

Broadcast Lending

*A Lender's Guide
To The Radio Industry*



national association
of broadcasters

A Publication of NAB Radio

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by
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The Deer River Group



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Other Sources of Information

As you work with your client on the lending proposal, you may have additional questions that neither this booklet nor the broadcaster can answer. These may be technical questions requiring the assistance of an engineer, legal problems that an attorney familiar with federal regulation could answer, or general information concerning future station value in the market that an acquisition consultant could answer. Below are a few of many sources of information about the industry. Any of them can direct you to an appropriate source if they cannot be of direct assistance.

National Association of Broadcasters
Radio Department or
Broadcast Management Department
1771 N St. NW
Washington, DC 20036
(202) 293-4955

Broadcasting Yearbook
Broadcast Publications, Inc.
1735 DeSales St. NW
Washington, DC 20036
(202) 638-1022

Radio Advertising Bureau
485 Lexington Ave.
New York, NY 10017
(212) 599-6666

Reference Note: The Deer River Group is an acquisition consultant and a group owner of radio, television, and cable television properties. The organization specializes in assisting prospective buyers and investors of, and lenders to, broadcast properties in several areas: education in the electronic media; determination of investment strategy; and analysis of potential acquisitions. The firm also consults in the development of financing plans, including preparation of lender and investor presentations, discussions with potential investors, as well as general investment banking functions. In addition, the firm advises on the development of operational plans and budgets, and the takeover and staffing plans following closing of a

purchase.

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I. Introduction

A. The Need for Education

Most lenders and investors entering the radio broadcasting industry have already formed opinions about radio. They know what they like to hear, whether it be music, news, sports, or a particular announcer. They know what the "top" radio stations in their home-town are. And they know which stations have the best reputations in town. These factors only involve the audible signs that appear to clientele of the radio station—its audience. These "hidden" characteristics are what really defines a radio station's value and ability to compete in the marketplace. These factors are the results of many others not heard or seen by the average listener, advertiser, or resident of the station's city of license.

A radio station is a very complex small-to-medium business. Its value depends not only on audible image, but on many other factors relating to areas such as federal and local governmental regulation, size and health of the local economy, other media competition, the expertise and competence of the station's management and staff, and the general desirability of the station in the radio station trading marketplace. Most lenders are not familiar with these factors. In fact, many radio station owners themselves are not able to determine station value or calculate projected return on investment for a new station investment without consulting an outside acquisition consultant, broker, or broadcast economic consultant.

B. How to Use this Booklet

This booklet will familiarize you with the radio industry and the concepts of investing in or lending to a rather unusual business. As a local purveyor of radio broadcasting programs and services to advertisers, the owner of your local station is an expert. The broadcaster knows the earning potential of the business, because he has seen the results through personal experience. Your client would like to make you a proposal for a particular purpose that he understands well. Your client would like to keep the loan on a local basis rather than use a distant but more broadcast-experienced bank because you are an important friend locally and an integral part of the community. Therefore, your local broadcaster has asked you to read this booklet as part of his task of educating you in the intricacies of the industry.

II. Broadcast Industry History and Regulations

A. Broadcast Regulation and Its Philosophy

In the early 1920s, AM radio stations began transmitting in various cities around the United States. They were under no regulation at the time. As more and more stations took to the

airwaves, technical problems of interference became severe. In separate Congressional Acts signed into law in 1927 and 1934, the federal government passed the Radio Act and then the Communications Act. The original 1934 Communications Act and its amendments are the basis for today's broadcasting regulation. Congress created the Federal Communications Commission (FCC) to oversee the regulatory structure. The FCC is an independent federal agency with five commissioners who are appointed by the President and confirmed by the Senate for seven year terms. One commissioner is appointed chairman to serve at the pleasure of the President.

Much of the original philosophy of broadcasting regulation is based on several simple premises that underlie an entire body of regulatory and court decisions. They are as follows:

- stations must be licensed so as to ensure interference-free operation at the highest reasonable technical standard;
- broadcasters use the airwaves as trustees for the public and federal regulation is proper, constitutional, and supercedes any claims of the states;
- licensees operate as public trustees and therefore must be chosen in consideration of their qualifications and character;
- station licenses must be granted so as to ensure the most equitable distribution of radio services among diverse population and geographic areas of the country;
- licensees must operate their stations in the "public interest, convenience, and necessity."

From a practical viewpoint, the large code of FCC regulations affect the individual station in two basic areas—ownership and operation. In ownership, the FCC currently limits the number of stations a single person or group of persons can own to seven AM and seven FM licenses and seven TV stations; the Commission places certain restrictions on the amount of alien ownership permitted and loosely defines the character qualifications needed to own a property; in addition, the FCC requires all sellers and buyers of stations to complete a transfer application which is then available for public comment and requires Commission approval. This last requirement forces a delay in the transfer process that is of more operational concern to the buyers and sellers than is the threat of a successful challenge to the transfer. If a transfer is delayed three months, for example, after the sale is announced, the station employees are understandably confused about the future of their jobs. Until the closing takes place after approval, the buyer may not exercise any control over the station's operation.

