Broadcast Station Valuations

In reality, one does not know the true "worth" of a broadcast station until that station has been sold on the open market. An after-the-fact analysis of station sales shows that, historically, broadcast stations have generally sold for (1) a multiple of Operating Income (so-called "broadcaster's cashflow"), (2) a multiple of revenues, or (3) some estimated market value which in turn represents an analysis of items (1) and/or (2).

In furtherance of an after-transaction analysis, it is often necessary to resort to a Price per Population or other such approach to reach a valid and reliable measure of value to be used in a predictive mode. This approach does not allow for an estimation of the impact that a station's operations or existing market conditions may have had in the buy/sell decision, however, it does serve a consistent approach when such qualitative information is not available.

Fair Market Value

In valuing closely held corporations or sole proprietorships where market quotations are not available, other available financial data, as well as all relevant factors affecting the fair market value may be considered. **Fair Market Value** is defined as the price at which a business would change hands between a willing Buyer and a willing Seller when the former is under no compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts. It is also generally understood that the parties have had the ability to buy or to sell and the transaction will be in cash or cash equivalents. In the United States, this value is the most widely recognized and accepted value related to business valuations.

Operating Multiples

The size of the multiple is most likely to be based on factors such as past Operating Income, past and projected economic conditions in the market served, available financing, competition, and perceived potential for improved operations. For the most part, estimated market values are the result of a projected performance as a percentage of local retail sales.

"Broadcaster's Cashflow"

Broadcasters regularly refer to Operating Income as "cashflow"; a misnomer. What a broadcaster means as cashflow is the profit before depreciation, amortization, interest, income taxes, non-recurring one-time charges, and non-operating corporate allocations, all of which could be subtracted from a new owner's profit and loss statement.

Revenues

Occasionally, broadcast stations will sell at a price based on a multiple of revenues. There is some justification for a station sales price based on such a multiple because of the ease with which radio operating expenses can be predicted.

When a station is purchased on a multiple of revenues, the Buyer is anticipating future operating profit or cashflow with the expectation that station programming and/or operations can be improved and anticipated increased revenues will be realized. The Buyer is still buying earnings, even if there are none at the time of the sale. Revenues are converted into projected earnings by the revenue's multiple.

The Relationship between Revenue and "Cashflow"

It is frequently assumed that at least 25% of the revenue of a broadcast station will be realized as Operating Income or "cashflow". This is not true for every station, but it is often considered a conservative estimate of broadcast station potential. There are stations which will show 45% to 55% of revenues as pre-tax income and some which run negative.

Once a station has reached equilibrium and is in the "black", it is estimated that 70% to 75% of additional radio revenue will flow to pre-tax income. Of course, not every station will operate on such a basis, but this increased earning potential is one of the major factors making broadcasting an attractive investment.

With the assumption of 25% of revenue converting to broadcast cashflow, the multiples applying to revenues or cashflow as a determination of station value net the same results.

For example, in today's market, many Buyers are agreeing to pay five to six times cashflow for broadcast station. This is a "market value" determination. With an assumed 25% cashflow, these multiples would equal 1.25 to 1.5 times revenues. In commonly acceptance real estate parlance, these valuations are equivalent to a 5% to 6% cap rate.

Ability to Service Debt

Another approach to establishing station values is based on a station's ability to service debt. This approach attempts to project the amount of debt a station's cashflow could serve given certain financing assumptions.

For example, if a station at the time of sale is capable of generating an average monthly cashflow of $20,000, a maximum, fully-amortized Note of $1.5 Million could be retired in ten years given an interest rate of 10% per annum. If this figure represents 75% of a station's purchase price (assuming a 25% cash down payment), the station's sales price ("value") becomes $2 Million (slightly more than 8 times cashflow).

The valuation resulting from the "debt service" model will vary depending on the terms and conditions of the financing. Today, non-regulated lenders are charging up to 15% interest and seller-financing is going for 6% to 7% interest per annum.

Base Value

Sometimes, it is necessary to calculate the value of a station in a given market when there is negative cashflow or the station is off the air. A similar situation occurs when a station has

recently signed on the air and, while it does not have a history of business success, the station may be experiencing significant increases in revenues and market share on a monthly basis.

This also occurs when a station is operating in a non-commercial or not-for-profit mode on a commercial frequency (applicable to radio stations where there is a distinction between the reserved and/or commercial band) or on a frequency which would warrant a greater value if operated in a commercial or for-profit mode. The licensed value has a higher "best use" value when operated in a commercial mode, regardless of all other aspects.

The "base value" approach is based on a mathematical approach to projecting how a particular station or stations would be able to perform given an average share of market listeners and an average share of market revenues.

