# ELEVEN COSTLY MYTHS AND MISCONCEPTIONS ABOUT BUYING BROADCAST STATIONS

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Broadcast station transactions are mined with bear traps disguised as conventional wisdom. Here are eleven myths about buying broadcast stations that could cost buyers money. These myths endure because they have a modicum of truth, and we all share a natural fondness for mental shortcuts and generalizations. Successful buyers separate facts from fables and recognize that each transaction is unique and should be approached from a zero-based mindset. This article debunks conventional wisdom and misconceptions and reveals the dollars-and-cents dangers of a simplistic, overly-generalized approach.

## Myth 1. Comparable Pricing: Oranges, Apples, and Canned Beans

Estimating the value of a broadcast property based solely on the recent sales price of a "comparable" property in another market is perilous because there are so many variables. At the very least, a potential buyer needs to consider such factors as (1) the station's facilities; (2) the population and related demographics of the market; (3) retail sales in and growth rate of the market; (4) the ratings performance of the station and the relative market share of television or radio advertising; (5) the competition and the status of consolidation in the market; (6) the nature of the buyer (*e.g.*, publicly held company or in-market broadcaster with consolidation economies); (7) television network affiliation and economic consideration; (8) the value of hard assets; (9) the station's over-the-air coverage of the local market (especially in radio); (10) cable and satellite penetration (including rates charged for local advertising); (11) the structure of the transaction (*e.g.*, asset or stock deal); (12) the timing of the sale (*e.g.*, during an Olympic or a political year), and (13) the current financing and trading climate.

What's more, comparables fail to take into account that each buyer will develop a projected broadcast cash flow (BCF) based on his or her own assumptions, which will be particular to the branding, programming, sales, and expense structure strategy of that buyer for the target station. A slight variation in any of these elements will produce a different BCF for each year following the acquisition, and therefore a different discounted BCF valuation. Another important element of projecting BCF is the capital structure of the buyer. The BCF can be the same, but if a buyer finances one transaction with 75% equity and another with 30% equity, the multiple that the buyer can afford to pay is quite different. Thus, using only comparables based on the sale of other stations ignores the fact that each station and market has a distinctive set of operating results, motivations for buyers, and capital structures, and that each property is unique. That is why experienced broadcasters regard the use of comparables as a way of "getting the ball on the green, but not in the hole."

**Myth 2. Cash Flow Multiples: Watch Out for The New Math**

Much like Gus Portokalos, the father in "My Big Fat Greek Wedding," who invited friends and family members to "say any word and I'll tell you how the root of that word is Greek," many buyers regard cash flow multiples both as the starting and end point of station value. But cash flow multiples do not account for structural differences within a market, potential new competition (*e.g.*, the construction of new stations), recent management changes to a sleepy competitor, market status (*e.g.*, fast-growing or mature), and the impact of non-broadcast media, such as cable television, newspapers, billboards, the Internet, portable digital content delivery devices (*e.g.*, video recorders, iPods, mobile video-on-demand), or emerging technologies (satellite and HD radio). Also, depending on market conditions at the time of the sale and the ability of the seller to command a premium, the sales price can be based on trailing cash flow (the past 12 months or longer), projected cash flow, or a multiple of cash flow as of the closing of the transaction. Multiples vary based on the type of station (AM, FM, VHF, UHF) and the size of the market.

A related myth is that BCF is easy to calculate. Care must be taken in calculating operating cash flow, which is pre-tax income before depreciation, amortization, interest, extraordinary expenses, and owner add-backs. Many sellers use a form of "adjusted BCF" to try to justify a higher BCF. They will "add-back" certain line items they consider to be one-time or non-operating expenses. While most buyers would agree with sellers who will add back expenses related to their personal Learjet or country club dues, responsible buyers will object if a seller tries to add back the payroll expense for a salesperson hired during the past 12 months who left after only three months. Similarly, many seller-owners will represent that their salaries should be regarded as cash flow, because they do not perform services. However, such statements should be scrutinized, because some owners actually do provide valuable services or have close relationships with key advertisers.  Buyers must remember that their own expense structure after closing will determine their BCF, regardless of how the seller operated the station.