From an operational standpoint, the FCC defines detailed engineering standards and procedures that must be followed. These pertain to the operating parameters of the transmitter, its location, frequency, power, tower height, and so forth. The Commission requires some individual operator licensing, and requires that certain logs of stations systems be kept. The FCC is also interested in the station's compliance with equal opportunity laws, fairness and equal time doctrines, and the general responsiveness of the licensee to community needs and problems. The Commission maintains a field staff that spot-checks the technical and paperwork compliance of stations on a random basis.

In addition to the two areas outlined above, the Commission coordinates the allocation and assignment of frequencies to cities of license and licenses to new applicants. The grant of license

to new applicants for frequencies not before used is generally accomplished through either a competitive hearing among the various applicants, or by an agreement among those applicants who are qualified to be licensees. However, Congress has authorized the FCC to use a lottery system, if it so chooses, to decide between substantially equally qualified applicants. To date, the Commission has not expressed an interest in applying the lottery system to applications for AM and FM stations.

B. Changes in the Regulatory Climate

Since the late 1970s, there has been movement to "reregulate" or to "deregulate" the broadcast industry. Both these terms have led to basically the same practical results from slightly different political perspectives, reregulation being the more moderate initial approach to today's free-market deregulation. However, the importance of changes in regulation is how they impact the individual station operator and investor.

Several studies of the impact of federal regulation on small businesses showed that the FCC, in its regulation of radio stations, was creating a paperwork burden unparalleled in the federal bureaucracy. The findings implied that no case could be made for retaining many regulations that were not founded in the enabling legislation of the FCC. The Commission began eliminating many burdensome regulations in the early 1980s, some of which were dropped by the initiative of the FCC itself, others as a result of industry petitions, and still more at the urging of Congress.

The impact of these changes affects both ownership and operations of stations. Many of these changes are still in the process of refinement and issuance, and the pace of change is very fast. So while there are examples here of some of the new regulations, please rely on the updated advice of your local broadcaster, an FCC attorney, or your own broadcast consultant.

On the ownership side, the FCC has rejected a proposal to require the splitting up of AM/FM combinations. It is considering raising the number of stations a single group of investors may own to a figure yet to be determined, but above the current seven AM and seven FM limit. It has also raised the limit of ownership that can be held by passive investment institutions, like banks, without counting the individual stations against the station limits.

In operations, the FCC has lifted many paperwork requirements, including the preparation and storage of program logs, simplification of engineering logs, and very streamlined renewal forms. Radio renewal license terms have been extended from three to seven years. There are no more requirements for proficiency examinations for engineers. There are no more minimum standards for public affairs, news, and other non-entertainment program percentages. There are no more requirements for formal ascertainment surveys of local public problems. And there are no limits on the number of commercial messages which may be aired during the broadcast day or hour.

Many other changes are contemplated or have already been proposed. The net effect of most of these changes has been a freeing up of the time previously spent by the broadcaster in completing forms that did not relate to increasing the quality or productivity of the radio station. The changes open up the avenues of free competition where each station must be successful on its own merits without depending on the federal government to assist.

III. Economics of Advertising Media and Radio

A. Revenue Sources for All Media

All media aimed at a mass audience (as opposed to those aimed at specific trade, wholesale, or business audiences) derive their operating revenues from relatively few sources. For the electronic media, almost all revenues come from advertising, which may be broken down into local, regional, and national advertising. Mass print publications receive a significant amount of revenue from circulation income not available to radio or TV, in addition to a large share of advertising revenues. Cable TV, at this time, derives virtually all of its revenues from subscription charges, with an increasing but still small amount coming from advertising.

The bulk of local radio advertising comes from retail outlets, such as banks, food, auto, and department stores. National or regional advertising revenues are mainly derived from either chain retail stores (such as fast-food restaurants), discount department stores, regional specialty shops, or manufacturers or providers of goods and services such as cosmetics, soft drinks, airlines, and brand-name foods.

Each advertiser develops a marketing and advertising strategy which is then implemented either by an employee of the concern buying the advertising (this is the case with most small local businesses), or by an advertising agency acting on behalf of the business. All national, most regional, and some local businesses use agencies. Agencies charge a fee (usually 15 percent) based on the total advertising expenditure for its services. The 15 percent commission is normally added to the basic ad cost or deducted from a rate specially constructed for agency buyers.