All such station valuations are highly subjective. Station performance is driven in varying degrees by management, programming, technical facilities, operating parameters, and the health of the local economy. Although this approach to station valuation tends to penalize the hypothetical station which might be a recent addition to the number of stations vying for a share of the marketplace, it should not be assumed that the results is a "zero-sum" situation whereby the available revenue pie will not expand and every competing station must expect a proportionately smaller slice.

In fact, experience has shown that as new stations enter the marketplace and establish themselves and their programming niche, new advertising dollars will be introduced into the total advertising revenue mix. While there is no guarantee that the newest station to enter the market will garner at least its proportionate share of the market listeners and/or its proportionate share of the market advertising revenues, this model does provide a reasonable assessment of the average, potential "worth" of the new and/or struggling station.

Value of Station Assets

The book value of a station's tangible personal property has very little relationship to its marketplace value. Broadcasting as an industry is unique inasmuch as the operating and production equipment rapidly depreciates in value either as a result of accelerated depreciation schedules or actual obsolescence while the station revenue and cashflow increase.

A good example of this can be seen in the fact that with the exception of certain variables, a radio station can be licensed and constructed to a small market for approximately $150,000 while at the same time the same radio station could be constructed to serve a major market for very little more. Nevertheless, the station located in the major market would be worth several times more than the small market station.

It is not uncommon when discussing station values with station owners who are considering the sale of the station to hear the position taken that the station is "worth" a certain amount because "That's how much I invested in it." The truth of the matter is that there is no direct relationship between how much money the station owner has invested in the station and the value of the station in the market place.

This is not to say that a well-equipped and constructed station which shows pride of ownership will not attract a Buyer quicker or at a higher value than a station which is poorly-equipped and constructed. However, often the “turnaround” station, appropriately priced, may sell faster than the station which operates at the top of the market. The driving force behind the value of any station is its revenues, cashflow, and/or its potential for achieving those.

Valuation Based on "Price per Pop"

It has become a common practice in broadcasting to gauge an estimated value of a station, whether radio or television, on a so-called Price Per Pop ("PPP") meaning a per-capita valuation tied some predicted or historical price that a purchaser might be willing to pay or a seller might be willing to accept, tied to the population base served by the station in question.

This PPP methodology is useful when no meaningful or limited financial information is available on which to base an appraisal. Such instances can occur when a prospective purchaser desires a "pre-acquisition" appraisal in order to determine a reasonable offering price. Another instance where the PPP methodology may be employed arises when station revenue is generated via translator-served areas. In fact a translator by itself is not going to be a primary source of revenue, and the translator on the open market would not be expected to fetch the same value as a primary station. Nevertheless, the population served by the translator does contribute to the potential revenue-stream of the primary station, therefore the population served does factor into the appraised value of the primary station.

The downside to the sole utilization of a PPP methodology without linkage to comparable sales is the possibility of not allowing for regional differences, a local economy, or a like-kind comparison of station performance underlying the financial calculation.

Non-Commercial Stations

In the experience of non-commercial operators, we have found that many so-called “rules of thumb” do not apply as they would with commercial operators. Many non-commercial operators are relying on subscriptions, donations, or other non-commercial “underwriting”. The experiences from working with our non-commercial licensees has been that there us a usual amount of income per capita on an annual basis that the station operator has come to expect. This, then, becomes a part of the financial basis for determining value.

The most helpful tool in determining value of non-commercial stations that operate in the reserved band (reserved for non-commercial uses only) is an after-the-fact analysis of comparable sales. When using so-called “comps” in establishing a reasonable Fair Market Value of non-commercial station, one must take into consideration the size and composition of the market with particular attribution to stations serving markets of a similar size and market composition as well as the station under scrutiny (i.e., comparing construction permits to construction permits and up-and-running stations to the same). When data is available, a useful and consistent approach is to link comparable sales information on a station-to-station basis to the Price Per Pop analysis.

Thoughts Concerning Television M&A Activity

Much has been written about declining TV viewership and the implied declining effectiveness of TV advertising. However, Nielsen data shows that total TV viewing continues to climb. While broadcast TV viewing has declined, spending on broadcast TV is projected to increase, indicating that broadcast television remains advertisers' preferred means of reaching large audiences. In fact, as media consumption fragments, advertisers are placing a premium on television's ability to reach mass audiences.

The Nature of Class A Status

The Class A television service is a system for regulating some low-power television stations in the United States. Class A stations are denoted by the broadcast call sign suffix "-CA" (analog) or "-CD" (digital), although very many analog -CA stations have a digital companion channel that was assigned the -LD suffix used by regular (non-class-A) digital low power TV stations.

The FCC created this category of service as a result of the **Community Broadcasters Protection Act** of 1999. Support for this ruling came largely from the Community Broadcasters Association, an industry group representing low-power TV station operators.

