues of $13,975 in the first year and $15,094 in year two.

The bulk of local sales development effort will be focused on developing ongoing customers, especially smaller retail and service firms which address themselves to black consumers and which, to date, have used mass advertising media because no medium was sufficiently productive for their target customers. As noted above, a variety of ancillary services must be provided to these new advertisers, but it has been the experience of incoming station management that such a client category realistically represents the potential for contributing 20% to 30% of total station revenues. Data informally developed by the Bellville Chamber of Commerce indicates that firms falling into this category represent as much as 8% of all retail sales in the market.

Station management believes that after an initial period of six to eight months, during which such accounts must be sought out and taught the benefits and methods of radio advertising, new black-oriented retail business will contribute 15% to 20% of station revenues.

B. Expense Strategies

1. SALARIES—Salaries at WTXA will be rigorously

managed. In the process of restaffing station management positions, i.e., general manager, sales manager and business manager, it is anticipated that major economies can be achieved over present salary costs. All personnel currently holding these positions have from 8 to 23 years seniority with Texarkana Communications and, consequently, enjoy liberal compensation plans. The incoming general manager owns a substantial portion of station equity and is willing to take the majority of his remuneration in the form of capital gains rather than salary. Individuals expected to fill the remaining management positions, although experienced in their fields, are all either moving to a larger market or a position of greater responsibility, and hence they have lower salary expectations than current department heads.

Because program appeal will rely more on the overall station image and less on the popularity of specific personalities, the incoming program director expects to replace the current on-air staff with experienced announcers.

2. OTHER EXPENSES—Through the introduction of a detailed budgeting and expense control system, relating individual expense categories to profit contribution, the incoming general manager and business manager anticipate reduction of overall station operating expenses, other than salaries and commissions, by 9%. The particular costs most amenable to reduction are engineering, news service and administrative.

C. Capital Strategy

The general capital strategy of Bellville Radio, Inc., will be to minimize debt commitments and secure, to as great a degree as possible, primary investors and lenders. An important goal will be the attainment of a 2:1 debt-to-equity ratio as rapidly as possible. Elements of this strategy will include:

- Purchase of all capital items whenever possible.
- Use of short-term borrowings from local banks to cover fixed costs during seasonal revenue fluctuations.
- Stringent enforcement of collections policy.
- Utilization of discounts for prompt payment.
- Accumulation of cash in anticipation of another station purchase, probably in the third year of operation. The development and implementation of this policy has been expressly directed by the Board of Directors.

D. Management Strategy

1. STAFFING PLANS—As noted earlier, Bellville Radio, Inc., intends to replace the general manager and three key station department heads and all on-air personnel. It is further anticipated that additional current employees will seek work elsewhere as the character of the station changes. Although the total planned reduction in force numbers only one person, the opportunities for personnel replacement described above will allow an overall reduction in salaries of nearly 25%.

As replacements for personnel are needed, they will be sought in the local labor force. A rigorous system of recruitment, skills assessment and training will be put in place within the first 6 months of ownership to ensure that the station staff represents the strongest mixture of skills and talents available.

No staff expansion, other than the addition of a part-time public affairs program producer, is anticipated during the first 2 years of operation. The expected cost of such a part-time employee should total no more than $4,000 per year.

2. CONTROLS ON BUSINESS ACTIVITIES—Control of station operations will be administered by Mr. Jordan Brooks, the incoming business manager. Based on his experience with a major Bellville accounting firm and as assistant controller of WAXM-TV, Mr. Brooks is prepared to develop and implement a detailed system of budgeting, performance management and control. L.W. Edmonds, CPA, a member of the Bellville Radio Board of Directors, has offered the services of one of his accounting firm's partners, in a consulting capacity, to aid Mr. Brooks in developing and implementing the system. It is anticipated that the general model to be followed will be that published by the Broadcast Financial Management Association in the *Accounting Manual for Broadcasters*.

3. COMMUNITY INVOLVEMENT—It will be an explicitly stated responsibility of all WTXA department heads to involve themselves actively in the civic, charitable and professional activities of the Bellville community, with particular emphasis on the activities of the black community. Review of management involvement in community activities will be scheduled semi-annually.

In addition, a part-time community affairs coordinator will be added to the staff to provide liaison between the station and community groups. As an early priority, the general manager will work with this coordinator and the minority community advisory committee set up prior to the last license renewal to create permanent communications channels between that committee and the station.

As noted earlier, the station will undertake, in its programming activities, to initiate, sponsor and promote civic, social and entertainment activities of interest to the black community.

E. Financial Policies

1. COLLECTIONS—All collections will be on a 30- to 40-day schedule. Receivables aged beyond 30 days will be pursued aggressively. No additional credit will be granted to accounts with receivables outstanding more than 60 days.

2. PROMOTION—Sales and audience promotions, other than those budgeted on an annual basis, will be avoided as a matter of policy. Where competitive activities clearly warrant additional expenditures and/or discounts, a complete analysis will be made of various alternatives and no promotion will be undertaken without the potential for the achievement of an audience or sales goal set for the station.

3. TRADE/BARTER—The general policy of the station will be that all sales are on a cash basis. Occasional situations may arise where the marginal cost of a sale is less than the value to the station of property offered in trade. In situations such as this, barter may be accepted as payment. Station management is well aware, however, that excessive use of barter negatively impacts cash flow and has a deteriorating effect on the station's image and competitive ability. In no year will the book value of bartered advertising time be allowed to exceed 5% of gross revenues.

4. CONTROLS—Financial performance targets of Bellville Radio, Inc., will include the following:

a. The current ratio (current assets to current liabilities) shall not fall below 1.5 to 1.

b. The ratio of debt to total capitalization shall not exceed 82% during the first year of operation; 70% during the second year of operation; 60% during the third year of operation; 55% during the fourth year of operation; and 50% during the fifth and later years of operation.

c. Receivables divided by average daily sales shall not exceed 31 days.

d. Net profits, after the first year, shall be at least 4% of total assets and 5% of gross sales.

In the event that any of these key performance goals is not achieved in a single quarter, station management shall prepare and present to the Board of Directors a detailed plan for correcting the problems. Should such goals not be met in two successive quarters, it shall be the responsibility of the Board to determine and take any actions necessary to achieve acceptable performance.

All financial statements will be reviewed annually by the Bellville accounting firm of Schneewind, Harte and Burger.

5. INCENTIVES, DEFERRED INCOME, ETC.—The incoming general sales manager, Raymond Barrow, has received a commitment from the president of Bellville Radio, Inc., for a personal incentive program. The terms of this program would provide for an additional year-end payment to Mr. Barrow of 1.5% of gross time sales. These arrangements and terms constitute standard practice in the broadcasting industry. Although no provisions have been made for a deferred-income program for any employees of the corporation, such a program may be instituted at a future date depending upon the financial performance of the station.

TABLE 27

VI. Financial Information

A. Current

1. SELLER'S BALANCE SHEET: WTXA RADIO

Assets

Cash		$ 11,786
Accounts Receivable	$ 59,861	
Less Allowances for Doubtful Accounts	(1,827)	
		58,034
Real Estate at Cost		2,850
Buildings	61,220	
Less Accumulated Depreciation	(47,190)	
		14,030
Broadcast Equipment	269,114	
Less Accumulated Depreciation	(177,970)	
		91,144
License at Cost	17,345	
Less Amortization	(14,620)	
		2,725
Furniture, Fixtures & Supplies	49,421	
Less Accumulated Depreciation	(32,120)	
		17,301
Vehicles	22,463	
Less Accumulated Depreciation	(5,210)	
		17,253
Total Assets		**$215,123**

Liabilities and Equity

Accounts Payable	$ 18,272
Notes Payable—	
Within 1 year	3,800
Accrued Interest Payable	814
Accrued Taxes Payable	9,728
Notes Payable—	
after 1 year	14,400
Total Liabilities	47,014
Shareholders' Equity	168,109
Total Liabilities and Equity	**$215,123**

2. BALANCE SHEET AT FAIR MARKET VALUE—Reflecting independent assessments of property, equipment and the station as the business entity.