Historically, total domestic advertising revenues have grown much faster than the rate of growth of the Gross National Product (GNP). As the consumer economy expands, the competition among competing businesses and products intensifies, with more products and services chasing roughly the same number of consumers. This fight for market share forces businesses to develop better products at lower prices and to expose them to the public through advertising. The advertising vehicle is so powerful that if a business uses advertising effectively, it can overcome many other objections to customer purchase.

B. Sources of Income for Radio

The traditional method of selling radio advertising is through the sale of advertising time. Most stations offer discrete units of advertising, such as the minute, half-minute, or ten second "spots." Some stations offer longer spots, such as five minutes, while others offer to sell entire half-hour or hour programs sponsored by the advertiser.

An advertiser may buy "run of schedule" advertising, which consists of spots placed in a variety of time periods during the broadcast day. The advertiser may buy particular time periods, or even fixed position spots that run at particular times. Or the advertiser may buy sponsorships of special features, such as news, weather, or sports events. Generally, the better the time period and fewer the spots an advertiser commits to in a schedule, the higher the per spot price.

One source of advertising revenue available both nationally and locally is "co-op." Under this sort of plan, a manufacturer

will pay for part or all of a local distributor's media cost in placing advertising. Most retailers are unaware of the availability of co-op dollars or are unwilling to process the paperwork to satisfy the manufacturers. But estimates reveal that hundreds of millions—or possibly *billions*—of co-op dollars are left unspent each year!

Radio traditionally draws on the same sources of advertising described above. The differences between radio's appeal to the listener and the appeal of other media are reflected in the particular mix of advertiser categories on radio. Radio projects a sound image which is a powerful tool in creating innovative mental images to sell a product. However, there are some advertisers who still believe that hard-copy print or moving-image television is the only way to "show" a product or service. Most local and regional supermarket chains and many clothing outlets maintain art departments for pasting up newspaper ads. The radio industry and individual stations must educate retailers about radio's effectiveness in increasing traffic for their stores. With each passing year, more and more advertisers try radio in their mix and find that it does produce results. There are fewer and fewer advertisers who decline to utilize radio at all.

Other services in addition to the standard radio advertising are being developed all the time. For example, some stations sell blocks of time to religious organizations, which then program fundraising efforts. Other stations sell the use of their SCA (subcarrier authorization, a radio frequency requiring a decoding device) to background music services. Some stations create their own services. Many broadcasters use their facilities to co-promote local concerts and other for-profit events. Also, AM and FM towers have rental value to non-broadcast users, such as paging services and microwave communications companies.

A number of stations also barter commercial time in return for merchandise or services of advertisers, rather than for cash. This use of advertising time should be watched carefully, for it can lead to abuse if not controlled, and it can diminish the cash value of the advertising time. Bartering is most useful for acquiring assets, services or merchandise from a business that will not buy time on a cash basis otherwise.

There are many other uses of a radio station's tangible assets and human talents that can create additional revenue sources for stations.

C. Projecting a Radio Station's Revenue and Growth

One way to estimate a radio station's potential for sales and sales growth is to create a model for projecting local advertising revenue. Other sources of sales may be known and should be added to the local projections, but projections for such areas as national advertising can only be estimated with the assistance of a national or regional sales representative. The rep will combine a station's internal projections of ratings (the station's ranking among other stations in the market) and demographic market shares (an analysis of the types of listeners broken down by age and sex) with a knowledgeable estimate of the dollars available in the market to arrive at an estimate.

Estimates of local revenue can be tied to historical figures that the FCC collected up until 1980. (The FCC decided not to collect the information for any future years.) These figures exist for local, national, and regional sales, expenses, and profit. The only FCC figures that are useful are sales figures. Expense and profit figures tend to be distorted, because most small broadcast

companies are closely held and therefore the owners operate their businesses so as to minimize profit and taxes, not maximize them. The figures gathered by the Commission have been released to the public for each market as a whole, but only for those markets with three or more independently owned stations. This procedure protects the confidentiality of each station's information.

Examination of the sales figures reveals a relationship useful in predicting future sales: the ratio of total sales in a market to the total retail sales in the same market. Nationally, about three-tenths of one percent (0.3 percent) of retail sales is translated into total radio dollars. Each market varies slightly from that average, but most by a small margin. The reasons a market could vary include greater and better competition from other media, proximity to nearby media or retailing markets, a traditional bias for radio by local advertisers due to strong educational efforts, and so forth.

To estimate the dollars available to radio in a market, it would be wise to use this national average and apply it logically to the local area. First, the market to be covered must be defined and the retail sales estimates found. Next, multiply the retail sales estimates by 0.3 percent and derive a total market radio sales estimate. If there is more than one station in the market, or if there are stations in nearby towns that will compete for radio dollars in the local station's coverage area, you must then estimate a share of the local dollars for each of the stations. This estimate will be much more subjective, but can be done fairly reasonably with good local information. For future years, the process is the same, but you will use local estimates of future retail sales as a basis for the calculation, and varying market shares, based on the operator's projections.

