



GARVEY SCHUBERT BARER

**10th ANNUAL ACCESS TO CAPITAL AND TELECOMMUNICATIONS
POLICY CONFERENCE
WASHINGTON, DC
July 18-19, 2012**

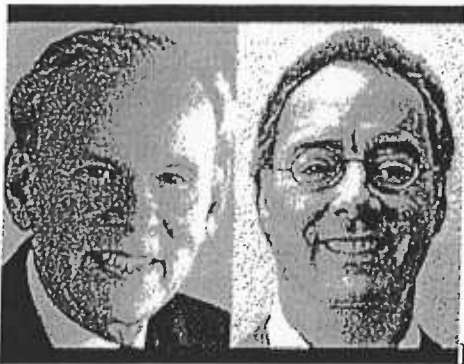
FINANCING LEGACY AND NEW MEDIA DEALS IN A DIGITAL ECONOMY

Contents:

1. Attracting OPM (Other People's Money)
2. How to Make Your Case for "OPM"
3. How to Maximize Your Chances of Getting "OPM", Part II
4. Demystifying the Equity Term Sheet
5. Seller Financing: The First Last Resort in a Tough Sales Market

Radio & Television Business Report

Attracting OPM (Other People's Money)



By John R. Brooks and Erwin G. Krasnow, Esq.

There has been a string of encouraging news lately for the beleaguered broadcast business, and not a moment too soon. Four Points Media, Freedom Communications and McGraw-Hill found ready buyers in Sinclair and Scripps for their TV groups in a flurry of activity. Dean Goodman and Jeff Warshaw, following in Randy Michaels' wake, recently announced new radio deals the size and likes of which haven't been seen for some time. Steven Price and Townsquare Media have been snapping up small market stations for the last few years. Ed Christian claims he's ready to jump back into the deal market. Dave Schutz reports that lenders are tiptoeing back to the NAB. There is nothing like a boost from industry wise men to assure the rest of us that it's safe to dive back into the pond. That's how recoveries start.

But most broadcasters don't have the market clout, credit lines and financial connections to get a deal done, even in the best of times. Many continue to labor in the lender penalty box after several years of busted covenants and payments, tense meetings with workout teams and write-downs. A whole host of media lending talent whose bread and butter was the middle market (deal size under \$10 million) are in retreat or gone – CIT, Wells Fargo, Foothill, ORIX, CapitalSource, Textron, Pacific Media, Westburg and the hedge fund crowd. It's unlikely that most of these companies will be coaxed back since credit people have long memories. Bank financing is available, but primarily for large companies (i.e., EBITDA greater than \$10 million) with strong financials. So what is a surviving broadcaster to do in the world of TV/Radio 2.0 (or is it TV/Radio 3.0)?

If you're a local broadcaster looking for a new lender, you have a lot of educating to do and you need the patience of Job — but that's no guarantee you'll be successful. Traditional lenders want hard assets – receivables, inventory, equipment, real estate – something in short supply on a broadcast balance sheet. They need to be convinced that a piece of paper posted at your transmitter site (your precious FCC license) is worth what you say it is. A qualified appraiser can help with that.

They also want businesses that are growing and profitable. If we could delete the debacle of 2008/2009 from our spreadsheets, what we're likely to see are two years of steady revenue growth with a forecast for more in 2012. While the core business remains fairly static, digital assets can add some punch if properly monetized. If

you're running your stations efficiently (without drawing blood), you should be generating operating margins in the 20's or better (depending on how big you are). This is a huge selling point as other businesses that the local banker is likely to see (manufacturers, wholesalers, retailers) can only dream of such margins, settling instead for single digits. But that's still no guarantee.

Finally, you need to develop your lender relationship if you don't already have one. That third "C" of credit – character – is everything to the local banker, and that's built up over time. It's also why most VC and private equity firms only back entrepreneurs who've been referred from a trusted source or with whom they've done business before. You need to present a well-organized, thoughtful business plan and forecast that shows why you'd be a good credit risk. This point cannot be over-stated. If you're uncomfortable with this process, there is an army of good consultants who can assist you.

As long as we're talking about local banks, the federal SBA program deserves a mention. The SBA will guarantee upwards of 85% of a qualifying bank loan, \$5 million or less but generally under \$1.5 million. If there is an SBA Preferred Lender in your community, it may be worth investigating. But like traditional lenders the SBA also looks for hard assets and will insist on personal guarantees, so this becomes another long (and arduous) education process.

