

SAGA COMMUNICATIONS INC

Form 10-Q

November 09, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the Quarterly Period ended September 30, 2006**

**or**

**TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the transition period from            to**

**Commission file number 1-11588**

**Saga Communications, Inc.**

*(Exact name of registrant as specified in its charter)*

**Delaware**

*(State or other jurisdiction of  
incorporation or organization)*

**38-3042953**

*(I.R.S. Employer  
Identification No.)*

**73 Kercheval Avenue**

**Grosse Pointe Farms, Michigan**

*(Address of principal executive offices)*

**48236**

*(Zip Code)*

**(313) 886-7070**

*(Registrant's telephone number, including area code)*

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer     Accelerated filer     Non-accelerated filer

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No .

The number of shares of the registrant's Class A Common Stock, \$.01 par value, and Class B Common Stock, \$.01 par value, outstanding as of October 31, 2006 was 17,833,432 and 2,395,690, respectively.

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****SAGA COMMUNICATIONS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>September 30, 2006 (Unaudited)</b>	<b>December 31, 2005 (Note)</b>
	<b>(In thousands)</b>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 8,972	\$ 15,168
Accounts receivable, net	23,195	22,998
Prepaid expenses and other current assets	5,694	5,596
Total current assets	37,861	43,762
Property and equipment	142,672	137,208
Less accumulated depreciation	72,130	67,539
Net property and equipment	70,542	69,669
Other assets:		
Broadcast licenses, net	149,774	148,925
Goodwill, net	49,596	48,762
Other intangibles, deferred costs and investments, net	12,375	7,747
Total other assets	211,745	205,434
	<b>\$ 320,148</b>	<b>\$ 318,865</b>

*See notes to unaudited condensed consolidated financial statements.*

Table of Contents**SAGA COMMUNICATIONS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>September 30, 2006 (Unaudited)</b>	<b>December 31, 2005 (Note)</b>
	<b>(In thousands)</b>	
<b>Liabilities and stockholders equity</b>		
Current liabilities:		
Accounts payable	\$ 1,291	\$ 1,245
Payroll and payroll taxes	6,148	7,063
Other accrued expenses	6,523	4,145
Barter transactions	2,125	1,691
Current portion of long-term debt		7,000
Total current liabilities	<b>16,087</b>	21,144
Deferred income taxes	<b>29,860</b>	26,174
Long-term debt	<b>136,911</b>	141,911
Other liabilities	<b>3,726</b>	3,812
<b>Stockholders equity:</b>		
Common stock	<b>213</b>	212
Additional paid-in capital	<b>48,680</b>	48,639
Retained earnings	<b>97,462</b>	88,685
Treasury stock	<b>(12,791)</b>	(11,002)
Unearned compensation on restricted stock		(710)
Total stockholders equity	<b>133,564</b>	125,824
	<b>\$ 320,148</b>	\$ 318,865

Note: The balance sheet at December 31, 2005 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

*See notes to unaudited condensed consolidated financial statements.*

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## SAGA COMMUNICATIONS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(Unaudited)			
	(In thousands, except per share data)			
Net operating revenue	\$ 35,791	\$ 35,961	\$ 104,727	\$ 105,345
Station operating expense	25,761	26,110	76,833	77,464
Corporate general and administrative	2,225	1,934	6,705	6,060
Operating income	7,805	7,917	21,189	21,821
Other expenses, net:				
Interest expense	2,375	2,082	7,007	5,511
Other (income) expense	(75)	(35)	(645)	1,503
Income before income tax	5,505	5,870	14,827	14,807
Income tax provision	2,241	2,430	6,050	6,130
Net income	\$ 3,264	\$ 3,440	\$ 8,777	\$ 8,677
Earnings per share:				
Basic	\$ .16	\$ .17	\$ .43	\$ .42
Diluted	\$ .16	\$ .17	\$ .43	\$ .42
Weighted average common shares	20,488	20,453	20,515	20,489
Weighted average common and common equivalent shares	20,502	20,631	20,532	20,726

*See notes to unaudited condensed consolidated financial statements.*

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## SAGA COMMUNICATIONS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	<b>Nine Months Ended September 30, 2006                  2005 (Unaudited) (In thousands)</b>	
<b>Cash flows from operating activities:</b>		
Cash provided by operating activities	\$ 19,600	\$ 19,012
<b>Cash flows from investing activities:</b>		
Acquisition of property and equipment	(6,836)	(9,054)
Proceeds from sale of assets	1,007	367
Increase in intangibles and other assets	(4,775)	(936)
Acquisition of stations	(779)	(31,577)
Net cash used in investing activities	(11,383)	(41,200)
<b>Cash flows from financing activities:</b>		
Proceeds from long-term debt		34,750
Payments on long-term debt	(12,000)	
Payments for debt issuance costs	(350)	
Purchase of shares held in treasury	(2,131)	(7,433)
Net proceeds from exercise of stock options	68	202
Net cash (used in) provided by financing activities	(14,413)	27,519
Net (decrease) increase in cash and cash equivalents	(6,196)	5,331
Cash and cash equivalents, beginning of period	15,168	9,113
Cash and cash equivalents, end of period	\$ 8,972	\$ 14,444

*See notes to unaudited condensed consolidated financial statements.*

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**SAGA COMMUNICATIONS, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**1. Summary of Significant Accounting Policies**

***Basis of Presentation***

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for annual financial statements.