IV. Operational and Competitive Strategy

A. Departmental Structure of a Radio Station

Some radio stations use elaborate organizational structures that include a business office, an advertising and promotion department, news and sports departments, and more. For simplicity, and to indicate the most common structure of a radio station, this booklet will describe the four departments always found at radio stations—programming, sales, technical, and general and administrative.

The programming department is the heart of the station. It provides the sound product that attracts listeners and sells advertisers. Usually a program director or operations director heads the department, which also includes other functions such as news, sports, audience promotion, and audience advertising. This department is responsible for implementing the programming strategy and philosophy developed by the general manager and program director. Everything that goes out over the station's signal is put together and aired by this department. Programs may originate live from a local studio, play over a tape automation system, or be broadcast from a distant satellite source.

Elements that comprise a local station's broadcast day include music, weather, local and national news, features such as talk shows, public service broadcasts, sports broadcasts, and a host of other special programs created or acquired for the local station. The purpose of the programming department is to execute a format of information and entertainment that fits a need of the community, that is saleable to advertisers, and that is within a budget set by the station's management. Even including those stations using automated or satellite-delivered long-form (hours at a time) programming, every station's sound is unique. No two have the same character, no two are localized the same way, and no two have the same attractiveness to advertisers.

The sales department consists of a sales manager and a sales force of local representatives and regional/national representatives. This sales team packages the station by developing rates for commercials and features to sell. Individual salespersons take time and money to train, and are therefore a very valuable asset of a radio station. Many training courses and consultants are available to assist local management in sales development, but the key to increasing sales that is more important than training is hiring the right people. If a station has a sales team that has worked together at the station for an extended period of time, the station should perform very well.

The smaller the market, the more critical are the relationships the salespeople develop with their accounts. With each additional month and sales call on the same account, the station's rep has more of an understanding of the client's business and personal habits and needs. That, in turn, allows the rep to create an advertising plan for the client that meets his expectations and should fulfill his business objectives. To many stations, the Radio Advertising Bureau's (RAB) "consultant sell" approach is the ideal one. This method projects the salesperson into the role of an advertising consultant to the client, advising the client of the broad picture of advertising for the business and in the community, while at the same time selling the virtues of radio and the station.

The technical department is now a fairly simple one, since the requirements for the technical maintenance are not difficult. Many stations with complex systems employ full-time chief engineers. Others with less equipment hire the services of outside contract engineers who live in the area. The local engineers, whether contract or employed, will perform routine logging requirements of the station and maintenance on all equipment, and will help design new studios, buy new equipment, and install simple additions to the existing plant. A number of well-qualified consulting engineers offer their services to stations for the major engineering tasks, such as applying to the FCC for new facilities, changes in tower height or antenna location, increase in power, and so on. For most stations, though, the bulk of the work to be done on a technical basis is studio-related maintenance.

The general and administrative area is the one that includes the functioning areas that are the back office—bookkeeping and the administration. A station may categorize the general manager (GM) as the chief administrator, although the GM is often placed in the sales department to emphasize his critical role as the lead salesperson. Most stations employ a full-time full-charge bookkeeper or office manager who is responsible for sending out the billing, managing the accounts receivable and payable, maintaining the ledgers, and creating profit and loss statements. An outside accounting service is sometimes employed to produce the profit and loss statements and handle the payroll mechanics, thus cutting down on internal needs. This

department is the catch-all for duties and functions not related to any other, such as liaison with rental property owners, taxing authorities, utilities services, legal and accounting firms, and so on. As computing hardware and software becomes less expensive, more stations are acquiring them to automate both traffic (the scheduling of programming and commercials) and billing, as well as general ledger functions.

B. People—The Key to Success

In all the departments described above the key ingredient to success is good people. There are people who not only have skills and intelligence, but who also have commitment to the radio station and the community. It is those people who spend inordinate amounts of time working at the station because they love it and they want it to succeed. The department heads are the most important people at the station, for they create the atmosphere and work environment for the rest of the staff. A radio station thrives on its morale. The more excited everyone at the station is about the sound and the ability of the station to be a winner, the better its chances of doing so. A radio station sells excitement and entertainment that can only be created by excited people.

C. Managing a Competitive Radio Station

In each one of the four departments described above, the management team must have a clear strategy and a plan for its implementation. The programming department must have a good picture of the competition—its strengths and weaknesses—and the audience that each station is aiming for in the market. Armed with that information and a sense of what its own station's strengths and weaknesses are, the team can develop a programming plan that targets the audience picked by the station. The implementation plan should include such elements as the requirements for personnel; wire, network, and local news services; live or automated entertainment fare; and sports and other features. If the station is in a market surveyed by Arbitron or Birch (currently the only two national radio ratings firms), then the programming department must also plan for additional promotional activity to position the station for ratings success.