Assets

Cash	$ 11,786
Net Accounts Receivable	58,034
Real Estate	18,800
Buildings	60,200
Broadcast Equipment	105,000
Furniture & Fixtures	17,500
Vehicles	17,200
Good will, including license	221,300
Total Assets	**$509,820**

Liabilities and Equity

Accounts Payable	18,272
Notes Payable—year	3,800
Accrued Interest Payable	814
Accrued Taxes Payable	9,728
Notes Payable—	
after 1 year	14,400
Total Liabilities	47,014
Shareholders' Equity	462,806
Total Liabilities and Equity	**$509,820**

3. STATEMENTS OF INCOME AND CASH FLOW OF SELLER

Income Statement Quarter Ending 3/31.

Local Income,		
Including Trades	$ 60,422	
National and		
Regional Income	8,186	
Total Income		**$ 68,608**
Direct Expense		
Agency Commissions	3,855	
Discounts	1,416	
Total Direct Expense		**5,271**
Selling Expense		
Selling Payroll	9,387	
Other	6,162	
Total Selling Expense		**15,549**
Technical Expense		
Salaries	4,074	
Power and Light	2,726	
Repairs and Maintenance	1,190	
Other	1,407	
Total Technical Expense		**9,397**
Program Expense		
Talent and Salaries	18,507	
Records	781	
News Service	1,236	
Royalties	1,419	
Other	1,877	
Total Program Expense		**23,870**
General and Administrative		
Salaries	11,913	
Depreciation & Amortization	6,810	
Reserve for Bad Debts	4,400	
Other	3,191	
Total General & Administrative		**26,314**
Total Expenses		80,401
Profit Before Taxes		$(11,793)
Plus Depreciation & Amortization		6,810
Broadcast Cash Flow		$(4,983)

4. MANAGEMENT ANALYSIS—In the opinion of the prospective management team, the current financial performance, as indicated by the above statements, does not reflect station WTXA's potential when reformatted and targeted to the proposed audience. Further, a number of operating economies can be achieved to improve financial performance. In Section V of this proposal a number of management strategies were described, which, when instituted by Bellville Radio, Inc., managers, will directly impact on revenues, operat-

ing expenses, collection of receivables, etc. Section VI.C. (below) contains projected statements of financial performances that reflect the aggressive and realistic management to be brought to the station by Bellville Radio, Inc.

5. SHORT-TERM FINANCING REQUIREMENT—Because station revenues at WTXA have traditionally varied on a seasonal basis by as much as 30%, short-term financing has sometimes been provided by the parent company, Texarkana Communications Corporation, to cover fixed expenses.

6. BANKING RELATIONSHIPS—WTXA has maintained banking relationships with two institutions, the First National Bank of Bellville, the largest local bank, and Citizens Bank of St. Louis, a major regional bank.

B. Historical Review of WTXA Performance (3 years).

This section of the proposal reviews the past performance of WTXA under its current ownership.

1. Revenues by Source
2. Operating Costs
3. Profitability and Cash Flow

The data are omitted from this illustration; actual audited statements would normally be provided.

C. Projected Performance Under New Ownership (5 years)

1. ASSUMPTIONS—Projected future financial performance is based on the following assumptions:

TABLE 28
Five Year Projected Cash Flow ($000)

	Year 1								
	1st Qtr	**2nd Qtr**	**3rd Qtr**	**4th Qtr**	**Total**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Revenues:									
National	4.9	7.3	10.0	13.0	35.2	78.9	94.7	108.9	118.7
Local	36.3	45.7	58.5	75.2	215.7	399.0	446.9	513.9	575.6
Total	41.2	53.0	68.5	88.2	250.9	477.9	541.6	622.8	694.3
Less Agency Comms. & Discounts	4.1	5.3	6.8	8.8	25.1	47.8	54.2	62.3	69.4
Net Revenues	37.0	47.7	61.6	79.4	225.8	430.1	487.4	560.5	624.8
Expenses									
Selling	8.5	10.7	13.7	17.5	50.5	98.9	107.2	117.7	125.0
Technical	9.0	9.0	9.0	9.0	36.0	38.5	41.2	44.1	47.2
Program	21.5	21.5	21.5	21.5	86.0	92.9	100.3	108.3	117.0
Promotion	10.0	10.0	0.0	0.0	20.0	10.0	2.5	2.8	3.0
G & A	17.6	17.6	17.6	17.6	70.2	75.1	80.4	86.0	92.0
Depreciation & Amortization	11.0	11.0	11.0	11.0	44.0	45.0	45.0	45.0	45.0
Interest Expense	9.0	9.0	9.0	9.0	36.0	34.0	28.0	24.0	19.0
Total Expenses	86.6	88.8	81.8	85.5	342.7	394.4	404.6	427.9	448.2
Income Before Taxes	(49.5)	(41.1)	(20.2)	(6.1)	(116.9)	35.7	82.8	132.6	176.7
Taxes	0	0	0	0	0	0.0	0.5	45.1	60.1
Net Income	(49.5)	(41.1)	(20.2)	(6.1)	(116.9)	35.7	82.2	87.5	116.6
Plus: Depreciation, Amortization & Interest	20.0	20.0	20.0	20.0	80.0	79.0	73.0	69.0	64.0
Cash Flow	(29.5)	(21.1)	(0.2)	13.9	(36.9)	114.7	155.2	156.5	180.6

a. Revenues: Revenues during the first quarter of operation will decrease by 40% as a result of reformatting. As the new national representative firm begins to become effective, national revenues will increase by 10% per month until national spending on Bellville black audiences reaches parity with that in similar markets. Beginning in month 4, as local marketing efforts begin to show results, local revenues, including new business, will increase by 12% per month for months 4 through 6, and by 7% per month thereafter until target market shares are reached. Overall increase in market revenues will be 8% per year. No seasonality factors will be applied because of an unknown date of commencement of operations.

b. Expenses: Reduction in total salaries will be $51,000 during year 1. Salaries will increase an average of 7% per year thereafter. There will be a reduction in overall operating costs of 9%. A one-time, special reformatting promotion expense of $20,000 is included. Interest expense is as proposed in the loan presentation.

VII. Purchase Price Rationale

The agreed-upon purchase price for WTXA reflects four general indicators of the station's value:

A. The station was independently appraised by Robert Irwin, of the station brokerage firm of Robert A. Irwin Associates, at a value of $490,000.

B. Analysis of a number of recent station transactions involving similar stations in similar markets suggest the value of the station could be as high as $550,000. Section

TABLE 29
Five Year Projected Sources and Uses of Funds ($000)

	Year 1							
	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Year 2	Year 3	Year 4	Year 5
Sources								
Net Profit	(49.5)	(41.1)	(20.2)	(6.1)	35.7	82.2	87.5	116.6
Dep. & Amort.	11.0	11.0	11.0	11.0	45.0	45.0	45.0	45.0
Total	(38.5)	(30.1)	(9.2)	4.9	80.7	127.2	132.5	161.6
Uses								
Equipment Purchase	0.0	0.0	0.0	0.0	10.0	20.0	20.0	20.0
Loan Repayment	0.0	0.0	0.0	13.0	52.0	52.0	52.0	52.0
Dividends	0.0	0.0	0.0	0.0	0.0	0.0	20.0	30.0
Total	0.0	0.0	0.0	13.0	62.0	72.0	92.0	102.0
Net Increase or Decrease in Working Capital	(38.5)	(30.1)	(9.2)	(8.1)	18.7	55.2	40.5	59.6
Beginning Working Capital	55.0	16.5	(13.6)	(22.7)	(30.9)	(12.2)	43.0	83.6
Net Change	(38.5)	(30.1)	(9.2)	(8.1)	18.7	55.2	40.5	59.6
End Capital	16.5	(13.6)	(22.7)	(30.9)	(12.2)	43.0	83.6	143.2

TABLE 30
Five-Year Project Debt Service Coverage and Financial Measures

	End of Year				
	1	2	3	4	5
Loan Repayment ($000)	13.0	52.0	52.0	52.0	52.0
Debt-to-Equity Ratio	4.2	2.2	1.5	0.9	0.5
Current Ratio	1.6	2.6	3.7	4.4	4.7
Return on Sales	(Loss)	7.5%	15.2%	14.1%	16.8%
Return on Invested Capital	(Loss)	(Loss)	18.4%	35.4%	44.9%

X of Appendix X contains a listing of the analyzed transactions with descriptions of stations, markets, and purchase prices and terms.