In our opinion, the accompanying financial statements include all adjustments of a normal, recurring nature considered necessary for a fair presentation of our financial position as of September 30, 2006 and the results of operations for the three and nine months ended September 30, 2006 and 2005. Results of operations for the nine months ended September 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

For further information, refer to the consolidated financial statements and notes thereto included in the Saga Communications, Inc. Annual Report on Form 10-K for the year ended December 31, 2005.

***Income Taxes***

Our effective tax rate is higher than the federal statutory rate as a result of certain non-deductible depreciation and amortization expenses and the inclusion of state taxes in the income tax amount.

***Revenue Recognition***

Revenue from the sale of commercial broadcast time to advertisers is recognized when commercials are broadcast. Revenue is reported net of advertising agency commissions. Agency commissions, when applicable, are based on a stated percentage applied to gross billing.

***Time Brokerage Agreements/Local Marketing Agreements***

We have entered into Time Brokerage Agreements ( TBA s ) or Local Marketing Agreements ( LMA s ) in certain markets. In a typical TBA/LMA, the Federal Communications Commission ( FCC ) licensee of a station makes available, for a fee, blocks of air time on its station to another party that supplies programming to be broadcast during that air time and sells its own commercial advertising announcements during the time periods specified. We account for TBA s/LMA s under SFAS 13, Accounting for Leases and related interpretations. Revenue and expenses related to TBA s/LMA s are included in the accompanying Condensed Consolidated Statements of Income.

***Stock-Based Compensation***

On January 1, 2006, we adopted the Revised Statement of Financial Accounting Standard No. 123, Share-Based Payment ( SFAS 123R ). SFAS 123R addresses the accounting for share-based payment transactions in which a company receives employee services in exchange for either an equity instrument of the company (typically stock options) or liabilities that are based on the grant date fair value of the award. The statement eliminates the ability to

account for share-based compensation transactions, as we formerly did, using the intrinsic value method as prescribed by Accounting Principles Board, or APB, Opinion No. 25, Accounting for Stock Issued to Employees, and generally requires that such transactions be accounted for using a fair-value-based method and recognized as expenses in our consolidated statement of income.

We adopted SFAS 123R using the modified prospective transition method which requires the application of the accounting standard as of January 1, 2006. Our 2006 consolidated financial statements reflect the impact of adopting SFAS 123R. In accordance with the modified prospective transition method, the consolidated

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**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
 financial statements for prior periods have not been restated to reflect, and do not include the impact of SFAS 123R. See Note 7 Stock-Based Compensation for further details.

Stock-based compensation expense recognized during the period is based on the fair value of the portion of stock-based payment awards that is ultimately expected to vest using the Black-Scholes option-pricing model. Stock-based compensation expense recognized in the condensed consolidated statement of income during 2006 included compensation expense for stock-based payment awards granted prior to, but not yet vested, as of January 1, 2006 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS No. 148 ( SFAS 148 ), Accounting for Stock-Based Compensation Transition and Disclosure, and compensation expense for the stock-based payment awards granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with SFAS 123R. As stock-based compensation expense recognized in the condensed consolidated statement of income for the three and nine months ended September 30, 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the pro forma information required under SFAS 148 for the periods prior to 2006, we accounted for forfeitures as they occurred.

**2. Recent Accounting Pronouncements**

On September 15, 2006, the FASB issued FAS No. 157, *Fair Value Measurements*, which provides guidance for using fair value to measure assets and liabilities. The standard also responds to investors' requests for more information about: (1) the extent to which companies measure assets and liabilities at fair value; (2) the information used to measure fair value; and (3) the effect that fair value measurements have on earnings. SFAS No. 157 will apply whenever another standard requires (or permits) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value to any new circumstances. SFAS No. 157 is effective January 1, 2008. We are currently evaluating the impact of SFAS No. 157 and its effect on our financial position, results of operations or cash flows.

On September 13, 2006, the SEC issued Staff Accounting Bulletin ( SAB ) No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB No. 108 provides guidance on the consideration of effects of the prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. The SEC staff believes registrants must quantify errors using both a balance sheet and income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB No. 108 is effective in our fourth quarter of 2006. We are currently assessing the impact of this pronouncement, if any, on our financial position, results of operations or cash flows.

On July 13, 2006, the Financial Accounting Standards Board (FASB) issued FIN 48, *Accounting for Uncertainty in Income Taxes and Related Implementation Issues* that provides guidance on the financial statement recognition, measurement, and presentation and disclosure of certain tax positions that a company has taken or expects to take on a tax return. Under FIN 48, financial statements should reflect expected future tax consequences of such positions presuming the taxing authorities have full knowledge of the position and all relevant facts. FIN 48 also revises the disclosure requirements and is effective for the Company as of January 1, 2007. We are currently evaluating FIN 48 and its effect on our financial position, results of operations and cash flows.