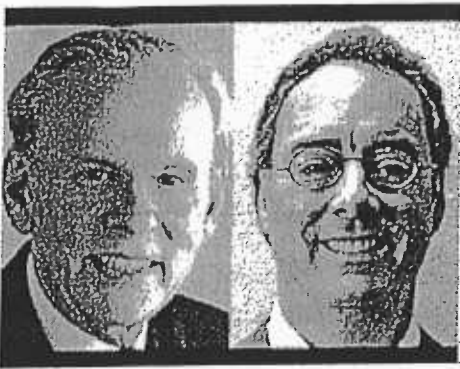
Your involvement with the banking world begins even before you start your business. Develop a good working relationship with the bank of your choice from the very beginning. Faster and better services are supplied when a bank is familiar with its customers and their business. In that environment, suggestions for keeping a business financially healthy are more readily given, crisis borrowing can be avoided and good loan planning can be developed.

John R. Brooks is a 25-year broadcast finance veteran, most recently as a Managing Director with Wells Fargo Foothill. He currently works as an independent broadcast consultant and writer. He can be reached at john@iheartcasey.com and (415) 272-5123.

Erwin G. Krasnow, the co-chair of the Communications Group of Garvey Schubert Barer, is a former General Counsel of the National Association of Broadcasters and the co-authors (with John M. Pelkey and John Wells King) of Profitably Buying and Selling Broadcast Stations. He can be reached at ekrasnow@gsblaw.com and (202) 298-2161.

Radio & Television Business Report

How to Make Your Case for “OPM”



By John R. Brooks and Erwin G. Krasnow, Esq.

To make your case for OPM (Other People’s Money), you will need a business plan. Business plans come in all sizes, shapes and forms. Some are works of art but the underlying investment proposition is underwhelming. Others are rough around the edges but may reveal a compelling “diamond in the rough.” There is no shortage of advice on how to write that business plan that will get funded.

Like a resume, a business plan is only as good as the underlying proposition. A gifted wordsmith cannot make a dubious investment into a sure thing. So let’s assume that the investment opportunity has been properly vetted. It meets the basic investor or lender criteria. Where do we go from here?

These seven steps are good places to start:

1. Do your homework by finding out the hot buttons of your potential lenders and investors – minimum/maximum size, valuation, upside, cash flow, management, market, competition, technical facilities, NTR (non-traditional revenue), digital assets. Make sure that you understand what they are and address them in your proposal. This may not be a ‘one size fits all’ project if you’re visiting with more than one institution.
2. Directly address the concerns of your sources of financing and equity. You may be dealing with a constituency new and skeptical about the broadcasting business. They may believe that traditional media is dead and need to be educated. While some aspects of your relationship are like other commercial loan and investment relationships, no other industry shares all of the challenges that broadcasting poses: Broadcasters have no inventory, and even their equipment has too little value to support their lending needs. Their individual receivables are often small. And under existing FCC rules and case law, their most valuable asset, the FCC license, can’t be subject to a security interest. Once again, education is the order of the day.

3. Don't rely on just one institution or investor. If at all possible, develop multiple relationships so that you have options. Generally, asset-based lenders will be a poor fit for broadcasters, most of whose value will be tied up in the FCC license. In contrast, cash-flow lenders will be focused on the value of the business.

4. Develop relationships with investors and lenders on the front end to understand what their "sweet spot" is and give them a chance to get to know you. They don't call it "relationship lending" for nothing. Learn how to speak their language, or maybe consider hiring someone who does.

5. Keep your money sources up to date. As you're looking at deals, give them a heads-up so they can follow your progress and prepare for the moment you're ready with a live project. Maybe they can help you tweak your deal analysis, but don't lean on them too much for free advice.

6. Ask for a meeting. Investors and lenders like meetings so that they can size up the principals directly, maybe even invite the boss. If you make it this far, buy that plane ticket. There is nothing like a physical presence to bring life to words and numbers on paper. But make sure you're prepared. Have an agenda. Don't overstay your welcome.

7. If you're raising debt and equity, make sure you have your equity lined up first. Countless lender meetings have ended with the words, "sounds good, come back to us when you have the equity." Don't confuse a lender with an automatic entrée to equity unless you've done business before or have an outstanding track record. In those cases a lender would probably be happy to vouch for you in a referral.

In next week's issue of RBR/TVBR, we will drill down to the meat of the business plan. What should be included in what sequence? How long should it be? What goes into the financial projections? Stay tuned.

About the Authors:

John R. Brooks is a 25-year broadcast finance veteran, most recently as a Managing Director with Wells Fargo Foothill. He currently works as an independent broadcast consultant and writer. He can be reached at john@iheartcasey.com and (415) 272-5123.

Erwin G. Krasnow, the co-chair of the Communications Group of Garvey Schubert Barer, is a former General Counsel of the National Association of Broadcasters, Washington counsel to the Media Financial Management Association and co-author (with John M. Pelkey and John Wells King) of Profitably Buying and Selling Broadcast Stations. He can be reached at ekrasnow@gsblaw.com and (202) 298-2161.

Radio & Television Business Report

How to Maximize Your Chances of Getting “OPM”, Part II



By John R. Brooks and Erwin G. Krasnow, Esq.