C. The price of $450,000 is approximately 2 times the station's current revenues. The multiple is reasonable in valuing mature, small-market FM broadcast properties operating at a break-even or slight cash-flow loss.

D. The projected performance of the station will amortize the acquisition costs and provide a reasonable return to the investors.

VIII. Financing Plan

A. The Financing Package

The financing package for the purchase of WTXA will be composed of approximately 25% equity and 75% debt, which will be payable over an 8-year period. Additionally, provisions have been made to meet temporary short-term start-up and seasonal financing requirements, which are adequate to cover contingencies. This package is consistent with the long-term objective of the principal investors of WTXA, who plan to use this station as the nucleus of a future station chain. The package as now structured provides sufficient strength and flexibility to operate the station effectively, provide security for the financial participants and meet long-term expansion objectives.

B. Equity Financing Plan

Bellville Radio, Inc., is capitalized at $125,000. Equity participants with their contribution and percent of ownership are listed in Parts I and IV of this proposal. In exchange for their contributions, the investors have been issued 125,000 shares of common stock. An additional 75,000 shares of stock remain available for issue for employee incentive plans or the raising of additional capital, although the need for such capital is not anticipated.

C. Debt Financing Plan

Lending to the corporation is to be structured in two tiers. Long-term debt will be composed of senior loans to finance the station purchase. Such debt is expected to comprise no more than 75% of the total capital structure at the date of purchase and to decrease steadily during the term of the loan. Short-terms debt will be available for working capital needs.

D. Additional Funding

Mr. William C. Johnson, Sr., has committed to lending to the corporation, on a one-year, interest-free subordinated basis, $20,000 as additional working capital, should the need arise.

E. Dividend Plan

No dividends are to be paid by the corporation during its first two years of operation. Beginning at the end of the second year, the Board of Directors may, at its discretion, and consistent with the restrictions of the senior lender, issue dividends to the stockholders. Such dividends shall be limited to no more than 33.3% of cash flow after payment of interest and principal.

APPENDIX E: Leveraged Buyouts

by David E. Schutz

Is it possible to buy a profitable $30 million station with little or no money down? The answer, surprisingly, is yes, through the use of a technique known as a leveraged buyout.

Many potential station owners search in vain for a "mismanaged" or "underdeveloped" station which they can improve and eventually resell at a profit. But a leveraged buyout potentially provides the broadcast entrepreneur with equal monetary rewards from acquiring an "already successful" station. This eliminates the risks associated with "turning a station around."

The sophisticated buyer realizes that the key to monetary rewards does not rest solely with how much you pay for a station, but rather *how you pay* for it! Leveraged buyouts are the easiest method by which the broadcast entrepreneur or first time owner lacking substantial capital can realize sizable monetary rewards from ownership of a station.

What Is A Leveraged Buyout?

- It is a method of financing the acquisition of a station wherein borrowed money is used to finance the majority, if not all, of the purchase price. The station's operating profits are then used to repay the loans.
- A leveraged buyout differs from other types of purchases using borrowed money. A much larger proportion of the purchase price, up to 100%, is paid with outside funds. This contrasts with the exclusive use of bank loans which are normally limited to 50–60% of the purchase price.
- The entrepreneurial organizer normally disburses a portion of the ownership (stock) in the station to his supplemental lenders. Typically these are private non-bank financial institutions, such as venture capital firms, which have little or no direct interest in the day-to-day operations of the station. This permits lower current interest rates on the supplemental loans.
- The entrepreneur who does not make any direct monetary investment himself is still left with a minimum 10-30% ownership in the station and control of its regular operations.

Why Are Leveraged Buyouts Occurring More Frequently?

The past several years have seen a dramatic rise in the number of station sales financed by funds from "non-broadcast" financial sources. These include commercial banks, venture capital companies, insurance companies and limited partnerships. The increased participation of these outside lenders/investors results from their recognition that commercial broadcasting is a growth industry with revenues and profits that are remarkably immune to recession and inflation.

In addition, annualized returns of *25-45%* for outside investors have prompted even greater interest. Many of these financial sources previously had shunned the industry. They failed to realize that a station's license represents a form of collateral as secure as the plant and equipment found in other industries.

Who Is Using the Technique?

Because of the nature of a leveraged buyout, it is most frequently used by individuals or smaller corporations which lack the financial resources to buy a station outright. A well-financed corporation which pays $50

million for a station expects to keep 100% of the equity in that station. In some cases the desire to maintain absolute control may stem more from emotional considerations rather than from objective financial analyses. In contrast, the entrepreneur or small company with more restricted resources is willing to surrender a portion of the equity to gain necessary financing.

Subordinated loans are the most important component of most leveraged buyouts. They provide the funds required to fill the gap between regular bank loans and the purchase price. If you are unfamiliar with the term, a "subordinated" loan is one where the lender accepts a secondary claim on the borrower's assets in the event of bankruptcy. This means that the subordinated lender's loan will not be repaid until all loans before it are fully repaid. Obviously this confronts the subordinated lender with a greater potential for loss than that faced by the "senior secured" lender.

To compensate for his greater loss potential the subordinated lender wants a higher return on his loan. This can be accomplished by either charging a higher direct interest rate or by sharing in the capital appreciation of the station. Since there are very few stations which can support loans with 30% simple interest, capital appreciation becomes the major source of monetary rewards for the lender. Typically the lender will be given "warrants" which will permit him to purchase stock in the station for a nominal price. To provide liquidity for the lender, the borrower also will agree to repurchase the warrants or minority stock at a price which relates to the station's current market value. These repurchase options typically are effective in the third through fifth year of new ownership.

What Type Of Station Is Best Suited To The Technique?

Because leveraged buyouts rely upon borrowed money, the primary concern for all parties is that the loans and equity investments will be repaid. The amount of money which will be lent on both a secured and subordinated basis and the minimum interest rates charged are all a factor of the "risk" of loss perceived by the lenders. While there is considerable value to an undeveloped station in a larger market, the last thing that a lender wants to do is to repossess and operate the station of a borrower who has defaulted on a loan. Thus, lenders spend considerable time analyzing a station's financial operations and the business skills of the entrepreneur who wants to purchase it.

Profitable stations with histories of stable audience, revenues and cash flows are the best candidates for first time leveraged buyout entrepreneurs. In such situations the new ownership simply has to continue the current operating policies. However, lenders frequently shy away from "overdeveloped" stations with unusually high audience and revenue levels. Such stations are considered to be highly vulnerable to increased competition in the market.

What Types Of Credentials Should The Entrepreneur Have?

Lenders, as mentioned previously, are concerned with managerial skills of the buyout entrepreneur. The last thing they want is a disruption in station profits caused by personnel changes or incompetent management. Thus, the entrepreneur should have some type of demonstrated ability in the broadcasting industry overall, and more specifically in the type of station or in the market where the new station is located. To help insure continuity of management, the entrepreneur will frequently provide current station management with some form of minor equity ownership in the buyer's company.

An Example Of The Leveraged Buyout Of A Television Station

To illustrate, let's assume that we are dealing with a VHF-affiliated TV station in a four-station market. We could just as easily substitute any other type of profitable radio or television station. During the past year it had $12,500,000 in net revenues and a 40% margin which produced $5,000,000 in broadcast cash flow (before taxes and depreciation).