In the sales department, finding the right people and keeping them are the keys to long-term consistent performance. If there is high turnover in salespeople, the advertising community will know it and will not develop relationships with the station conducive to increasing sales volume. The sales manager (or general manager if acting in that capacity) must be a solid individual, have a close knowledge of the community, know how to identify, hire, and train new salespeople, and be keenly aware of the internal relationship between the sales, programming, engineering and bookkeeping departments that is critical to the station's success.

The engineering and general and administrative departments must be responsive to the needs of their respective constituents. They are both service departments that provide products and support for the sales and programming departments. The equipment at the station needs to be functioning and provide the best possible sound for the listener at all times. A station cannot expect peak listenership or strong programming department performance if the production or transmitting equipment is poorly maintained or not state-of-the-art. Listeners

do not know what state-of-the-art equipment sounds like, but they do know which station in town sounds the most pleasing and the most professional. The back office must give the sales staff the best information possible on the current receivables status of the station's clients, on availabilities on the program logs, on each salesperson's performance, and so on. Management and ownership reports are critical to the operation of any small business, and owners must have direct control of such reports as monthly profit and loss statements, balance sheets, payroll summaries, aged accounts receivable lists, and payables updates. In addition, the bookkeeper needs to monitor the filing requirements of all governmental agencies and prepare the books at year-end for the outside accountants to use for tax return and audit preparation.

V. Evaluation of Radio Properties

A. The Market for Radio Stations—How It Works

Like any other business, radio stations exist in a market that trades in the assets, stocks, and licenses of the stations. Unlike other businesses, however, every time control of a radio station is transferred, the sale must have prior approval of the FCC. This involves two steps: the parties agree to a sales contract that is subject to FCC approval; then both buyer and seller complete their respective portions of the FCC transfer application and submit them to the Commission for approval. The reason for Commission approval stems from the original Communications Act and subsequent rulings, which set certain guidelines for the ownership and transfer of licenses.

The license transfer application is available for public comment or petitions to deny for a specified time period. Following that period, the Commission is free to approve or deny the transfer, or to impose conditions on the transfer which would bring the transfer into compliance with the Commission's rules and regulations. It is normal, barring unusual circumstances, for licenses to be transferred without Commission changes, and although extended delays in the process do exist, they are most often caused by lack of manpower in the FCC rather than by substantive problems with the application.

Many stations in smaller markets, or that sell for low prices, are sold directly by the sellers to buyers. A system of brokerage is available to assure the seller that potential buyers are screened before they see the financial data or physical plant of the station. Most sellers are legitimately concerned about maintaining the confidentiality of the sale, because information leaks can damage a station's image. If the station's employees become aware of the sale without being told by management, their respect for the owner's honesty is compromised. Most employees fear for their jobs during a sale and begin looking for new positions immediately. Competing radio stations use such information to advise advertising clients not to buy time on the station that is being sold because there will be major changes at the station. And as the financial data of the station being sold are widely circulated in the industry, the owner is less able to negotiate a reasonable deal if potential buyers think

the station has not been sold quickly and is a difficult property to buy.

There is an active market for the sale and purchase of radio stations. About 10 percent, or 700-800, of all radio stations change hands each year. The bulk of stations that are up for sale are transferred within six to nine months after the initial offering. But there are wide variations on sale times as certain categories of stations are studied. For instance, daytime AM stations in competitive markets take a longer time to sell, while highly profitable full-power FM stations in growth markets sell very quickly. The pricing and flexibility of the terms of the sale as set by the seller also determine the speed of a sale.

B. A Station's Value—Tangible & Intangible Assets

The radio business is different from most traditional manufacturing or service industries. The companies that own stations normally have few tangible assets beyond those required to broadcast their signals: broadcast studio and transmitting equipment, towers and antennas, and the real estate needed to house those assets (which may be owned or leased). There is no inventory and no work in progress. The intangible assets are comprised of the use of the license (which is only granted to the licensee and not owned by it) and the goodwill of the station. The goodwill has a number of different forms. It includes the base of advertiser and listener support in the community and also includes the general staff of the station, which is enhanced by the competence and longevity of individual staff members.

As radio stations sales are analyzed, the ratio of tangible assets to goodwill varies with the size of the market and therefore the sales of the station. The smaller the station, the more tangible assets will be present as a percentage of total station value. As the price of a station goes up, the percentage of tangible assets compared to total price declines. As an example, if a small market radio station sold for \$300,000, it might have tangible assets and real estate worth \$200,000, representing 66 percent of the station's value. A station selling for \$3,000,000 might have assets worth \$1,000,000, representing 33 percent of the total value.