Unlike traditional low power TV stations, Class-A stations were given primary status during the transition to digital television, meaning that a full-service television station could not automatically displace a Class A low power TV station from its broadcast frequency, except in rare cases. In contrast, traditional low power TV stations often find their frequencies assigned to full-service digital TV operations, forcing them to relocate to another frequency. This is especially true in large cities, where available broadcast spectrum is scarce, and low power TV stations find themselves forced to cease operations due to no suitable spectrum. This was especially so with the taking of the 700 MHz band (channels 52 to 69) from the upper UHF TV band.

The Spectrum Debate & Incentive Auctions

The National Broadband Plan (the "Plan"), first released by the FCC in March 2010, set forth a number of initiatives to optimize the availability of wireless broadband services to US consumers and enterprises including making more spectrum available for the carriers and potential new

entrants to satisfy growing wireless demand. Specifically, the Plan recommended that an additional 500 MHz of spectrum be made available for broadband use by 2020, with 300 MHz available for mobile use within 5 years, 120 MHz of which would result from a reallocation of spectrum currently utilized by existing TV stations especially within the top 30 markets.

Should local TV stations in the top 30 markets sell spectrum, we believe it would make for a healthier local market for those remaining broadcasters, including low power stations. These remaining broadcasters might also become a conduit or partner for wireless carriers, as broadcast signals could alleviate traffic on carrier 4G or LTE networks.

In December, 2013, the FCC announced that it was delaying the anticipated FCC Spectrum Auction and subsequent repacking until mid-2015. At the auction, TV stations will consider bids to relinquish their airwaves and either go out of business or be placed in another channel. The spectrum will then be put up for licensing by wireless carriers, who covet the low-frequency

airwaves because they can cover greater distances and travel more easily through physical barriers.

The anticipated Spectrum auction has led to a rush of low power acquisition in certain congested markets primarily in the category of Class A stations or non-Class A stations with an anticipated high likelihood of surviving the repacking. The result will be to auction full power TV stations and Class A low power stations only. Non Class A low power stations and translators will not participate in either the reverse or forward portions of the auction.

There have been a small number of companies formed for the purpose of acquiring Class A low power facilities with the speculation that they will fetch a higher gain at auction when the time comes. While this remains to be seen, there has grown a distinct difference in value at the time of a sale between the Class A stations and the standard low power stations.

Considerable pressure has been placed on the FCC to maximize revenue from the auction. The proceeds will be used to compensate broadcasters and fund a $7 billion public safety communications network.

It remains unclear whether enough broadcasters will sign up for the auction, which is voluntary. Stations affiliated with the Big Four networks aren't expected to participate, leaving smaller stations aimed at religious, ethnic and local audiences as the most likely participants. Whether those stations will yield enough spectrum for the auction to be deemed a success is an open question.

As of this date, (well-past mid-2015), the incentive auction has not come to pass. Once that portion of the FCC initiative does occur, the reverse auction portion of the transition may not actually take effect until the year 2020. The key post-auction moment for broadcasters will come when the FCC issues its new table of allotments containing the new channel assignments for the broadcasters choosing to remain on air. The table is in essence the plan for the repacking of the TV band, in which the FCC will aggregate the entire recovered spectrum in the upper part of the TV band and pack the remaining broadcasters in the lower part.

Thus, in the overall, the television industry has seen a speculative uptick in values for full power stations and Class A low power stations and to a limited degree low power and translator stations.

LPTV Digital Transition

Although Congress established a hard deadline of June 12, 2009 for full-power TV stations to cease analog broadcasts and begin operating only in digital, the statutory deadline did not apply to Class A stations, standard low power television stations, or translators. Therefore, while all full-power television stations have ceased over-the-air analog broadcasting, many low power stations are continuing to transmit analog signals.

The FCC established September 1, 2015 as the date for the termination of all analog low-power television service. After that date, analog television was to no longer exist in the United States.

That deadline has now been extended to coincide with the FCC incentive/repacking initiative. This deadline was again extended through the incentive auction process.

Low power stations have the opportunity to seek either an on-channel digital conversion of their existing analog facilities ("flash cut") or may construct and operate a second digital companion channel during the remainder of the digital transition. However all low power stations will be required to decide a single digital channel to continue to operate after the digital transition date.

Historical M&A Activity

As a part of its on-going industry review, MCH Enterprises maintains records of purchase / sale transactions throughout the radio and television industries as they are published in the public record. While not every transaction is reported, the majority of them are and the majority of those are captured. Inherently, much detail is left out of the public record. For instance information regarding the financial performance of a subject station is usually not available and the underlying criterion on which the purchase price was arrived is not subject to public announcement.