In calculating BCF, the station's accounting methodology also should be taken into account.  Most smaller operators use a "hybrid" of cash and accrual-based accounting.  This practice inaccurately represents a significant potential liability: accrued sales commissions, bonuses, and rep firm fees. Commission and bonus payments often are computed on a given month's profit and loss statement directly from the same month's payroll records that also include compensation for salaried employees, and in the case of rep firm fees, the station's payable system. This practice becomes problematic when sales commissions and representative fees are paid on collections (and not billing) and bonuses are paid on various rating cycles or annual goals. The buyer's due diligence team should determine which commission payment policy (billing or collections) the seller embraces.  This is one reason a buyer also should request line-item detail for any long- or short-term liabilities that appear on the seller's balance sheets.  Some buyers review the actual check ledger for a period of at least six months as well as the two most recent tax returns.  A broadcast lender emphasizes the need to look at a full 24 months of financials in determining BCF due to the seasonality of the broadcast business and such factors as revenues for political candidates and the Olympics.  In situations where sellers are reluctant to provide financial information, buyers should be wary of proceeding down a dark alley.

When evaluating the BCF of a television station, the expense of syndicated programming should be examined to ascertain whether it has been "written down," either when the station was most recently purchased or if a program has become an underperformer.  Although a program may be amortized at $5,000 a week, it may be costing the station $25,000 per week.  While most owners of television stations are consistent in amortizing first-run programming, many stations use a form of accelerated amortization for off-network programs (e.g., Friends, Frasier).  Accelerated amortization which front-loads the amortization in the earlier years is a more realistic approach to align the value of the program each year with its ratings/revenue performance.  (In connection with programming expense of a television station that relies mainly on syndicated programs, care should be given to determining how long the station is bound to each program, whether straight-line or accelerated amortization was used, and whether the purchase price was reasonable at the time of purchase.)  In addition, a buyer needs to factor in projected increases in rights fees (*e.g.*, NFL, NCAA, news, sports, etc.)  Also, if the price was fair but the term of the agreement is too long, the buyer could inherit an albatross toward the end of the program contract.  If network compensation is a significant portion of a television station's revenue, a buyer should take into account the possibility that upon expiration of the affiliation agreement, network compensation will be significantly reduced, eliminated or reversed.

Rather than relying solely on a station's trailing cash flow, experienced buyers value assets based on an average of three benchmark methodologies: "comparables" (see Myth No. 1), revenue multiples (see Myth No. 2), and discounted cash flow analysis. A discounted cash flow analysis projects the performance of a station over a set number of future years (generally at least seven to eight years), then discounts the stream of cash flow including those of the terminal (end value) of the asset. The cash flows are discounted using a discount rate that reflects the cost of capital and the buyer's capital structure (*i.e.,* percentage of debt vs. equity). This analysis is a standard MBA approach for valuing the stream of future profits for any type of business.

## Myth 3. The Myth of Gross Revenue Formulas: Gross Input, Gross Output

One of the oldest myths is the oft-repeated formula of "X to X-1/2 times gross revenues equals selling price." This formula, a moving target since the 1990s, was created in an attempt to correct the relaxed accounting practices of some individual station owners located in small markets. (Group owners are more likely to have financial statements that follow generally accepted accounting principles.) Historically, profit statements of stations owned by individual entrepreneurs were often distorted because the owners found ways to "expense" some items that otherwise would not be deductible. Buyers would compensate for this distortion by using a gross revenue formula rather than a multiple based on cash flow. In recent years, the gross revenue formula rarely has been used by experienced buyers, who liken the approach to driving blindfolded.