In the future we expect that revenues and profits should grow at 10% per year. Since this is a mature station in an average market we normally would expect to pay about 9-times current cash flow on a "cash basis." However, the seller is willing to extend some favorable financing and will allow us full use of the accounts receivables for one year, so we agree to a purchase price of $50,000,000 (10 × cash flow), paid as follows:

	Amount	Percent of Financing
**Senior secured bank loan* 8 yrs. @ Prime + 1 1/2% (14%)	$30,000,000	59%
**Seller's note*; 5 year, interest only @ 10%	10,000,000	20%
**Subordinated note*; 5 years, 9%, interest only, (1st year interest deferred; warrants for 35% of stock)	7,500,000	15%

**Equity investors*; will provide $3.5 million of which $1 million is for working capital	3,500,000	6%
TOTAL:	51,000,000	100%

In the example we assume that the bank loan will have an interest rate of prime + 1 1/2% or 14%. The seller's note provides for interest payments *only* for five years with those payments due on the anniversary date of the sale. The subordinate lenders will receive 9% interest for their money plus 35% of the stock in the station. The equity investors will own 50% of the station. Finally, the entrepreneur who puts the deal together but *does not* provide any significant capital will receive 15% of the station's stock.

The ownership interests in the station are as follows:

Equity investors	50%
Subordinated lenders	35%
Entrepreneur	15%

The station's revenues and loan repayments during the first five years of new ownership appear below: (These figures are in aggregate dollars, rounding to the nearest $100,000, and include the effects of overall monetary inflation.)

Station Resale After Five Years

Let's assume that after five years of ownership that the station is resold in year five. We also will assume that it is sold on a "cash basis" for a multiple of 9-times current cash flow (this is the same multiple for a "cash sale" that existed in year one): $72,000,000. Repayment of the outstanding debt leaves $29,100,000 in "net equity", as follows:

Year Five Selling Price:	$72,000,000
Less: Senior Bank Loan	24,700,000
Seller's Note	10,000,000
Subordinated Note	8,200,000*
Net Cash Realized:	29,100,000

(*Includes $700,000 in deferred interest accruing in 1984 which was added to the outstanding principal)

TABLE 31
Stations Revenues & Loan Repayments

Years
(Dollars in Thousands)

	One	Two	Three	Four	Five
Station's Net Revenue	$13,800	$15,100	$16,600	$18,300	$20,100
Operating Margin	40%	40%	40%	40%	40%
Cash Flow	$ 5,500	$ 6,000	$ 6,600	$ 7,300	$ 8,000
Less:					
Interest					
bank loan	4,200	4,200	4,100	4,000	3,800
seller's note	1,000	1,000	1,000	1,000	1,000
subordinate note	700*	700	700	700	700
Depreciation	1,500	1,500	1,500	1,500	1,500
Taxable Income (Loss)	($1,900)	($1,400)	($700)	100	1,000
Less: Income Tax (45%)	-0-	-0-	-0-	-0-[1]	-0-[1]
Net Income (Loss)	($1,900)	($1,400)	($700)	100	1,000
Add: Depreciation	1,500	1,500	1,500	1,500	1,500
Funds for loan repayment	300*	100	800	1,600	2,500
Bank Loan: Start/Yr.	$30,000	$29,700	$29,600	$28,800	$27,200
Repayments	300	100	800	1,600	2,500
End/Yr.	$29,700	$29,600	$28,800	$27,200	$24,700

*Interest on the subordinated debt accrues for tax purposes during the first year but no payment is actually made, the interest is simply added to the principal.
[1]Tax loss carry forwards eliminate taxes in years four and five.

The $29,100,000 in net proceeds would then be divided among the common stock holders in direct relationship to their holdings. Their gross profit and annual return on their investments appear below:

	Equity %	Gross Profit	Annualized Return
Subordinated Lender	35%	$10,200,000	27%
Equity Investors	50%	14,600,000	33%
Entrepreneur	15%	4,300,000	*

(*The entrepreneur's return cannot be annualized since we assume that he does not make an initial cash investment.)

Example—Leveraged Buyout Of A Radio Station

Leveraged buyouts can be used with radio properties as readily as they are with television stations. An example of a radio buyout with 100% leverage appears below.

Let's assume that we have a mature radio station in a market with good growth (12% per year). The station has been well managed and you believe that it will be able to maintain its audience and revenue shares for the foreseeable future. It currently is operating with a 35% cash flow margin which should be sustainable in the future. During the past 12 months it generated approximately $550,000 in cash flow.

You have the opportunity to buy the station for $4,800,000. This is about 8.7 times its trailing cash flow (8.0 times the coming year's cash flow). In addition we agree to purchase the current accounts receivables for $300,000. The acquisition will be leveraged by obtaining loans from the following sources:

		Percent Financing
Senior Bank Loan P + 1 1/2% (14%)	$3,000,000	(59%)
Seller's Note @ 12% (int. only 5 yrs.)	500,000	(10%)
Subordinated Loan @ 8% (warrants for 55% equity)	1,600,000	(31%)
	5,100,000	(100%)

The operation projections for the station during the next five years are as follows:

Years (Dollars in Thousands)

	One	Two	Three	Four	Five
Station Revenue (12%)	$1,700	$1,900	$2,100	$2,400	$2,700
Cash Flow (35%)	600	650	750	850	950
Less:					
Interest:					
Bank loan	$ 420	$ 421	$ 416	$ 396	$ 359
Seller's Note	60	60	60	60	60
Sub. Loan	130	130	130	130	130
Fund for loan repayment	$ (10)	$ 39	$ 144	$ 264	$ 401

(*It's assumed that depreciation and tax loss carry forwards eliminate taxes.)

Resale Of The Station After Five Years

Let's assume that the station is resold at the end of the fifth year of ownership for $8,100,000; cash (8.5 times cash flow). In addition we also sell the accounts receivables for $500,000 (2 months collections). Upon repayment of the $2,160,000 balance of the bank loan, the seller's note and the subordinated loan leaves $4,340,000 of equity which is distributed as follows:

Selling Price:	$8,600,000 (includes receivables)
Less: Bank Loan Balance:	2,160,000
Seller's Note:	500,000
Subordinated Loan:	1,600,000
Net Equity:	$4,340,000

The effective capital gains and annualized returns for the subordinated lenders and the entrepreneur are:

	Gross Profit	Annualized Return
Subordinated Lenders:	$2,380,000	28% (includes 8% annual interest)
Entrepreneur	$1,960,000	N/A

Conclusion

- Leveraged buyouts are an increasingly common technique for acquiring successful broadcasting stations. They permit a corporation or individual to acquire a relative large and successful station with a very small, or in some cases, no capital investment of their own.

- The most crucial source of funds in a leveraged buyout is the subordinate lender. To attain the 25–30% annual returns required by these lenders most are granted some form of equity ownership in the buyer's company. About two-thirds of their earnings will normally come from the capital gains associated with this equity when the station is resold or their shares are repurchased. While this may initially appear to be a high return, it can be easily obtained in the typical buyout, as illustrated previously.

- Equity investors in a typical buyout should expect 30–40% annual returns, although higher levels are possible. An entrepreneur who organizes a buyout and supervises the station's continuing operation, but does *not* contribute any capital, should expect at least a 10–20% equity interest in the station.

- The best buyout candidates are successful stations which have histories of stable audiences and cash flows. The most desirable organizer of a buyout is a corporation or individual with previous experience in operating the type of station being acquired. It is often helpful to provide some form of minor equity ownership for the station's current management to insure their continuing employment at the station.

APPENDIX F: Financial Resource Index

Institutions listed in this appendix have participated in one or more broadcast acquisitions. This Financial Resource Index is designed to aid broadcasters in obtaining capital for financing telecommunications properties. Some financial institutions doubtless have been inadvertently omitted.

The Financial Resource Index is a guide to *potential* sources of capital. These sources have been used by broadcasters in the past. However, it must be noted that each institution has its own criteria for lending such as minimum lending limits, group owner limitations, geographic considerations, and the like. Check with the institutions you believe would be appropriate before making a detailed presentation for their use.