Last week we talked about the importance of a good business plan as part of a comprehensive strategy to cultivate interest from potential investors and lenders in your company. So what is a good business plan? That will vary based on specific concerns among institutions and investors, but here are some general tips for getting a fair shot at “OPM.”

Paper or Electronic: With rare exception, there is a strong preference for an electronic document in a Word, Excel or PDF attachment to an e-mail. They’re easy to read and easily portable on a laptop or tablet. If an institution wants paper they can hit “Print.”

Length: Oftentimes, less is more. People are busy sifting through proposals stacked up in their InBox and, consequently, may have short attention spans. For that reason, “teaser memos” are often used to layout the deal basics in no more than two or three pages. They usually include a company/deal overview, industry metrics if relevant, sources and uses of funds at close, projection summary and management bios. Most importantly but all too often forgotten are the “beg” (what you are asking for) and your contact information.

Assuming the teaser gets a thumbs-up, how long should the formal business plan be? There is no magic number, but keeping in mind the “less is more” notion — a nice round number to strive for is ten to fifteen pages of text (excluding projections, coverage maps, etc). If the institution is interested, they’ll ask for more. Just be ready to deliver.

Executive Summary: In one to two pages, make your elevator pitch. It has many similarities to the teaser memo but provides more color and fewer graphics to the reader. The first paragraph should be your hook, because that’s all the attention you may get. What makes your deal stand out from others? A unique value or upside proposition? A management team uniquely qualified to execute this plan?

Proposed Terms: A one to two page summary term sheet is helpful to outline structural issues that should be flushed out up front – borrower structure, guarantors, collateral, proposed payment schedule, existing debt and principal distributions. Don't try to insert rate and fee expectations; they will be negotiated later if you get that far.

Industry: Some business plans contain an industry overview when it is unnecessary because the reader already is knowledgeable about broadcasting and may feel patronized. However, for broadcast rookies it is essential to explain the basics of this business – operations, competition, growth outlook, collateral issues. In other words, what makes this a compelling capital deployment opportunity compared to other alternatives?

The Business: This is a description of the company's markets, technical facilities, ratings and competition. Much of this information can be in table form with additional color to give the reader a feel for the markets at the ground level. What are the strengths/weaknesses of the market, the competition or the company? Has the company adequately identified and addressed the risks?

Financials: All too often, business plans provide projections without any historical context so it's difficult for the reader to determine if the projections are realistic. Sometimes there's good reason for this – a start-up, bankruptcy or format change. Nonetheless, your potential lending and investing sources like to have some kind of a base line from which to measure future performance. This is especially important in light of the unprecedented impact of the recession on broadcasting in recent years.

Financial projections should include an income statement, balance sheet, cash flow statement and ratio analysis. Cash flow, including projected capital expenditures and working capital consumption, is particularly important but too often glossed over. Many times below the line items (LMA payments, other debt payments, distributions, depreciation, projected taxes, alimony, child support, gambling debts, the boat payment, the Jag, the ski lodge, the father-in-law's "salary") are omitted and may understate cash flow available for debt service.

Projections are only as good as the assumptions, particularly with respect to revenue growth. If revenue is projected to grow at anything over 1% per year (the analysts' consensus), it needs to be substantiated. Does this market enjoy an unusual lift? Is it a ratings play? Has the sales force been decimated? Is there significant non-broadcast revenue for the taking? If you can't substantiate your projections, your suitor may decide that you will only grow at 1% per year, which may undermine your entire investment thesis.

Bottom line growth based on expense cuts is much easier to document and easier for institutions to understand. Unfortunately, broadcasters have been in a belt tightening mode for the last few years and opportunities to streamline bloated expenses have diminished.

Management: The management section, like the elevator pitch, should convince the reader that this team has the experience necessary to execute the business plan presented. What is their track record? Have they operated in these markets or markets that are very similar?

Other: Depending on the kind of company, coverage maps may or may not be relevant. Institutions want to know that the company's signals cover their target audience. Radiocator.com does an adequate job, but an engineer or appraiser can produce a more precise map if you're willing to spend some money. This is more important for AMs than FMs, and more important for radio than TV. For TV it's more about cable and satellite carriage and channel position.

Looking for OPM will likely be the most challenging task you will face in your quest for broadcast station ownership and expansion. Preparing and pitching a persuasive business plan will draw upon all of your skills, knowledge and then some. The good news is that if you're successful your efforts will be well rewarded.

About the Authors:

John R. Brooks is a 25-year broadcast finance veteran, most recently as a Managing Director with Wells Fargo Foothill. He currently works as an independent broadcast consultant and writer. He can be reached at john@iheartcasey.com and (415) 272-5123.

Erwin G. Krasnow, the co-chair of the Communications Group of Garvey Schubert Barer, is a former General Counsel of the National Association of Broadcasters, Washington counsel to the Media Financial Management Association and co-author (with John M. Pelkey and John Wells King) of Profitably Buying and Selling Broadcast Stations. He can be reached at ekrasnow@gsblaw.com and (202) 298-2161.