Sellers of smaller stations also may have a generous view of accounts receivable that, when scrutinized, reduces BCF. Buyers should carefully analyze the station's bad debt history. Also, trade and barter revenue can be problematic in smaller markets where trade is used quite heavily. Whenever significant trade revenue is reported, trade receivables and trade expense should be reviewed.

The need for careful examination of financial statements is not limited to small markets. Buyers are inclined to accept at full value financial information covering a station's operations that is included in statements audited by a reputable CPA firm. But there is no guarantee that such statements are accurate. The biggest danger here is when expenses are pushed up to corporate and not included as part of station operations, thereby distorting BCF. Also, many allocations may or may not be made when the statements are extracted. Moreover, if items were not material to the full-blown financial statements, they may not have been addressed by the auditor—but may be material to the single station statements that were audited as part of the whole. Thus, buyers need to examine the financials for each station in a group.

However, station revenues—past, present and potential—are still of paramount importance. Past revenues not only reveal trends in the station's development, but also may provide insights into the market's viability. A buyer may be able to determine if station growth has peaked, is growing, or has slowed. Projections of potential revenues determine how much a buyer can afford to pay for a station and still realize a reasonable return on its investment. A useful working assumption is that a station's revenues roughly should be equivalent to the total radio or television market revenues multiplied by that station's percentage share of the total audience. Yet, even within this rough approximation, there will be wide variations based on station format, technical facilities, network affiliation, location, and performance. Moreover, buyers should consider whether traditional sources of television revenue will be sustainable after the transition to digital (Congress has set February 17, 2009 as the deadline for television stations to complete the transition).

## Myth 4. Current Seller's Revenues and Profit Growth Are Constant: The Herd Instinct Run Amok

There are "boom times" when revenue typically grows between 10% and 15% annually and the percentage of cash flow growth is even greater. Myopic buyers mistakenly assume that revenue and profit growth will continue at peak levels for many years. Conversely, when the economy or station values are soft, many buyers assume that such conditions are a long-term inevitability. Yet within these peaks and valleys in any given market, there will be stations that either over- or under-perform. Also, even when the overall economy is flat or down, there will be markets that experience relatively higher growth rates (*e.g.*, Las Vegas, Phoenix, Austin) for reasons unique to their regions.

No matter how seamless the transition from seller to buyer may appear, there always are very nervous employees at the station, even if everyone retains the same position before and after the closing. This anxiety revolves around factors of change such as new leadership, different systems, and new approaches to dealing with staff, customers, and the public. These inevitable, albeit subtle, changes often will cause growth to slow or stop, at least for a portion of the first year. If more substantial changes in programming, marketing, or staff are made, revenues and broadcast cash flow may decline while the new operating plan is implemented and perfected.

A related myth is that station culture does not affect future value. Buyers, particularly larger companies, put most of their due diligence time into such "tangibles" as signal, equipment, market size, BCF, and in-market competition. However, especially in smaller and medium markets, "intangibles" such as the leadership, culture, and creativity of the station often are the most significant factors contributing to its success. Buyers without direct operational experience may make the mistake of ignoring a few cardinal rules about employees working for smaller, more personal companies:

- Individuals don't work for companies; they work for themselves and the incentives that come from the owners and managers. When an employee leaves, those remaining may feel that they have lost a friend or a member of an extended family and may feel threatened about their own futures. Buyers should know beforehand if they are going to be able to keep key personnel, and, if not, who will replace them.

- The most important element of successful sales and growing revenues is the rep-client relationship, especially in smaller and unrated markets. (Experienced operators get this—bankers rarely do.) Great ratings, sparkling promotions, and clever packages will do nothing if the buyer loses key sales people who have established relationships in the market. Be especially cautious if only one or two sales people are pulling in 80% of the billings. In addition, the current owner's personal relationships with key advertisers and in the community may drive revenue. A transition plan should be developed in these instances to ensure stability and solidify advertiser relationships (perhaps by retaining the owner in a consulting arrangement).