The Financial Resource Index is divided into two main sections, Lenders and Investors, with subsections under Investors that include investment banks, venture capital firms, insurance companies and other investors. The information supplied is courtesy of Frazier Gross & Kadlec, Inc. and is taken from its *1987 Directory Of Lenders And Investors To The Broadcast Industry.*

LENDERS TO THE BROADCAST INDUSTRY

American Security Bank, N.A.
1501 Pennsylvania Avenue, N.W.
Washington, D.C. 20013
Gregg E. Johnson, Vice President, (202) 624-4818
Susan Ness, Vice President, (202) 624-7668

AmeriTrust Company National Association
900 Euclid Avenue, T-10
Cleveland, Ohio 44101
Chesley Y. Maddox, Asst. Vice President, (216) 687-8432
Paul F. Carrazzone, Asst. Vice President, (216) 687-8434

AmSouth Bank
P.O. Box 11007
Birmingham, AL 35288
John McRoberts, Sr. Vice President, (205) 326-4938
Leon Hill, Vice President, (205) 326-5198

Australian & New Zealand Banking Group Ltd.
120 Wall Street
New York, NY 10005-3990
Roger Dorian, Vice President, (212) 820-9808

Bank of America
555 S. Flower Street
EMHS #5144—49th Floor
Los Angeles, CA 90071
Donald R. Beck, Jr., Vice President, (213) 228-3292
John K. Rogers, Asst. Vice President, (213) 228-2438

Bank of Boston
100 Federal Street
Communications Division HO-4-1
Boston, MA 02110
Robert A. Bachelder, Vice President, (617) 434-8762
Elizabeth J. Mercurio, Vice President, (617) 434-7680

The Bank of California, N.A.
400 California Street
San Francisco, CA 94104
Paul S. Foster, Sr. Vice President, (415) 765-2313
Paul E. Gaenger, Vice President & Mgr., (415) 762-2706

Bank of Montreal
430 Park Avenue
New York, NY 10022
Yvonne Boss, Account Manager, (212) 605-1424
Anat Schwartz, Account Officer, (212) 605-1477

Bank of New England, N.A.
28 State Street, 32nd Floor
Boston, MA 02109
Katherine C. Marien, Sr. Vice President, (617) 973-1917
Paula H. Lang, Vice President, (617) 973-1959

The Bank of New York
530 Fifth Avenue
New York, NY 10036
Gerald L. Hassell, Sr. Vice President, (212) 536-9019
Robert B. Purcell, Vice President-Group Head, (212) 536-9021

The Bank of Nova Scotia
67 Wall Street
New York, NY 10005
James N. Tryforos, Senior Rep., (212) 208-6737
Michael G. Locke, Senior Rep., (415) 986-1100 (San Francisco)

Bank One, Indianapolis, N.A.
101 Monument Circle
Indianapolis, IN 46277
Dale C. Arfman, Vice President, (317) 639-8365

Bankers Trust Company
280 Park Avenue
New York, NY 10017
William B. Schink, Vice President, (212) 850-3212

Banque Paribas
Park Avenue Plaza
New York, NY 10055
M. Steven Alexander, Vice President, (212) 872-7115
Donald Maley, Vice President, (212) 872-7008

Barclays American/Business Credit
111 Founders Plaza
East Hartford, CT 06101
J. Chris Webster, Vice President, (203) 528-4831
Claudia S. Horn, Loan Officer, (203) 528-4831

BayBank Boston, N.A.
175 Federal Street
Boston, MA 02110
Carroll R. Highet, Vice President, (617) 482-1040
Frederica See, Assist. Vice President, (617) 482-1040

Central Trust Company, N.A.
201 East Fifth Street
Cincinnati, OH 45202
J. Eric Lenning, Sr. Vice President, (513) 651-8692
Daniel M. Witten, II, Vice President, (513) 651-8692

The Chase Manhattan Bank
One Chase Manhattan Plaza
New York, NY 10081
Laura L. Calhoun, Vice President, (212) 552-4845
Thomas V. Reifenheiser, Vice President, (212) 552-4415

Chemical Bank
Broadcast & Cable Industries Group
277 Park Avenue
New York, NY 10172
Henry D. Morneault, Vice President-Group Head,(212) 310-6027
Lewis C. Kleinhans, Vice President, (212) 310-6340

Citibank, N.A.
399 Park Avenue
New York, NY 10043
Gary Corr, Vice President, (212) 559-7825
Gayle Robinson, Vice President, (212) 559-7051

Connecticut National Bank
777 Main Street, MSN-225
Hartford, CT 06115
Christopher M. Byrd, Vice President, (203) 728-2525
Laurie Price, Assist. Vice President, (203) 728-4552

Continental Illinois National Bank
231 South LaSalle Street
Chicago, IL 60697
Mary Cloonan, Vice President, (312) 828-7833
Cathleen Strenk, Second Vice President, (312) 828-7831

Deposit Guaranty National Bank
P.O. Box 1200
Jackson, MS 29205
W. Stan Pratt, Exec. Vice President, (601) 354-8595
Frank Fillingim, Sr. Vice President, (601) 354-8219

Equitable Bank
6100 Executive Blvd. #300
Rockville, MD 20852
Charles Coudriet, Sr. Vice President, (301) 468-5005
Nicholas Yakubik, Vice President, (301) 468-5013

First American National Bank
First American Center
Nashville, TN 37237
David M. Jensen, Sr. Vice President, (615) 748-2758
David J. Reynolds, Vice President, (615) 748-6954

First National Bank of Chicago
One First National Plaza—Suite 0083
Chicago, IL 60670
Jacqueline A. Hurlbutt, Sr. Vice President, (312) 732-6955
Norberto Kogan, Vice President, (312) 732-6954

First National Bank of Maryland
P.O. Box 1596
Baltimore, MD 21203
J. Roger Sullivan, Jr., Sr. Vice President,(301) 244-4088
Leon W. Wynne, Vice President, (301) 244-4090

First National Bank of Minneapolis
First Bank Place, M4FE321
Minneapolis, MN 55480
Terry L. Adams, V.P./Division Head, (612) 370-4850
Nick Bluhm, Vice President, (612) 370-5268

First Pennsylvania Bank N.A.
16th & Market Streets
Corporate Banking—19th Floor
Philadelphia, PA 19101
Anthony D. Braxton, Vice President, (215) 786-8244
Thomas P. Kelly, Vice President, (215) 786-8267

First Security Bank of Utah, N.A.
15 East 100 South, 2nd Floor
Salt Lake City, Utah 84111
Roger G. Shumway, Sr., Vice President (801) 350-5315
D. Kevin Imlay, Asst. Vice President, (801) 350-5541

First Union National Bank
First Union Plaza
10th Floor, Corp-6
Charlotte, NC 28288
Robert F. Buckfelder, Vice President, (704) 374-4552
Paul Thomason, Assist. Vice President, (703) 374-6104

First Wisconsin National Bank of Milwaukee
777 East Wisconsin Avenue
Milwaukee, WI 53202
Michael J. Fredrich, Vice President, (414) 765-5747
Richard E. Zerkel, Vice President, (414) 765-4445

Fleet National Bank
111 Westminster Street
Providence, RI 02903
Colin J. Clapton, Sr. Vice President, (401) 278-6267
Mary E. Gooding, Vice President, (401) 278-6513

Indiana National Bank
One Indiana Square, #465
Indianapolis, IN 46266
Dennis L. Bassett, First Vice President, (317) 266-5287
Jason R. Boyewsky, Vice President, (317) 266-5851

InterFirst Bank Dallas, N.A.
901 Main Street
Dallas, TX 75201
Alan Cawthon, Vice President/Dept. Manager, (214) 977-2063
Cathy Pombier, Asst. Vice President, (214) 977-2052

Manufacturers Hanover Trust Company
270 Park Avenue—10th Floor
New York, NY 10017
Magna L. Dodge, Sr. Vice President, (212) 286-7857
Joan M. Fitzgibbon, Vice President, (212) 286-6882

Marine Midland Bank, N.A.
140 Broadway, 18th Floor
New York, NY 10015
Jose A. Echevarria, Vice President/District Manager,(212) 908-6652
Dave Carrington, Vice President, (212) 908-6652

Maryland National Bank
1110 Vermont Avenue, NW, Suite 1000
Washington, D.C. 20005
W. Peter Torri, Vice President, (202) 822-8111
Jesse Swartz, Vice President, (301) 244-1210