Radio & Television Business Report

Demystifying the Equity Term Sheet

Jul, 5 2012



By John R. Brooks and Erwin G. Krasnow, Esq.

Congratulations! Thanks in large part to your following the practical pointers we gave you on putting together a business plan in support of your pitch for obtaining Other People's Money (see "[How to Make Your Case for 'OPM,'](#)" Radio Business Report/Television Business Report, May 31, 2012, and "[How to Maximize Your Chances of Getting 'OPM,'](#)" Radio Business Report/Television Business Report, June 12, 2012), you've made it past the gatekeeper and now you have your equity term sheet in hand.

You're home free. Or are you? What exactly is this document your investors e-mailed you? It's only three pages long. It doesn't seem very substantial. Let's look at it.

Beware: Receiving a term sheet does not mean that the Fat Lady has sung. It is "an agreement to agree." Terms sheets (also called memorandums of understanding) are similar to letters of intent because they are preliminary, mainly non-binding documents, that are meant to memorialize the intentions of the parties to enter into a definitive agreement at some point in the future.

Various investors have their own style but term sheets are usually in a "bullet-point" format. They usually start with a summary of the investors' understanding of "the deal." We're paying X amount for the stations, it will take Y amount of capital (the other part of Y is Part Two, stay tuned) and here's what we'll consider providing with many, many caveats. Such as, 'if you get the flu, we're out.' (That was a joke, but not entirely!)

The Purchase – The term sheet may say that the investors are buying 100% of the Class A Series Preferred Stock of your company. What is preferred stock? Basically what they're saying is that whatever you own now ranks below what they're buying. Your investors get first dibs before you. From an investor's point of view, preferred stock provides lots of advantages: it can be converted into common stock, has a liquidation preference

over common stock and usually has anti-dilution provisions, special voting rights and mandatory or optional redemption schedules. In a nutshell: your money is at the bottom of the pile.

The Return – X% cumulative preferred return, compounded monthly, payable as a dividend as cash flow is available plus (a) Y% of any cash flow or (b) a “capital event.” It must be redeemed within three years of the initial investment with “liquidation preferences.” This is pretty harsh language but the reality is that they are putting capital at risk and they want it back, so your investment will have to wait.

Investor return expectations can vary considerably. A typical private equity firm that answers to institutional investors will aim to double its money with a “liquidity event” (company sale or IPO) in three to five years. Private investors may be more patient and flexible on returns, but that’s a function of investment risk. The total return is a function of the fixed rate on their investment (the preferred return) plus a back-ended “promote” (their share of the profits from the liquidity event).

What does the management team get out of this? Depends on how much leverage they have to negotiate, but typically they’ll be offered the opportunity to earn as much as 10 to 20% of the back end, pro rated over three to five years. Some investors and private equity firms will insist that management have skin in the game and invest alongside them. How much? Enough to demonstrate that they’ve put a chunk of their personal net worth on the line.

Conditions to Closing – The list of conditions may seem like a throwaway but may be the most important part of the document. It refers to such matters as site visits, reference checks, payment of all associated fees and costs, analysis of financial statements, appraisals, satisfaction of debt terms and other “customary” due diligence.

Further Funding – This is an acknowledgement that the equity commitment is contingent on further debt funding, and if it isn’t raised the deal is off. Speaking of debt funding, in next article, we will tackle the challenge of demystifying the debt term sheet.

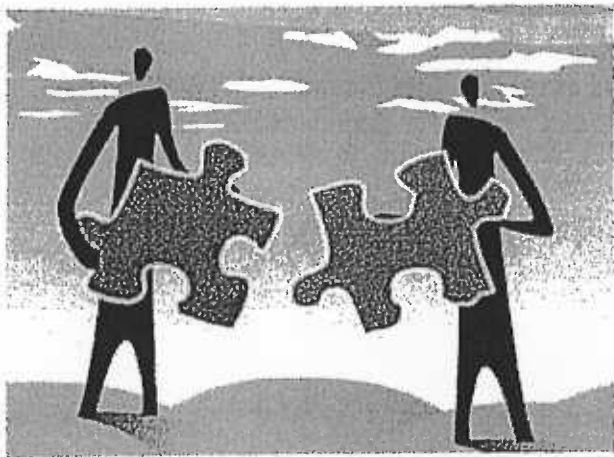
John R. Brooks is a 25-year broadcast finance veteran, most recently as a Managing Director with Wells Fargo Foothill. He currently works as an independent broadcast consultant and writer. He can be reached at john@iheartcasey.com and (415) 272-5123.