- People appreciate the truth, whether it's good news or not. If buyers plan to change the format, reduce the staff, move the facilities, or make any other major change, the best chance of retaining quality employees is to level with them. Uncertainty is the greatest enemy of employee morale. This uncertainty is why the period between the announcement of the sale and the closing is often a minefield. After the recent years of consolidation, no one believes the line "we aren't going to change a thing." A little honesty with staff members at the outset will pay big dividends later.

## **Myth 5. Real Estate: Lots of Value**

Broadcast stations often have several acres of real property for their transmitter and tower site plus additional space and structures for studios. Sadly, this independent value of land for real estate does not add much to a station's fair market value. The value of a station's antenna site separate from the broadcast property is irrelevant unless the tower can be easily moved or used for other purposes, *e.g.*, leasing space to cellular operators. Increasingly tougher zoning laws, the FCC's short-spacing rules, neighborhood restrictions (relating to lighting, signage and architectural styles), and newly-adopted federal environmental standards make it difficult to find a substitute tower site or to upgrade the existing tower. By contrast, the FCC's liberalized main studio rule allows buyers much greater latitude in relocating the station's studios. Typically, the real estate element of a deal is of relatively low value compared to the value of the station's license, its technical facilities, and/or its operations/results. Yet, from a buyer's perspective, it is often essential that the seller either include the tower site as an asset, or be able to assign a long-term tower lease with attractive terms, in order to keep the station on the air. Viewed separately, communications towers are an asset that might be monetized or turned into a profit center.

A related misconception is that excess assets add to the station's value. This is not true: in addition to owning real estate, a station can own equipment in quantities and qualities that do not translate into increased value. It's similar to the myth that if a homeowner adds an expensive swimming pool to a house, the value of the house will increase by more than the cost of the pool. In many cases, the homeowner will not recoup the cost of the investment. The key issue for buyers should be the stream of income; anything that can add to or subtract from that stream should be part of the analysis.

## **Myth 6. 100% Leveraged Purchase: Don't Bank on It**

For most purchases, it is foolhardy to assume that banks or other lending institutions will supply most, much less all, of the necessary funds for an acquisition. A purchase price at nine-to-12 times cash flow effectively stretches this cash flow too thinly for the lender, especially when up to 80% of the acquisition price must be repaid with interest. Other than Wall Street and "seller paper," banks and commercial finance companies are arguably the "cheapest" source of financing. However, it is increasingly difficult to find conventional lenders for station acquisitions, especially a single station acquisition in a market as it leaves the buyer vulnerable to competitive pressure from larger groups. Many lenders tend to focus on "bricks and sticks" that will rarely cover the purchase price. Some lenders, such as Bank of America, also have private equity arms that provide "mezzanine funding" or outright equity plays (at one time, Bank of America's private equity group held 26% of the stock of Cumulus and served on its Audit Committee).

If you are able to work with a knowledgeable and experienced lender, consider getting that lender involved as early as possible. An experienced broadcast lender can help you to assess the marketplace, the appropriate multiples, and the risks in ways that may prove useful even if the lender does not ultimately bankroll the deal.

As of this writing, some hedge funds are loaning money to broadcast stations, making senior debt easier to secure. (Hedge funds are pools of capital that seek high returns by employing higher-risk strategies.) However, a senior secured lender typically requires a pledge of the "stock" of a licensing entity, and 100% of its assets as collateral. Such lenders may also require personal guarantees. Should a borrower wind up in default of a loan document's financial covenants, the senior lender can compel a "fire sale" to recoup its investment. In today's marketplace, borrowing multiples used by banks and finance companies range from 4 to 7 times cash flow (the lending multiples will drop to 4 to 6 times for cash flow under $10 million). Some lenders will stretch the borrowing multiple a little more if they believe there is enough upside potential, or if the buyer is a successful group owner.