Mercantile-Safe Deposit & Trust Co.
2 Hopkins Plaza
P.O. Box 1477
Baltimore, MD 21203
Michael Vaughan, Sr. Vice President, (301) 237-5645
Andrew G. Huff, Vice President, (301) 237-5483

Merchants National Bank & Trust
1 Merchants Plaza
Indianapolis, IN 46255
Raymond A. Murphy, Vice President, (317) 267-7920

Michigan National Bank
30445 Northwestern Highway
Farmington Hills, MI 48018
Richard L. Schickedanz, Group V.P., (313) 737-3189
Elizabeth A. Wysocki, Vice President, (313) 737-3195

Norwest Bank Minneapolis
Eighth & Marquette Avenue
Minneapolis, MN 55479-0058
Dan Brian, Sr. Vice President, (612) 372-7993
Gerry Stenson, Vice President, (612) 372-9383

Old Stone Bank
One Old Stone Square
Providence, RI 02903
Robert J. Maccini, Asst. Vice President, (401) 278-2532
William Allen, Loan Officer, (401) 278-2573

The Philadelphia National Bank
Broad & Chestnut Street
FC1-7-51
Philadelphia, PA 19101
Peter L. Davis, Sr. Vice President, (215) 629-3937
James H. Brooks, Jr., Sr. Vice President, (215) 629-3892

Pittsburgh National Bank
Fifth Avenue and Wood Street
Pittsburgh, PA 15265
James P. Conley, Vice President/Mgr., (412) 355-2480
Tom Hoyt, Asst. Vice President, (412) 355-2556

Republic Bank Dallas
P.O. Box 225961
Dallas, TX 75265
Phyllis B. Riggins, Sr. Vice President/Div. Mgr., (214) 922-7894
Sarah W. Rathjen, Vice President, (214) 922-5536

Rhode Island Hospital Trust National Bank
1 Hospital Trust Plaza
Providence, RI 02903
J. Michael Saul, First Vice President, (401) 278-7849
John McJennett, Sr. Vice President, (401) 278-8520

Security Pacific National Bank
333 South Hope Street
Los Angeles, CA 90051
Zelbie Trogden, Managing Director, (213) 613-6906
Albert Kelley, Vice President, (213) 613-5353

Shawmut Bank of Boston
280 Park Avenue
New York, NY 10017
Alice Frentz, Group Vice President, (212) 682-3754

Society Bank
800 Superior Avenue
Cleveland, OH 44114
Charles P. Coon, Vice President & Mgr., (216) 344-5786
Kathleen M. Mayher, Asst. Vice President, (216) 344-5727

South Carolina National Bank
101 Greystone Boulevard
Columbia, SC 29226
Steve H. Taylor, Asst. Vice President, (803) 765-3023
David L. Beard, Regional Sr. Lender, (803) 239-1992

Southeast Bank, N.A.
One Southeast Financial Center-19FCR
Miami, FL 33131
Howard M. Halle, Vice President/Group Head, (305) 375-6632
C. French Yarbrough, Sr. Vice President/Region I, (305) 375-6616

State Street Bank & Trust Company
225 Franklin Street
Boston, MA 02101
Kenneth J. Mooney, Vice President/Department Head, (617) 654-3874
Patrick C. Barber, Asst. Vice President, (617) 654-3857

Texas Commerce Bank
712 Main Street
Houston, TX 77001
Mike Addy, Exec. Vice President, (713) 236-4029
Joe McKinney, Exec. Vice President, (713) 236-5750

Union Bancorp
445 South Figueroa Street
Los Angeles, CA 90071
Craig W. Dougherty, Vice President/Manager, (213) 236-5780
James L. Leahy, Vice President, (213) 236-7155

Union Trust Company
P.O. Box 404
New Haven, CT 06502
Richard E. Nelson, Sr. Vice President, (203) 773-5890

Washington Trust Bank
P.O. Box 2127
Spokane, WA 99210
Jack Snead, Vice President, (509) 455-3821

INVESTORS

Investment Banks

Acquisition Funding Corporation
535 Madison Avenue, Suite 2700
New York, NY 10022
George V. Grune, Exec. Vice President, (212) 826-5959
Jeffrey B. Morford, Vice President, (212) 826-5959

Butcher & Singer, Inc.
211 South Broad Street
Philadelphia, PA 19107
Marshall W. Pagon, Sr. Vice President, (215) 985-5141
Howard Verlin, Vice President, (215) 985-5240

Carolina Securities Corporation
127 West Hargett Street
Raleigh, NC 27602
James C. Hill, Jr., Exec. Vice President, (919) 832-3711
Clayton J. Duncan, Exec. Vice President, (919) 832-3711

Chrysler Capital Corporation
100 Ashford Center North, Suite 310
Atlanta, GA 30338
Mr. M.W. Jacobs, Vice President, (404) 392-6781

ComCapital Group
19 West 44th Street—Suite 1000
New York, NY 10036
Paul C. Raeder, President, (212) 302-8720
David E. Schutz, Managing Dir., (201) 891-7758

Deer River Group
2000 L Street, N.W.
Suite 200
Washington, D.C. 20036
Mr. Robin B. Martin, President, (202) 659-3331
Erwin G. Krasnow, Esq., Gen. Counsel, (202) 775-1062

Drexel Burnham Lambert
55 Broad Street
New York, NY 10004
Arthur Phillips, First Vice President, (212) 480-7356

First Boston Corporation
Park Avenue Plaza
New York, NY 10055
Chuck Ward, Managing Dir., (212) 909-2601
Fred Smith, Managing Dir., (212) 909-2166

Firstmark Financial Corporation
110 East Washington Street
Indianapolis, IN 46204
William E. Kennedy, Admin. Vice President, (317) 262-5858
Edwin D. Brubeck, Asst. Vice President, (317) 262-5858

Georgetown Capital Corporation
3050 K Street, Suite 330
Washington, D.C. 20007
Roy Hayes, President, (202) 944-4500

Heller Financial, Inc.
200 North LaSalle
Chicago, IL 60601

Henry Ansbacher, Inc.
277 Park Avenue, 47th Floor
New York, NY 10172
Peter R. Kent, President, (212) 668-5544
Matti Prima, Vice President, (212) 668-5544

Jesup & Lamont Securities Co., Inc.
360 Madison Avenue
New York, New York 10017
John Palmer, Managing Director, (212) 907-0100
Peter A. Haring, Jr., Managing Director, (212) 907-0111

L. F. Rothschild
55 Water Street
New York, NY 10041

Ladenburg, Thalmann & Co., Inc.
540 Madison Avenue
New York, NY 10022
Porter Bibb, Managing Director, (212) 872-1410
Averell Mortimer, Managing Director, (212) 872-1413

Legg Mason Wood Walker, Inc.
7 East Redwood Street
Baltimore, MD 21203
Jack B. Dunn, IV, Vice President, (301) 539-3400
Paul J. Durbin, Vice President, (301) 539-3400

Lepercq, de Neuflize & Co.
345 Park Avenue
New York, NY 10154
Michael J. Connelly, Managing Director, (212) 702-0140

Morgan Stanley & Co.
1251 Avenue of the Americas
New York, NY 10020
Steven Rattner, Managing Director, (212) 703-7771
Peter Currie, Vice President, (212) 703-7817

PruCapital, Inc.
Three Gateway Center
Newark, NJ 07102
John G. Lapham, Vice President/Corp. Finance, (213) 617-1090 (Los Angeles)
Steve Berman, Vice President, (201) 877-4954

Raffensperger, Hughes & Co.
20 North Meridian Street
Indianapolis, IN 46204
Robert H. Shortle, Vice President/Corp. Finance, (317) 635-4551

Rodgers Group
100 Oakland Street
Bristol, CT 06010
David Rodgers, President, (203) 583-9945

Rotan Mosle, Inc.
2600 Renaissance Tower
Dallas, TX 75270
Michael D. Riggs, Sr. Vice President, (214) 651-6911
Bruce Swenson, Sr. Vice Pres., (214) 651-6919