Erwin G. Krasnow, the co-chair of the Communications Group of Garvey Schubert Barer, is a former General Counsel of the National Association of Broadcasters, a coauthor (with John M. Pelkey and John Wells King) of Profitably Buying and Selling Broadcast Stations and Washington counsel to the Media Financial Management Association. He can be reached at ekrasnow@gsblaw.com and (202) 298-2161.



Seller Financing: The first last resort in a tough sales market

30 April, 2010 09:39:00



With bank financing virtually non-existent, most broadcast station deals will require seller financing. RBR/TVBR asked a prominent communications deal lawyer with Garvey Schubert Barer and the former head of media lending at Wells Fargo Foothill to prepare the definitive primer on seller financing. Using the knowledge they gained from their involvement in media and telecommunications deals totaling in excess of \$20 billion, Erwin Krasnow and John Brooks written an article with practical advice on avoiding the pitfalls and potholes of transactions involving seller paper. It provides all of the knowledge that owners and prospective buyers will need to know about a station transaction involving an installment sale:

According to The Wall Street Journal, U.S. banks last year posted their sharpest decline in lending since 1942(1). The tightening of credit and declining valuations of broadcast stations are making financing packages

much more difficult to obtain even for qualified buyers with solid banking relationships. Little bank financing is available except for large (i.e. EBITDA or broadcast cash flow greater than \$10 million) companies with strong financials. Because traditional financing is so difficult to obtain, sellers of broadcast stations should consider offering financing to the buyer, sometimes referred to as “carrying paper,” for a portion of the purchase price. This form of financing was common in the broadcasting business up until the late 1970s, before banks embraced the value of an FCC license as legitimate collateral and began lending to broadcasters on a larger scale.

(1) “Lending Falls at Epic Pace,” *The Wall Street Journal*, February 24, 2010, p. A1.

Seller financing is, once again, one of the very few alternatives for getting most transactions done. The amount of seller financing available for broadcast station purchases can vary dramatically but frequently falls in the range of 33% to 75% of the total purchase price. Not surprisingly, sellers want as much of the purchase price in cash as possible at closing while buyers want to pay as little as possible. Interest rates on seller notes vary widely. The terms of these notes are often similar to that of typical bank term notes in a broadcast transaction: five years.

This article discusses both the benefits and the risks of seller financing. It also suggests ways to reduce the risk for sellers of allowing buyers to pay all or a portion of the purchase price by means of an installment sale.

BENEFITS

- i) Generally, sellers receive a higher purchase price if they accept an installment sale. Data compiled by business brokers nationally indicates that there is generally a 30% or greater price premium for businesses offered with seller financing, compared to those requiring all cash up front.
- ii) With bank financing virtually non-existent, seller “paper” greatly increases the chances that a station will be sold.
- iii) Seller financing eliminates the uncertainty of a transaction where the closing is subject to a buyer-financing contingency. It also widens the universe of potential buyers.
- iv) The interest rate in a seller-financed transaction will significantly add to the actual amount received by the seller. For example, a seller balloon note of \$100,000 at 8% carried for nine years will double the take home to \$200,000.
- v) With interest rates on money market and savings accounts the lowest in decades, typically less than 1%, sellers can obtain a much higher interest rate on a note from a buyer. The seller has an advantage vis-à-vis other sources of financing, in that the seller is already familiar with the station that is being sold, the anticipated source of the cash flow that will service the note and the collateral to which the seller will have recourse in the event of default.
- vi) For some sellers, the income tax consequences of an installment note may be more advantageous than those of an all-cash sale. Capital gains from the sale in most instances may be reported in installments, stretching out taxes over the term of the loan, although installment treatment is generally available for profits treated as capital gains. Savings from the installment method may be affected by changes in applicable federal and state tax rates between the year of the sale and the years in which principal payments are received. Installment sale treatment, however, may not be available in all circumstances or for all assets sold.
- vii) An installment sale can be structured in a flexible manner, so that the interest rate, the payment schedule, the repayment period and other terms reflect the financial situations of the seller and the buyer.

viii) Seller financing often leads to a speedier sale – the buyer does not have to meet with loan committees or obtain the assurances necessary to satisfy a lender’s due diligence requirements. (Another benefit of seller financing is the buyer does not pay loan processing or guaranty fees and is not subjected to invasive lender controls or audits.)