Private equity greatly increases an entrepreneur's blended "cost of capital." While the interests of private equity investors are generally more closely aligned with those of the entrepreneur, these types of investors usually require a controlling interest in the company. In a venture-backed transaction, management often works for a carried interest which, in the nomenclature of private equity, is essentially a stock option pool representing 10-15% of the profits from the investment.

"Mezzanine financing," sometimes referred to as "stretch senior financing," costs somewhere between senior debt and private equity. It acts more like senior debt, and also may have convertibility features—"a wolf in sheep's clothing." Borrowers need to beware of the caveats and covenants that the mezzanine lender requests. In today's market, the interest cost of mezzanine or bridge financing is in the teens.

The amount of "personal equity capital" an entrepreneur contributes toward the purchase price will determine his or her ability to avoid the risks and potentially severe consequences of accepting restrictive financial covenants and overly intrusive equity investors. With lenders using five to eight-and-a-half times BCF, less equity is needed today than 10 years ago.

At the same time, however, mezzanine financing may fill in the buyer's financing holes and allow the deal to move forward.

One of the consequences of over-leverage is that the buyer will have little or no room for error. This is particularly true in a buyer's first year or two of ownership, but it also applies to a buyer's adding a station to an existing market cluster. Buyers will make mistakes. Some miscues might be easy to fix, such as hiring the wrong person; others will have more serious consequences, such as format decisions. In all these cases, the buyer needs deep pockets to cover losses or reductions in BCF and to spend more to make the necessary adjustments. High leverage does not permit much room for mistakes, because the buyer may have no more funding available or the incremental cost may be prohibitively high.

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

Not all properties are underdeveloped and have upside potential. Nonetheless, some purchasers acquire a station based on blind faith that they are smarter and better managers than the current owners. Turn-arounds demand considerable experience in the broadcast business and should be avoided by a first-time buyer. To paraphrase Warren Buffett, many experienced broadcasters believe it is better to buy a wonderful station at a fair price than a fair station at a wonderful price. One broker advises his clients that a turn-around should be the fifth station that they buy at the earliest, and that perhaps they never should buy one: "Swing for singles and doubles and you might hit a home run. Swing for the fences—you strike out a lot." Also, first-time buyers of radio stations need to realize that consolidation has tilted the playing field in favor of incumbents who can afford to pay more and be tenacious competitors.

Buyers are usually lured to turn-arounds because of their discounted prices. A turn-around may be so attractive on paper that a prospective buyer can project the returns required to attract private equity. Buyers often recite the mantra of "buy low, sell high." But where buying low means acquiring a sick or a severely damaged station, many buyers underestimate the time needed to reverse the bad performance and the cost and likelihood of doing so. Heated enthusiasm to make the deal may charge ahead of the cold reality of what it really will take to turn the station around; too much enthusiasm can be catastrophic for an overly leveraged buyer. Conversely, if the buyer has a plan for the market that entails significant changes in the station, such as adding it to a cluster, moving the station, changing format, or upgrading the signal, an underperforming station, properly discounted, may be an ideal buy. During the past year, for example, some Hispanic broadcasters met with success in purchasing stations with little or no cash flow and changing the format to Hispanic programming.

### Myth 8. The "Greater Fool Fallacy"

One of the major reasons for higher cash flow multiples is the "Greater Fool Fallacy": "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 assumption has encouraged some buyers to pay unjustifiably high prices, only to lose substantial sums upon resale or find themselves defaulting on loan agreements. A corollary of the myth is that all stations can be resold to a major player. But major players have a way of changing their minds and leaving would-be sellers high and dry; also, even if they want to buy another in-market station, the FCC's ownership rules may not permit the purchase.