Salomon Brothers, Inc.
One New York Plaza
New York, NY 10004
Nancy B. Peretsman, Vice President, (212) 747-5990
Jarlath A. Johnston, Vice President, (212) 747-7359

Samuel Montagu & Company, Ltd.
535 Madison Avenue, 34th Floor
New York, NY 10022
Norman Liu, Vice President, (212) 702-5469
Janice Eberhardt, Vice President, (212) 702-5478

Skye Communications Corporation
CityPlace, 31st Floor
Hartford, CT 06103
William L. Fleming, President, (203) 275-6556

Smith Barney, Harris Upham & Co.
1345 Avenue of the Americas
New York, NY 10105
Francois de Visscher, Vice President, (212) 698-6387

Veronis, Suhler & Associates, Inc.
515 Madison Avenue
New York, NY 10022
John S. Suhler, Pres./Chief Exec. Officer., (212) 935-4990
Marvin L. Shapiro, Exec. Vice President, (212) 593-2626

Wertheim Schroder & Co.
200 Park Avenue
New York, NY 10166
Gary Stevens, Assoc. Managing Director, (212) 578-0232

VENTURE CAPITAL FIRMS

Allied Capital Corporation
1666 K Street, N.W., Suite 901
Washington, D.C. 20006
George C. Williams, Board Chairman, (202) 331-1112
David Gladstone, President, (202) 331-1112

Allstate Insurance Company
Allstate Plaza, E-2
Northbrook, IL 60062
Leonard A. Batterson, Dir, Venture Cap. Division, (312) 291-5681
Paul J. Renze, Investment Analyst, (312) 291-5681

AMEV Venture Associates
One World Trade Center—50th Floor
New York, NY 10048
Martin S. Orland, General Partner, (212) 775-9100
Emmett Bonner, General Partner, (212) 775-9100

Associated Southwest Investors, Inc.
2400 Louisiana Northeast, #4-225
Albuquerque, NM 87110
John R. Rice, President, (505) 881-0066

Atlantic Venture Partners
801 North Fairfax Street
Alexandria, VA 22314
Wallace L. Bennett, President, (703) 548-6026

BT Capital Corporation
280 Park Avenue
New York, NY 10017
James G. Hellmuth, Dep. Chairman, (212) 850-1916
William J. Drake, Asst. Vice President, (212) 850-1938

BancBoston Capital Ventures
100 Federal Street
Boston, MA 02110
Paul F. Hogan, President, (617) 434-5700
Jeffrey W. Wilson, Vice President/Treasurer, (617) 434-2428

Broadcast Capital, Inc.
1771 N Street, N.W.
Washington, D.C. 20036
John E. Oxendine, President, (202) 429-5393
Kenneth O. Harris, Vice President, (202) 429-5393

Burr, Egan, Deleage & Co.
One Post Office Square—Suite 3800
Boston, MA 02109
William P. Egan, General Partner, (617) 482-8020
Brion B. Applegate, General Partner, (415) 362-4022

CVC Capital Corporation
131 East 62nd Street
New York, NY 10021
Mr. Jorg Klebe, President, (212) 319-7210

Communications Partners, Ltd.
2400 InterFirst Plaza
Dallas, TX 75202
Eric C. Neuman, Managing Partner, (214) 651-9180
G. Bradford Bulkley, Managing Director,
(214) 651-9180

Continentai Illinois Equity Corporation
Continental Illinois Venture Corporation
231 South LaSalle
Chicago, IL 60697
Scott E. Smith, Vice President, (312) 828-8021
Burton E. McGillivray, Vice President, (312) 828-8021

Criterion Venture Partners
1000 Louisiana—Suite 6000
Houston, TX 77002
David O. Wicks, Jr., Sr. Partner, (713) 751-2408

E. M. Warburg, Pincus & Co., Inc.
466 Lexington Avenue
New York, NY 10017
Ernest H. Pomerantz, Managing Director,
(212) 878-0662
Sidney Lapidus, Managing Director, (212) 878-0605

First Chicago Venture Capital
Three First National Plaza—Suite 1330
Chicago, IL 60614
Paul J. Finnegan, Sr. Investment Mgr., (312) 732-8067
Jim N. Perry, Investment Mgr., (312) 732-5416

Fleet Venture Partners
111 Westminster Street
Providence, RI 02903
Robert M. Van Degna, Managing Partner,
(401) 278-5597

Foster Management Company
437 Madison Avenue
New York, NY 10022
Michael J. Connelly, Exec. Vice President,
(212) 753-4810

Gold Coast Capital Corporation
3550 Biscayne Blvd., #601
Miami, FL 33137
William I. Gold, President, (305) 576-2012

Golder, Thoma & Cressey
120 South LaSalle
Chicago, IL 60603
Bruce V. Rauner, General Partner, (312) 853-3322
John von Schlegell, Sr. Associate, (312) 853-3322

Interfirst Venture Corporation
901 Main Street, 10th Floor
P.O. Box 83000
Dallas, TX 75283-0644
James A. O'Donnell, President, (214) 977-3160
Sallee McDermitt, Investment Associate,
(214) 977-3169

Investments Orange Nassau, Inc.
260 Franklin Street, Suite 1500
Boston, MA 02110
Richard D. Tadler, General Partner, (617) 439-6160
F. Dan Blanchard, Vice President, (214) 385-9685

Media Investments, Inc.
P.O. Box 334
Ft. Worth, TX 76101
Lynn Farr, President, (501) 932-5260

Narragansett Capital Associates
40 Westminster Street
Providence, RI 02903
Gregory P. Barber, General Partner, (401) 751-1000
Jonathan M. Nelson, General Partner, (401) 751-1000

New England Capital Corporation
One Washington Mall
Boston, MA 02108
Z. David Patterson, Exec. Vice President,
(617) 722-6400

Prudential Venture Capital Management, Inc.
717 Fifth Avenue, Suite 1600
New York, NY 10022Mr. Dana J. O'Brien, Vice
President, (212) 753-0901

Rust Ventures L.P.
114 West 7th Street, Suite 1300
Austin, TX 78701
Bill Wood, Partner, (512) 479-0055
Jeff Garvey, Partner, (512) 479-0055

Skora Funding Group
49 West 12th Street
Executive Suite
New York, NY 10011
Allan E. Skora, President, (212) 691-9895

TA Associates
45 Milk Street
Boston, MA 02109
David D. Croll, Managing Partner, (617) 574-6719
Richard H. Churchill, General Partner, (617) 574-6723

The Venture Capital Fund of New England
100 Franklin Street
Boston, MA 02110
Richard A. Farrell, General Partner, (617) 451-2577

Walden
750 Battery Street
San Francisco, CA 94111
George Sarlo, General Partner, (415) 391-7225

Wescot Capital Corporation
1601 North 7th Street
Phoenix, AZ 85006
Scott Eller, President, (602) 254-3944
Karl Eller, General Partner, (602) 254-3944

Whitehead Associates
15 Valley Drive
Greenwich, CT 06830
Joseph A. Orlando, President, (203) 629-4633
William E. Engbers, Vice President, (203) 629-4633

Wind Point Partners
1525 Howe Street
Racine, WI 53403
Arthur Del Vesco, General Partner, (414) 631-4030

INSURANCE COMPANIES

Aetna Life & Casualty
CityPlace-YFC4
Hartford, CT 06103
Alvin E. Taylor, Asst. Vice President, (203) 275-2770
John W. Reams, Analyst, (203) 275-2776

Connecticut Mutual Life Insurance Co.
140 Garden Street
Hartford, CT 06154
Richard J. Cobb, Jr., Invest. Officer, (203) 727-6598

Equitable Capital Management Corporation
1285 Avenue of the Americas
New York, NY 10016
Ina Lane, Asst. Vice Pres., (212) 554-2407
Gilbert Campbell, Managing Dir., (212) 554-3194

Home Life Insurance Company
253 Broadway
New York, NY 10007
Bruce A. Maier, Vice President, (212) 306-2058
Diane Hom, Vice President, (212) 306-2052