A change in the ratio of tangible assets to goodwill from one station offered for sale to another does not imply a change in the validity of either station's value. Physical assets play a very small part in determining the overall value of a station, and only become a serious factor when they either hinder the short or long-term growth potential of the facility, or if there are assets that have a value for use other than in a radio station that justify their value separately from that of the radio station.

Most stations are sold at a price determined in lengthy negotiations between buyer and seller. Several guidelines are used to frame the price and terms in view of the business realities and growth potential of the station. Sellers of stations calculate both their broadcast cash flow figure and gross cash sales figures in the present and make rough estimates of those figures in future years. (Broadcast cash flow is gross cash sales, minus commissions, minus the station's operating expenses; it is the same as operating cash flow before depreciation, interest, and taxes.) Multiples of cash flow and sales are used to estimate rough values of stations. For mature stations with limited future growth, buyers are willing to pay in the range of six to ten times cash flow for a station; for a high growth potential property, they might pay between eight and fifteen times cash flow. If a station has a negative cash flow or another unusual situation, these multiples would not apply.

A more difficult multiple to use is one of gross sales. Cash flow is what ultimately pays for the station. Similar revenues do not directly relate to similar cash flows at different stations because operating costs from station to station and market to market vary greatly. However, if cash flow in a particular station can be raised by cutting expenses and maintaining the level of service on the station, then high sales cap indicate strong cash flow potential. Most buyers are willing to pay one and a quarter to two times sales for mature stations, and two to four times sales for growth situations.

C. Use of Appraisals

Stations are bought because the buyer feels he can do a better job of increasing sales and cash flow and therefore future value than the seller was able to do. The prices paid for most properties indicate that the buyers foresee substantial improvements in performance. It stands to reason, then, that the value of a property depends greatly on the plans and expectations of each buyer. One buyer may see little growth in a station and be willing to pay a certain price for it; another buyer with a different perspective may see an opportunity with the resources available to build the station dramatically, and therefore may offer a much higher price for the station. Who is right? Both are using their best judgement about the future of the station. Each proposed acquisition must therefore be judged on the credibility of past record and performance of the buyer. If the buyer has judged situations correctly in the past, has a record of strong operating experience, and has the resources to implement his plans, then his plan is just as valid as someone with lower expectations.

If an appraisal is used to value a property, remember that it is prepared by an independent individual whose sole purpose is to attempt to determine what the market value of the property is today—that is, what price and terms the station will sell for in today's market using information generally available to any buyer. The appraiser will use yardsticks and methods of determining value that may not incorporate the wisdom and planning skills of an individual buyer. This may tend to undervalue a property if the buyer is astute, or it may overvalue a property if the buyer is not experienced. A good appraisal will be detailed as to the assumptions of future performance, and will allow you to judge its relevance to your client's plans. Radio station appraisers are experts in the field, and their estimates of value can be relied on as true indicators of market price. As in any industry, the consistency of appraisal figures may vary from one appraiser to another depending on the qualifications and experience of the appraisers.

D. Investment Strategy Choices

Before any prospective investor commits funds to a broadcasting property, there are a number of questions that must be addressed relating to overall investment strategy. Rather than illustrate the wide variety of possible investment choices an individual might have, it is simpler to pose typical questions that should be asked before an investment is made. Each investor or group will answer questions according to the perspective and

resources he brings to the deal. The questions that follow are typical of those an investor might ask of any deal:

- Is this a long-term or short-term investment?
- Do I want to turn around an ailing station and add value to the property with my own work, or would I prefer to buy a more mature property that is producing cash flow consistently and does not require much additional management expertise?
- Do I want to be an owner-operator so I can learn the business, or do I want to be an absentee owner and hire a manager to live and work in the community?
- Will I depend on the station to support me from the day I close the deal, or can I allow the station to develop before I can take out any earnings?
- Do I need partners or additional financing to make the deal work? (This implies cash needs for not only the acquisition itself, but also for any capital improvements, promotions and advertising, and working capital not available from the cash flow of the station.)
- If I get partners, do I need persons with experience in broadcasting, or can they be passive investors?
- Should I build a new station and create (from nothing) an image, a sound, and a staff, or should I buy an existing property?
- Should I buy an undervalued AM with the prospect of building it up and raising its perceived value and price multiple, or should I stick with known good value and buy a more expensive FM?

There are many more elements to structuring the strategy of a broadcasting investment, but the issues posed by the above questions raise many of the central points of concern.