A veteran broker says that he has never met a buyer who didn't think he was a much better broadcaster than the seller. He asks: "Can you imagine someone saying: 'I paid a fair price to Phil for the station. He's a better operator than I am, so I guess our revenue and cash flow will be a little lower next year than it is today.'" When buyers are very optimistic, they would be well advised to take a more conservative position when talking to lenders. It's better to make less aggressive promises to lenders than explain why you did not make your projections. A balancing act works best: borrowers should promise as poor a performance as they can, while still showing enough promise to get the loan.

In today's trading climate, a buyer should always operate on the premise that he or she is the greater fool! A very wise, experienced, disciplined group operator once said, "You can fix bad programming; you can fix a bad sales department; you can sometimes fix a bad signal; but you can never fix paying too much." If you pay too much, you will spend the first two or three years justifying the price you paid. Some buyers want a station so badly that they over-pay, drown in debt, and suffer mental and emotional stress. They also assume that the economic climate will always be improving and that the economic base of every market is stable. Tell that assumption to someone who bought stations in New Orleans or Biloxi. Also, it is risky to assume that broadcasting will go forward in a business as usual mode—a factor that is difficult to quantify will be the impact on station values of a crowded media world where media platforms and technologies converge, change and develop.

### Myth 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 or investment bankers to locate a property. Intermediaries play a useful role in bringing prospective buyers together with station owners desiring to sell their station. They exist for a reason: a third party can say things to buyers and sellers that he or she could never say to each other. Even Michael Jordan, one of the most marketable personalities, uses an agent. As in the real estate business, most broadcast acquisitions involve the services of brokers. However, unlike the real estate business, where multiple or open listings are common, media brokers usually have exclusive listings.

Keep in mind that brokers and investment bankers want to work with financially qualified buyers. Accordingly, it is important for prospective purchasers to "flash the cash" upon entry. Indeed, the buyer's primary task is to convince the intermediary that he or she will be able to close the transaction. In recent years, investment bankers and some brokers also work on the "buy side" of a transaction and assist buyers in raising capital, although representing sellers continues to be the norm. On the buy side, brokers have a special feel for knowing what a particular station will sell for and sometimes can keep the prospective purchaser from overpaying.

What do brokers and investment bankers bring to the table for sellers? They provide several key functions that sellers cannot or should not do for themselves. First, they help the seller place a realistic value on the station, determine a selling strategy, and generate marketing materials. Second, they find and qualify buyers who have the ability to close the deal and will keep the sale information confidential. Third, they become intermediaries between the seller and potential buyers in the complex negotiating dance, particularly at the stage leading up to choice of the buyer whose offer will be accepted. They often act as a "buffer" when communications break down and emotions erupt. These tasks require industry and market knowledge, as well as marketing, selling and negotiating skills, including more than a little bit of diplomacy.

Because the fee arrangements are not made public, a mythology exists concerning the fees paid to brokers and investment bankers. For many years, the industry norm has been a structure known as the "Lehman formula": 5% of the first $1 million of the total sales price (including deferred compensation; 4 % of the second million; 3% of the third million; 2% of the fourth million; and 1% of the fifth million and amounts greater than $5 million. The fees were normally paid at the closing. With respect to deals under $1 million, it is not uncommon for an intermediary to charge a higher percentage (*e.g.*, 10%) or a fixed fee ($25,000- $50,000). Some brokers use a "reverse Lehman" (1, 2, 3, 4, 5) as a way of giving them a greater incentive to obtain a higher sales price. In recent years, a number of larger firms charge 5% of the first $3 million; 2% between $3 million and

$25 million; 1.5%, between $20 and $50 million; and one percent, above $50 million. Although not publicized, it is not uncommon for brokers and sellers to negotiate the fee formula.

## Myth 10. 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. (A battle-scarred veteran of broadcast transactions believes that Murphy was an optimist!) Some buyers are seriously undercapitalized, because they underestimate expenses, overestimate revenues, and do not allow for contingencies. Others fail to research and evaluate a given market, and do not understand the implications of a station's current and potential technical facilities. They put on rose-colored glasses when looking at aspects of the transaction that should be examined through a magnifying glass. In particular, buyers should be leery of taking at face value statements by the seller such as, "Don't worry about the tower—you can move it closer to the big city." When in doubt, always do your own due diligence. If you are not in doubt, you should be. In other words, always do your own due diligence.