Massachusetts Mutual Life Insurance Co.
1295 State Street
Springfield, MA 01111
Clifford M. Noreen, Assoc. Dir./Corp. Fin., (413) 730-6087
Robert Joyal, Vice President, (413) 730-6062

Mutual of New York
(MONY) Financial Services
1740 Broadway
New York, NY 10019
Diane L. Kaufman, Vice President, (212) 708-2662
Michael D. Kouvaras, Asst. Vice President, (212) 708-2659

Phoenix Mutual Life Insurance Co.
One American Row
Hartford, CT 06115
Sandra Becker, Invest. Officer, (230) 275-5653

Teachers Insurance & Annuity Association
730 Third Avenue
New York, NY 10017
Nancy D. Freund, Sr. Portfolio Analyst, (212) 916-4327
Charles C. Thompson, III, Second Vice President, (212) 916-4335

OTHER INVESTORS

Advest Credit Corporation
One Commercial Plaza
Hartford, CT 06103
John E. Moylan, President, (203) 527-8188
John V. Danner, Regional Manager, (201) 272-1333

BancBoston Capital, Inc.
100 Federal Street
Boston, MA 02110
Frederick M. Fritz, President, (617) 434-4012
Craig H. Deery, Vice President, (617) 434-0025

Park Leasing Company
611 Fifth Avenue
P.O. Box 1719
Des Moines, IA 50306
Robert W. Arnold, Board Chairman, (515) 288-1023
Bill Crawford, President, (515) 288-1023

Phillips Credit Company
100 East 42nd Street
New York, NY 10017
J. Walter Corcoran, President, (212) 850-5130

Raymond James & Associates
1400 66th Street North
St. Petersburg, FL 33710
Robert M. McKown, Jr., Sr. Vice President & Partner, (813) 381-3800
Ronald L. Miller, Sr. Vice President & Partner, (813) 381-3800

APPENDIX G: Outline of an Asset Purchase Agreement

1. Assets to be purchased by Buyer—usually listed comprehensively in exhibits
   a. Personal property
   b. Contracts, leasehold interests
   c. Interests in real property, manner of conveyance specified, e.g., general warrant deed
   d. Licenses
   e. Books, financial records
   f. Rights in call letters, trade names, etc.
   g. Insurance

2. Assets excluded from transaction
   a. Cash
   b. Accounts receivable

3. Purchase price, manner of payment
   a. Aggregate
      i. "Earnest money deposit"
      ii. Other escrowed amount
      iii. Balance due at closing
      iv. Deferred portion: form of note attached as exhibit, along with other seller financing instruments, e.g., security agreement, pledge agreement
   b. Prorations of items of deferred income and prepaid expense at closing

4. Assumption by Buyer of specified liabilities
   a. Principally contracts, leases, agreements listed in an exhibit
   b. All other liabilities expressly excluded

5. Closing—specify date, time and place, with reference todate on which conditions for closing, including FCC approval, have been fulfilled

6. Representations and Warranties of the Seller
   a. Corporation is in good standing
   b. Officers have authority to enter into and perform agreement
   c. No other consents are required except those disclosed
   d. Agreement does not conflict with any law or any other agreement
   e. Complete list of personal property has been provided, Seller has good title
   f. FCC licenses are in good standing
   g. Operation of station is in accordance with law, FCC rules
   h. No litigation pending or threatened
   i. Taxes paid
   j. Insurance up to date
   k. Records are complete
   l. All material contracts have been disclosed
   m. Financial statements: no material adverse change
   n. Seller has good title to real property

7. Representations and Warranties of Buyer
   a. Corporation is in good standing
   b. Officers are authorized to execute and perform agreement
   c. Agreement does not conflict with law, any other agreement

8. Conditions of Buyer's obligation to close
   a. Seller in compliance with its covenants, representations and warranties
   b. Approval as to form and substance of instruments to be delivered to Buyer at closing
   c. Legal opinion of Seller's counsel
   d. All necessary consents to assignment of contracts, leases, etc. to Buyer have been received

e. No legal proceedings pending or threatened that would affect the transaction or impair the value of the assets
f. Licenses in good standing

9. Conditions to Seller's obligation to close
   a. Buyer in compliance with covenants, representations and warranties
   b. Approval as to form and substance of instruments to be delivered to Seller at closing
   c. Legal opinion of Buyer's counsel

10. Mutual conditions to obligations
    a. FCC consent. Often consent is required to be final, no longer subject to agency or judicial review

11. Application for FCC consent
    a. When it is to be filed
    b. Duty of parties to prosecute in the face of objections

12. Documents to be delivered by Seller at closing, including, but not limited to, bills of sale, assignments of licenses, contracts, leases, etc.

13. Documents to be delivered by Buyer at closing, including but not limited to promissory note, other instruments required to secure Buyer's obligations

14. Further covenants of Seller and Buyer
    a. Control of station not to be transferred before closing
    b. Buyers to have access to facilities and records prior to the closing
    c. Seller to furnish Buyer with monthly profit and loss statements
    d. Seller to use best efforts to preserve the business, maintain equipment, obtain assignments of contracts, leases to Buyer, take all necessary actions to keep FCC license in good standing
    e. Seller not to take any action that would adversely affect its representations and warranties

15. Restrictive covenants, e.g., non-compete covenant, if any

16. Risk of loss upon Seller prior to closing

17. Termination
    a. Different provisions depending on whether caused due to:
       i. Seller's breach or default
       ii. Buyer's breach or default
       iii. Failure to obtain FCC consent
    b. Sometimes provides for liquidated damages from Buyer
    c. Sometimes provides for specific performance by Seller

18. Survival of representations and warranties past closing

19. Indemnification

20. Expenses
    a. Usually each party bears its own expenses
    b. Brokerage fee typically borne by Seller
    c. FCC filing fees usually split

21. Assignment of rights under agreement

22. Name and address of parties to whom notices under agreement should be sent, manner of giving notices, e.g., by hand, registered mail, overnight courier, etc.

ABOUT THE AUTHORS

ERWIN G. KRASNOW

Mr. Krasnow has served as Senior Vice President and General Counsel of the National Association of Broadcasters. He holds a Doctorate of Jurisprudence from Harvard Law School and a Masters of Law from Georgetown University. He is Treasurer of the Broadcast Capital Fund, Washington Counsel for the Broadcast Financial Management Association and a partner in the Washington, D. C. law firm of Verner, Liipfert, Bernhard, McPherson and Hand. Mr. Krasnow is co-author of three books including *Buying or Building A Broadcast Station*, and *101 Way To Cut Legal Fees and Manage Your Lawyer*. He has been described by the *Legal Times* as "a dean of the Washington communications bar" and by *American Film Magazine* as a "super-lawyer of communications."

J. GEOFFREY BENTLEY

Mr. Bentley is an attorney in the Washington, D.C. office of Birch, Horton, Bittner, Pestinger and Anderson, P.C. After graduating from The University of Michigan Law School in 1973, he worked as an attorney in the FCC's Broadcast Bureau for nearly four years. Since 1977, he has been in private practice, representing clients before the FCC on a variety of regulatory matters and advising on legal issues in connection with the sale and acquisition of numerous radio and television stations. Mr. Bentley is active in the Federal Communication Bar Association. In 1982, he co-authored the first edition of *Buying or Building a Broadcast Station* with Erwin Krasnow. He has also been a panelist at several NAB conventions on legal and financial aspects of buying and selling broadcast stations.

ROBIN B. MARTIN

Mr. Martin, founder and chief executive officer of The Deer River Group, has consulted for over 200 radio and television station owners and has owned 12 broadcast properties. As an owner/operator, Mr. Martin runs a group of radio stations and oversees investments in television and cable TV; in addition he is an acquisition and financial consultant to the broadcast and cable industry. He holds a bachelor's degree in electrical engineering and a master's in communication from Rensselaer Polytechnic Institute. He served in the Ford White House and on a number of broadcast industry panels. He is currently a member of the National Association of Broadcasters medium market committee. Mr. Martin is the author *Broadcasting Lending*.

National Association of Broadcasters
1771 N Street, N.W.
Washington, D.C. 20036