VI. A Look into the Future

A. The Growth of Advertising Media

Advertising media have been expanding at a growth rate far exceeding that of the general economy, as measured by the Gross National Product. All important economists predict that this trend will continue for the foreseeable future. The media provide inexpensive, flexible, and—in the case of radio—portable entertainment of almost any variety one chooses. The media attract huge audiences and therefore provide a somewhat captive and measurable group of consumers who can be reached through media vehicles. As our capitalist society expands and even contracts during recessions, producers of goods and services need to educate potential customers as to the existence and value of their products. The competition of increasing numbers of suppliers of similar retail products forces each producer to create a niche in which the business can carve out a market share for the product. Only advertising can create the awareness and the level of understanding needed for a consumer to make a buying decision.

B. Competitive Change in Media

During the last few years, there has been an explosion in the number of new additions to the list of electronic media and communications systems competing in the marketplace. This section will only discuss those media that will be competing directly with radio, either for local or national advertising dollars.

The video- or television-oriented media are creating new methods of distribution at a rapid pace. Cable television has existed for years, and provides the local viewer with better local signals while importing distant signals, pay services, and made-for-cable programming. On many of the pay channels, local systems are selling and inserting local spots, and using rates and marketing techniques similar to those of radio. No significant revenues have been allocated to cable on a local level yet, but it promises to be a strong competitor to radio. Cable is now carried in more than 40 percent of all U.S. homes. Satellite transmission will be a new source of multi-channel television service for many rural and ex-urban viewers in the near future. These channels will carry national advertising to defray the enormous start-up costs and produce a profit, but will carry no local programming.

Many of the other new technologies require in-home equipment, such as video disc playback machines and videocassette recorders and players.

The new audio improvements are mainly centered on the improvement of the quality of sound over broadcast stations or at home. One of these improvements is the use of digital processing to reduce noise. The equipment is now available, but is just being put into use by recording studios and radio broadcasters. AM stereo radio broadcasts will become more available to the listening public over the next few years, and will mark the first change in AM sound in years. Radio broadcasters are now switching to satellite reception of their network services. This will enable individual stations to improve the quality and diversity of their network programming. A satellite distribution system allows the network to send many more hours and different types of programs to their affiliates each week, thus enriching the local programs with special features and news from around the world.

C. Radio as a Unique Medium

Radio is unique because it is the only medium, electronic or otherwise, that is truly flexible. It requires only the ear's attention to be fully appreciated. Therefore the technology can be contained in a small environment and can be transported virtually anywhere—in a car, in a headset, or near a pool. Its detractors would say that radio does not have the ability to create a visual image the way a video medium does. But if an announcer on the radio suggested the image of an elephant charging down a nearby hill, through a grassy field towards you, I do believe you would have a very clear image in your mind. And that is why radio has survived and prospered through all the years and all the competition—it relies on and stimulates the imagination of the listener. Radio creates a world of entertainment that each listener wants to hear and be a part of, and thereby creates an advertising environment that cannot be duplicated.

VII. Lending Opportunities and Considerations

A. Security

Lending institutions have several considerations to examine while reviewing a loan application. The main ones include the nature of the business enterprise and the character of the borrower. But high on the list of important topics is security. Since radio stations have few tangible assets relative to the total market value or purchase price of the station, a lender must derive comfort in additional ways that the loan is protected.

The protection available to a lender is multi-faceted. The value of a radio station is easily appraised by experts in the field. You can request an appraisal be conducted in such a fashion as to indicate value under normal and reasonable operating conditions expected under the borrower's leadership, as well as the value of the bare license and tangible assets, without any significant goodwill. The last figure will give you the worst-case value of the property. There is such a value for every radio station and it is higher than the value of the equipment and real estate because the license itself has an intrinsic value, which is determined by its power and frequency, and the city of license. A certain value even exists when the station is not operating on the air.

In reality, the vast majority of radio stations that have operating difficulties do not go silent (off the air). Under bankruptcy proceedings, the courts still must abide by FCC transfer regulations, and in most cases the trustee encourages the continued operation of the station to protect the value of the station and the security of the creditors. There are lawyers and brokers who are familiar with distress sale properties and who can assist the parties with interest to retain the value of their assets and to ensure an efficient transfer of the license.

In many acquisitions, the buyer will use more than one source of funding to complete the transaction. The elements may include venture capital equity or debt, stockholder equity and debt, seller debt, and bank or insurance debt. To retain the best position with respect to the security of the assets, many debt lenders insist that they have a first security position with respect to all the assets, including the tangible equipment, real estate, furniture and fixtures, and record library. Receiving a pledge of the stock of the licensee corporation or a power of attorney from a partnership or sole proprietorship allows the lender to retain some rights to the license. Those security rights would be tied to the lending agreement, and would always be subject to approval by the FCC if they affected a change in control of the license.

A lender also would gain additional comfort if his loan is senior to other debt or equity rights. In other words, a senior bank loan might have precedence over a venture capital company loan; if the station needed additional funds not readily available to the owner, the venture capital firm would have a vested interest in arranging additional sources to protect its junior position. Most sellers, however, will not give up their first security interests in the assets unless a

significant, if not the entire, portion of the acquisition price were paid in cash. A lender can be of valuable assistance to the buyer during the acquisition negotiation process and prior to the signing of a purchase contract by detailing its security requirements for a particular transaction.