RISKS

i) The biggest risk for the seller is that the revenues and cash flow of the station will decline before the buyer makes full repayment. While the seller may hold a senior secured lien on the assets and have other forms of security, these might not provide sufficient security if the value of the station declines sharply, whether due to poor management by the buyer, general market conditions or other causes.

ii) If the buyer stops making payments, the only practical recourse for the seller will be to foreclose on the station. Foreclosure is a costly and time-consuming process and entails a court proceeding. It may require appointment of a receiver or trustee to operate the station and to conduct a judicial sale. The assignment of a station license to a receiver or trustee will require prior Commission approval. However, this can be obtained by means of abbreviated procedures through the use of a “short form” application (FCC Form 316). When a new buyer is selected, a so-called “long form” application (FCC Form 314 or 315) will need to be filed with the Commission.

iii) The debtor/buyer can stop or significantly delay the foreclosure process, through a bankruptcy filing. A debtor in financial distress may have an involuntary bankruptcy petition filed against it by other creditors. The assignment of the station’s license to the buyer/licensee as the debtor-in-possession will require the filing of a short form application with the FCC. Even in the best case, bankruptcy involves substantial delays and costs, and may further damage the value of the collateral.

iv) There is a significant additional tax risk if the seller carries a balloon note with current interest payments for an extended period – especially if the note is for a significant portion of the purchase price. The holder of the note may have to recognize and pay tax at ordinary income rates on the deferred interest as it accrues, even if not paid.

RECOMMENDED ACTIONS

Do Due Diligence

i) The best way for a seller to reduce risk is to select a well capitalized buyer with a proven record of success in operating similar stations. An essential first step for the seller is to conduct due diligence concerning the financial qualifications of the buyer, including the buyer’s background, credit record, management experience, ownership of broadcast stations, personal assets and character. Sellers should not hesitate interviewing buyers as they would when hiring an employee. If a seller has any doubts about a buyer’s ability to operate the station and to pay the note, third party input should be solicited – such as other sellers who have closed deals with the prospective buyer. Also, it might be fruitful for the seller to talk with the buyer’s previous employers and employees. An experienced broker will assist in qualifying potential buyers by making sure they have sufficient funds and management capability to make a down payment, to operate the station, and to retire debt to pay the purchase price.

ii) By providing financing, a seller is betting on the buyer’s ability to contribute its operating skills both to generate the cash flow needed to service the debt, and to maintain sufficient value in the station to have the incentive to continue to make payments on the note. For example, the seller may be an absentee owner physically removed from the local market. The buyer may be a local resident who knows the market backwards and forwards. These local relationships may be uniquely valuable, and unavailable to the seller. Advice to sellers: if you are not confident the buyer can operate the station successfully, do not offer financing. Not confident? We recommend that you stop reading this article!

Dollars and Sense Issues

iii) Sellers should make sure that the purchase price reflects the risks of an installment sale. Accordingly, there should be a premium added to the purchase price for an installment sale as compared to an all cash deal. This premium can be reflected in the purchase price or in the terms of the seller financing, such as the interest rate.

iv) To minimize the risk of an installment sale, the buyer should be asked to make a significant down payment at the closing. It is usually in the seller's best interest to finance no more than one-third to one-half of the purchase price. However, in the current climate of limited capital, the seller may need to be flexible – where it is prudent. A buyer with a sizeable down payment at risk has a powerful incentive to pay off the balance on a note for fear of losing the original down payment.

v) The interest rate negotiated between the buyer and the seller will be a function of market factors, competition and perceived risk. With bank financing virtually non-existent, the seller may be justified in commanding a premium over a "market" bank rate. But the buyer will take into consideration the "value" of seller financing in proposing the purchase price. The rate is a delicate balance between the needs of the buyer and the seller. Another factor to keep in mind is that sellers generally pay capital gains taxes on the purchase price and taxes at ordinary income rates on the interest.

vi) Because the Internal Revenue Service tends to give special scrutiny to transactions between "related parties," providing seller financing to family members could be subject to audit. Related parties, according to the IRS, includes members of a family (brothers, sisters, half-sisters, spouse), ancestors (parents, grandparents, etc.) and lineal descendants (children, grandchildren, etc.). See "Keeping Your Station All in the Family," by Erwin G. Krasnow, Radio Business Report/Television Business Report, April 7, 2010. Many special IRS regulations dealing with related party transactions make the installment method unavailable and/or convert capital gain to ordinary income. In other cases, although the installment method may be available, a subsequent disposition of the station by the buyer within two years after the closing may require the acceleration of the recognition of the rest of the gain, even if the note is not paid off. Also, losses on sales to related parties may be disallowed – something quite relevant in this era of depressed valuations. Because related party transactions are subject to numerous special tax rules, the sale of a station to a related party should be structured only with the assistance of competent tax counsel.