Care must be taken to find out whether there are skeletons in the station's closet. For example, it is important to focus on both the assignability and the terms of contracts and leases, especially transmitter site leases, program contracts, and network affiliation agreements. Some television networks issue "side letters" that kick in only if the station is sold (one side letter provided that unlike the current licensee, the new owner of the station would be obligated to pay the network if the affiliate were to preempt programming). Ask for a copy of all such side letters.

Another corollary of Murphy's Law is "that aspect of the deal in which you have the most confidence will be the first to collapse." Be wary of every element of the deal. (For example, as network "comp" disappears for television stations, it is important to know how many years are left on the current affiliation agreement, and whether it will be assigned.) Try to foresee problems early. Scrutinize each little item in the contract and the station's performance. Imagine what could go wrong if you were putting a jinx on the deal. Even then, you'll miss something! Buyers should adopt the mantra formulated by Andy Grove, former CEO of Intel, as a corollary to Murphy's law, which states that everything that can go wrong will go wrong: "Only the paranoid survive (now more than ever)."

## Myth 11. Letters of Intent Are Non-Binding

Many buyers and sellers are very casual about letters of intent ("LOI"), often to their detriment. Letters of intent have been characterized as "gentlemen's agreements." A legal scholar commented that a gentlemen's agreement is "an agreement, which is not an agreement, made between two persons, neither of whom is a gentleman, whereby each expects the other to be strictly bound without himself being bound at all." Too many sellers and buyers enter into LOIs with the attitude that they are not binding. Lawyers should be involved early and heavily at the LOI stage.

An LOI is a critically important document with legal and practical consequences; it should not be executed without obtaining legal advice. There are times when seller and buyers want "truth" in the LOI and other times when they don't—without the involvement of counsel, they usually don't know if they are getting one with or without teeth. Even when drafted carefully, litigation might ensue. Beware: although the LOI states that it is not a binding offer, some courts have imposed a duty to negotiate in good faith. Many brokers advise sellers to agree to a loose LOI just to get the deal signed. However, including key items in the LOI can prevent misunderstandings that subsequently result in a busted deal. Potential buyers certainly don't want to negotiate the asset or stock purchase agreement during this early pre-due diligence period, but they can't afford to assume that important issues will be easy to negotiate later without their inclusion within the framework of the LOI.

A well-drafted and negotiated LOI makes the negotiation of the definitive agreement speedier and easier. A second advantage is that financial institutions may be more willing to fund a transaction if it is backed by an LOI. Finally, letters of intent have been called a form of "anti-renegotiation" insurance, because they inhibit the lawyers and the parties from renegotiating the terms of the deal. Experienced buyers give careful consideration to the provisions they want to include in an LOI — they look at the letter as a strategic and tactical document. It essentially is an option to acquire the station and usually binds the parties to exclusively negotiate a definitive agreement in good faith within a certain time. As such, the LOI benefits the buyer. Buyers should consider whether they want to include "no-shop" or "breakup fee" provisions in the LOI so that negotiations can proceed without the threat of "party crashers." Sellers should make sure that the LOI identifies which provisions are binding and which are non-binding.