B. Acquisitions

A potential client may propose to you that you lend a radio group funds to assist in the acquisition of an existing station. You should expect a full presentation on the past, present, and future operations of the station. You will be able to judge the buyer's competence to some degree by the sophistication of the presentation and the client's ability to verbalize clearly the station's future plans.

To be a complete proposal, the presentation should contain at least the following elements: a narrative history plus a compendium of facts and figures about the market; a history of the station's position and competition in the market; a history of the ownership and operations of the station; a detailed briefing on the purchase terms and conditions; a plan for the financing of the acquisition, including working capital, improvements, and contingency funding; proposed ownership structure of the new venture; short and long term financial projections, including profit and loss statements, with assumptions and justifications, balance sheets, and debt repayment schedules; and the exact loan request to be made of the lender.

An acquisition, by its nature, is a less risky venture than a new start-up radio station. The station has established a going market value based on its history of sales and cash flow. However, the price a buyer must pay for a going station reflects this additional value and most properties sell at a price that includes a significant amount of goodwill.

Borrowers who are buying existing properties can often obtain financing from the seller for a major portion of the total price. In addition, some of the remaining consideration may be in the form of a consulting agreement or an agreement not-to-compete with the seller. If a bank loan is requested, it may be for working capital, capital improvements, or the down payment. If the buyer has received seller financing, he may well have had to pledge all the tangible assets and the stock of his company to the seller. (The FCC does not allow the direct pledging of the license, since it is only transferable by prior FCC approval.) The borrower will most likely wish to secure the bank loan with the cash flow of the station or the excess value of the station over indebtedness as measured by an outside appraisal.

C. Constructing a New Station

If a person has just received a construction permit (CP) from the FCC to build a new station, all the grantee has claim to is a piece of paper. There usually is no equipment or real estate, and there definitely is no on-going business, for the station is not yet on the air. The CP, however, has a value. It is anticipated that the Commission in the near future will allow CP holders who have not yet put the station on the air to sell the CP at a profit. Presently they are only allowed to sell at a profit after the station has been on the air for a certain period of time, depending upon the circumstances of the CP grant. Otherwise the owner can only receive the actual costs spent in obtaining the CP.

For a new CP to gain significant value over the assets acquired to put it on the air, it must become a factor in the local media market. This requires solid programming, sales, and staffing planning. It also requires advertising and promotion to announce the station's arrival and to attract listeners. For a period of several months after the station goes on the air, there will be virtually no sales and even less cash flow from operations. Therefore, the station needs funds not only to build the station, but to promote it and to operate it more than a few months without cash flow from operations.

Even with all the start-up costs of a new-build station, the total funds required will be less than for an acquisition, because goodwill is not being acquired—it is being created by the owners. The owner will probably have available the assets of the station to pledge for a loan unless he has decided to lease rather than to buy the equipment. Once the station is on the air, it will have a value that is almost instantly higher than the tangible asset value; how much higher will depend on the type of facility, market location, competition, and so forth. There is a market for both unbuilt and newly built CPs that enables fairly easy sales of such properties.

D. Upgrading an Existing Facility

Radio stations, like any other businesses, need periodic updating of plant and equipment. The audio and transmitting equipment available on the market today generally has a useful life of five to seven years for studio equipment and ten years or more for transmitting gear. Much of the equipment in ongoing stations has been in service for a number of years and needs to be upgraded. It is customary for well-run operations to budget a capital outlay program to replace the major equipment in their stations on a regular basis, and to budget for regular and continuing maintenance.

Stations also move their physical facilities, either studios, transmitter sites, or both, as circumstances warrant. A move could be appropriate if a studio lease has expired or the rent has dramatically increased, if the station decided to build new studios on its own or more attractive leased property, or if moving the tower(s) would create a better signal. The costs to move a studio facility or tower site can be significant and should be considered as a long-term upgrading of the station's total assets. It may be difficult to assess the immediate impact of a move on revenues, but the station's owners should be ready to justify the expenditures in a formal presentation.

E. Refinancing Loans/Packaging New Groups

Refinancing existing indebtedness in the radio industry is no different than in any other business. The various reasons it may be advantageous to the owner include the ease of administration by consolidation of a series of different loans, stretching out loan terms, adding new working capital to bolster operational strength, changing interest rate structure from floating to fixed or vice versa, and so on.

Occasionally an owner will package existing financing on one or more owned stations with a new acquisition or a major upgrading project. This type of financing or refinancing allows the lender to gain additional security in the form of the business value of a group of stations in diverse markets rather than the value of only one station in one market.



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