FCC Issues

vii) The FCC and the courts have recognized that a lender cannot have direct security interest in the license itself, but can take a security interest in the proceeds of the sale of a station and its license. The definition of collateral in the security documents should include the "proceeds of the sale" of FCC licenses. The rationale for such a distinction is that a security interest in the proceeds of the debtor's license would not give the creditor control over the license itself. Without the license, the liquidation value of the collateral would be only a fraction of the station's value. If the station is sold as a "going concern," however, the lender has a much better chance of being paid in full. Consideration should be given to including a provision in the loan documents that if and when the communications laws permit a security interest in an FCC license, then a security interest is granted in any and all FCC licenses.

viii) When seller financing is used, the Commission's prohibition against a seller maintaining a reversionary interest on default comes into play. Section 73.1150 of the FCC's rules, the Commission's "rule against reversion," prohibits clauses in contracts that (a) provide for reversion (i.e., reassignment of a license) or "reacquisition" of station control in the event of default by the purchaser, and (b) reserve to the seller any rights to use the facilities of the station as a condition of the sale. In interpreting its prohibition against reversions, the FCC has consistently refused to grant transfer and assignment applications where the seller retained the right to regain the status of licensee through reversion of stock control or reassignment of the station's license. FCC policy demands that the buyer/licensee be free to dispose of the control of the licensee entity or the station license without the former owner's consent. Because a seller will want to be protected in the event the buyer

defaults on the note, the temptation will be to include a provision whereby the seller can get the station back if the buyer defaults. Beware: This is a classic example of a prohibited reversionary interest. The temptation to provide the seller with a reversionary interest in the event of a default on a note is so great that the FCC staff frequently will ask the parties to a transaction involving seller paper to confirm that the transaction does not give the seller the right to get the station back in the event the buyer defaults on the note.

ix) If the buyer is a corporation or a limited liability company, additional security should be obtained by a pledge of the corporate stock or the LLC units. Under the pledge agreement, the secured party maintains physical possession of the security. Sellers might consider adopting the approach of many broadcast lenders who require that the borrower set up a separate "license subsidiary," namely, a company whose only asset is the FCC license of the station. The seller and the buyer then enter into an agreement whereby the stock or LLC interest of the license subsidiary is pledged to the lender. Significantly, the seller may not exercise voting rights until the FCC has approved the new holder of the station's licenses. The requirement for prior FCC approval should be recited in the pledge agreement. Also, provision should be made for allowing the stock to be sold at a public auction in the event of a default, or in a private sale to a buyer found after the default, at which time the seller could also be a bidder.

Getting Secure

x) Assuming that no bank financing is involved, the seller always should obtain a first security interest or lien in the personal and intangible property owned by the station. The lien should be memorialized in a security agreement. This agreement provides for the enforcement of the seller's rights against the collateral if the buyer defaults on the promissory note.

xi) The security agreement should contain covenants by the buyer concerning operation of the station in accordance with all laws and regulations, timely payment of all taxes, maintenance of the assets in good condition and repair and keeping the assets free of liens and encumbrances. The buyer should submit monthly, quarterly or annual financial statements and allow the seller at reasonable times during the buyer's normal business hours to inspect the assets and to inspect, audit and copy the buyer's books and records relating to the assets. (Remember, when the FCC transfers the license to the buyer, the responsibility is out of the seller's hands – no matter that the seller may still have money on the line.)

xii) Like banks and other financial institutions, the seller should negotiate for protections to ensure that the buyer does not strip the station of its value. Thus, provisions should restrict compensation, dividends, capital distributions and other payments to the new owners, prohibit the sale of assets except in the ordinary course of business, and require the maintenance of specified minimum levels of working capital until the purchase price is paid. Bank financing usually will include other protections for the lender, such as requiring maintenance of specified ratios between cash flow and debt service that can give the lender an early warning if the borrower is not doing well. Sellers providing financing can also benefit from such protections, although there is often an expectation on the part of buyers and their counsel that seller financing will be much easier to deal with than bank financing. The FCC has allowed security agreements prohibiting the purchaser from making major expenditures not customary in the ordinary course of a broadcast operation without the lender's approval. The Commission also permits the loan documents to require the borrower, in the event of a default, to cooperate with the lender in the appointment of a receiver.

xiii) It is important to create a public record of the seller's security interest by filing a UCC (Uniform Commercial Code) Financing Statement (UCC-1) with the appropriate state or county office in the location or domicile of the buyer. If the buyer is a corporation, LLC or other business entity, this usually will be the state where the buyer is incorporated or organized, even if different than the state in which the station is located, but local laws can differ. A filing made in the wrong place can be worthless, so it is important to be careful. Also, a filing made too late can be ineffective against creditors with liens arising before the filing, so speed is important. The description of collateral in the UCC-1 filing should be specific. A perfected and timely filed

security interest will provide protection in the event of a bankruptcy and for priority in the event of a dispute with other subsequently-secured creditors.

xiv) The security agreement and the UCC Financing Statement do not cover real estate. To create a lien on real estate, the seller should obtain from the buyer a first or second mortgage or deed of trust on the station's real estate or other real estate owned by the buyer, which should be recorded with the appropriate land records offices (usually in the state and county where the land is located). When tower sites are involved in the transaction, sellers should consider obtaining leasehold mortgages on the tower, together with lease assignments of any subleases of space on such towers.

xv) Security interests in certain kinds of assets require other procedures. For example, a security interest in a vehicle can be perfected by placing the creditor's name on the vehicle title as a lien holder, and a security interest in trademarks and servicemarks can be perfected by a filing with the Patent and Trademark Office.