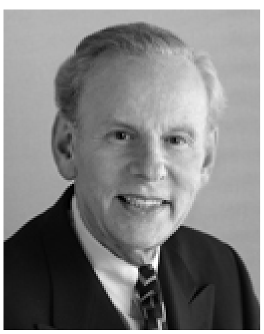
## A FINAL CAVEAT

Billionaire oil tycoon J. Paul Getty disclosed his formula for success: "rise early, work hard, strike oil." Sad to say, no one-size-fits-all formula exists for buying stations. In the broadcast business, the only rule of thumb for "striking oil" is to be aware that no magic bullet formulas exist. Steven

Levitt, co-author of *Freakonomics*, points out that much of what we hear and are taught turns out to be false on closer scrutiny. Whether it is the so-called expert advice contained in this article, what you read in the trade press, or what your mother told you, it is important to take the time to figure out for yourself whether the advice is really true in each broadcast transaction. Levitt's golden rule is "don't trust, just verify."

Reliance on one or more of the myths and misconceptions about the broadcast station acquisition process is like fool's gold – what looks like a golden opportunity may well turn out to be a bad investment. Buying a broadcast station is a complex process involving business, legal, technical, and people issues. However, by heeding the advice contained in this article (with a healthy dose of skepticism) and by pursuing an acquisition with thorough due diligence and the assistance of a team of expert legal, engineering, and business counsel, the process can be rewarding. You may even strike oil.

## ABOUT THE AUTHOR



Erwin Krasnow's experience in communications law is unusually extensive. He has been described as "a dean of the Washington communications bar" by the *Legal Times*, as a "superlawyer of communications" by *American Film Magazine*, and as "the guru of communications law" by the *Broadcast Cable Financial Journal*. He chairs Garvey Schubert Barer's Communications and Information Technology Group.

Described by Paul Kagan Associates as "one of the broadcast industry's leading dealmakers" and by Radio Business Report as "a preeminent communications lawyer who knows the business of buying and selling radio stations," Erwin has represented sellers and buyers of broadcasting, cable and telecommunications properties in transactions totaling well in excess of $21 billion.
Erwin formerly served as Senior Vice President and General Counsel of the National Association of Broadcasters and as Administrative Assistant to the late Congressman Torbert Macdonald, Chairman of the House Communications and Power Subcommittee. He has served on graduate and law school faculties at Ohio State, American, Temple, George Washington, Catholic, and Georgetown universities.

Erwin is co-author of several books, including *Radio Financing: A Guide for Investors and Lenders*, *The Politics of Broadcast Regulation*, *Buying a Broadcast Station: A Due Diligence Guide*, *100 Ways to Cut Legal Fees and Manage Your Lawyer*, *An Insider's Guide to Radio Station Acquisition Contracts*, *Buying or Building a Broadcast Station*, *Radio Deals: A Step by Step Guide*, and *FCC Lobbying: A Handbook of Insider Tips and Practical Advice.* He also has written more than 300 articles and monographs on communications law, media transactions, and FCC decision-making.

Erwin is the Founding Director and Vice Chair of Broadcast Capital, Inc., a minority broadcast investment fund; Director and Vice Chair of the Minority Media and Telecommunications Council; Washington counsel to the Broadcast Cable Financial Management Association; and past President of the Library of American Broadcasting. He has served as Co-Chair of the Communications Law Committee of the Federal Bar Association; Treasurer of the Federal Communications Bar Association; and President of the Capitol Hill Bar Association.

Erwin was selected by the Office of Communication, United Church of Christ, as the 1999 recipient of the Donald H. McGannon Award for his "special contribution in advancing the role of women and people of color in the media." In 1987, he received the Distinguished Education Service Award, an award given to a person who has made "a significant and lasting contribution to the American system of broadcasting," by the Broadcast Education Association. COMM/ENT Law Journal, Hastings College of Law, selected him as the 1984 recipient of the Roscoe Barrow Award for "outstanding achievement in the field of communications." In May 2004, he was named as the recipient of the Jack Zwaska Lifetime Achievement Award by the Broadcast Cable Financial Management Association in recognition of his contributions to "the growth of our association and the industries we serve," and in July 2004, the Minority Media and Telecommunications Council (MMTC) selected him for induction into the MMTC Hall of Fame for his "many years of exceptional contributions to the diversity and success of America's most influential and most important industries."