Notes on the Promissory Note

xvi) A promissory note is a written promise to repay a loan or debt under specific terms (usually at a stated time, through a specified series of payments, or "on demand"). Notes typically contain provisions setting forth grace periods, late charges, default interest rates and attorneys fees. With respect to late charges, as with interest rates, there may be limits imposed by state law on fees that the seller can charge in the event of a late payment.

xvii) The note should include an acceleration clause which will make the entire amount of the note due if a default is not cured within a specified grace period, whether that default is failing to make a payment when due or a breach by the buyer of any of the covenants or protective provisions of the note, security agreement or purchase agreement. The note should also include a provision whereby the buyer acknowledges and waives its rights to notice of default, demand and notice of acceleration. The note should specifically provide that the outstanding principal balance is immediately due and payable upon the sale of substantially all of the assets of the maker or all of the ownership interest of the maker.

xviii) The note should include a confessed judgment clause, in which the buyer authorizes a judgment to be entered against it if it is necessary to take the buyer to court. Rules and practices vary from state to state. Some states impose restrictions on confession of judgments (or even prohibit them entirely in certain kinds of transactions), but generally a confession of judgment complying with applicable state law will limit the defenses that a defaulting buyer can assert and give the seller a speedier remedy.

xix) Only one copy of the note should be signed, and that original should be held by the seller. Some courts insist on the production of the original note, not a photocopy or an electronic copy.

xx) If the buyer were to have problems in making payments under the note, the buyer might try to make claims of breaches by the seller under the purchase agreement and attempt to offset them against the principal of the note. We recommend that the seller include a provision in the purchase agreement and the note that the buyer waives any and all rights to offset, deduct or withhold any payments against the note.

Other Considerations

xxi) Post-closing, the buyer should be required to keep the assets fully insured against fire, theft or vandalism and general liability until the note is paid. The seller also should be designated as an additional insured under the policy. The buyer should be required to inform the seller of any changes in coverage or a cancellation. To reassure the buyer, the insurance proceeds to the seller can be limited to the amount of remaining money owed on the note, with the balance going to other beneficiaries.

xxii) One of the principals of the buyer might be asked to take out a life insurance policy with the selling entity as the beneficiary in an amount equal to the unpaid balance of the note. Disability insurance policies on key

members of the buyer's management team might be considered, but they are not often used because of their expense.

xxiii) In addition to the guaranty of the business entity acquiring the station, the seller should ask for a personal guaranty from the buyer's principals and their spouses. A personal guaranty is not a specific lien on any particular asset, but provides for personal liability as needed to pay the note. A personal guaranty, like a note, can also be secured by the pledge of specific assets; if the guaranty is not secured, it would be necessary to obtain a judgment against the guarantor before seizing the assets to satisfy the obligation. The spouse's signature is needed to prevent the transfer of assets to the spouse to dilute the buyer's net worth and to make sure that jointly owned assets will be available to pay a judgment.

xxiv) If the buyer is lucky enough to obtain partial bank financing and the seller is compelled to subordinate payments to senior financing, the seller will need to enter into negotiations with the lender with regard to subordination and the relationship with each other with respect to the buyer and the collateral. The seller should seek to limit the depth of its subordination, including limitations on the principal amount of senior indebtedness, the interest rate on the senior indebtedness and amendments of the payment terms of the senior indebtedness, which have the effect of putting the payment of the subordinated seller financing at greater risk.

Deal makers in today's broadcast station market recognize that sellers and buyers are operating in an environment of uncertainty and lack of access to capital. The familiar rules and standards that previously applied to broadcast M&A have disappeared. Banks are wary of putting capital at risk when there is a perceived risk that their capital will not be returned with a profit. For the prospective station buyer or seller, this does not mean that radio and television are dead. It means that the investment paradigm is moving to a new level of equilibrium. For value investors with solid operating skills and creative approaches to closing deals, this creates a buying opportunity - - one with mutual benefits to the seller and the buyer.

--Erwin G. Krasnow, a partner with the firm of Garvey Schubert Barer, is a former General Counsel of the National Association of Broadcasters, and coauthor (with John M. Pelkey and John Wells King) of *Profitably Buying and Selling Broadcast Stations*. He can be reached at ekrasnow@gsblaw.com and (202) 298-2161.

John R. Brooks is a 25-year broadcast finance veteran, most recently (until 2009) as a Managing Director with Wells Fargo Foothill. He currently works as an independent broadcast consultant and writer. He can be reached at johnrbrooks@comcast.net and (415) 272-5123.

Krasnow and Brooks are in the process of writing of a more comprehensive piece about financing radio station transactions in the new millennium.

Disclaimer: Any tax advice contained in this article is not intended to be used, and cannot be used, for the purpose of avoiding federal tax penalties.