On October 6, 2005, the FASB issued FASB Staff Position ( FSP ) No. FAS 13-1, *Accounting for Rental Costs Incurred during a Construction Period*. Under FSP No. FAS 13-1, rental costs associated with ground or building operating leases, that are incurred during a construction period, shall be recognized as rental expense and included in income from continuing operations. The guidance in this FSP was effective January 1,

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**SAGA COMMUNICATIONS, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
2006. The adoption of FSP No. FAS 13-1 did not have a material on our financial position, results of operations or cash flows.

On June 1, 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections a Replacement of APB Opinion No. 20 and FASB Statement No. 3 ( SFAS 154 ). SFAS 154 changes the requirements for the accounting and reporting of a change in accounting principle. SFAS 154 applies to all voluntary changes in accounting principle, as well as to changes required by an accounting pronouncement that does not include specific transition provisions. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS 154 did not have a material impact on our financial position, results of operations or cash flows.

**3. Intangible Assets and Goodwill**

Under SFAS No. 142 Accounting for Goodwill and Other Intangible Assets, ( SFAS 142 ) goodwill and intangible assets deemed to have indefinite lives are not amortized and are subject to annual, or more frequent if impairment indicators arise, impairment tests.

We consider FCC broadcast licenses to have indefinite lives. Factors that we considered in evaluating that the radio and television FCC licenses are indefinite-lived intangible assets under SFAS 142 include the following:

The radio and television broadcasting licenses may be renewed indefinitely at little cost.

The radio and television broadcasting licenses are essential to our business, and we intend to renew our licenses indefinitely.

We have never been denied the renewal of a FCC broadcast license.

We do not believe that there will be any compelling challenge to the renewal of our broadcast licenses.

We do not believe that the technology used in broadcasting will be replaced by another technology in the foreseeable future.

Based on the above, we believe cash flows from our radio and television licenses are expected to continue indefinitely.

Separable intangible assets that have finite lives are amortized over their useful lives using the straight-line method. Favorable lease agreements are amortized over the lives of the leases. Other intangibles are amortized over five to forty years.

Table of Contents**SAGA COMMUNICATIONS, INC.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****4. Common Stock and Treasury Stock**

The following summarizes information relating to the number of shares of our common stock issued in connection with stock transactions through September 30, 2006:

	<b>Common Stock Issued</b>	
	<b>Class A</b>	<b>Class B</b>
	<b>(Shares in thousands)</b>	
Balance, January 1, 2005	18,699	2,360
Exercised options	42	
Issuance of restricted stock	51	9
Balance, December 31, 2005	18,792	2,369
Exercised options	8	5
Issuance of restricted stock	91	21
Balance, September 30, 2006	18,891	2,395

We have a Stock Buy-Back Program (the Buy-Back Program) to allow us to purchase up to \$30,000,000 of our Class A Common Stock. From its inception in 1998 through September 30, 2006, we have repurchased 1,727,089 shares of our Class A Common Stock for approximately \$24,769,000.

On September 13, 2006 we entered into an agreement with a third party broker to repurchase Class A Common Stock under our Buy-Back Program in compliance with the guidelines and limitations of Rules 10b5-1 and 10b-18 under the Securities Exchange Act of 1934. The agreement ended on November 8, 2006.

**5. Total Comprehensive Income and Accumulated Other Comprehensive Income**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>(In thousands)</b>			
<b>Total Comprehensive Income Consists of:</b>				
Net income	\$ 3,264	\$ 3,440	\$ 8,777	\$ 8,677
Accumulated other comprehensive income (loss):				
Change in market value of securities, net of tax				2
Gain realized on sale of securities, net of tax				(62)

Total comprehensive income	\$ 3,264	\$ 3,440	\$ 8,777	\$ 8,617
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## 6. Acquisitions

We actively seek and explore opportunities for expansion through the acquisition of additional broadcast properties. The consolidated statements of income include the operating results of the acquired stations from their respective dates of acquisition. All acquisitions were accounted for as purchases and, accordingly, the total costs were allocated to the acquired assets and assumed liabilities based on their estimated fair values as of the acquisition dates. The excess of consideration paid over the estimated fair value of net assets acquired has been recorded as goodwill, which is deductible for tax purposes.

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**SAGA COMMUNICATIONS, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
***Pending Acquisitions***

On January 21, 2004, we entered into agreements to acquire an FM radio station (WOXL-FM) serving the Asheville, North Carolina market, for approximately \$8,000,000. We are currently providing programming to WOXL-FM under a Sub-Time Brokerage Agreement. This transaction is subject to the approval of the FCC and has been contested. We expect to close on the acquisitions when all required approvals are obtained.

On August 28, 2006, we entered into an agreement to acquire an FM radio station (WCNR-FM) serving the Charlottesville, Virginia market for \$3,250,000. On September 1, 2006 we began providing programming under an LMA to WCNR-FM. The transaction is subject to FCC approval and we expect to close on the acquisition in the first quarter of 2007.

On October 5, 2006, we entered into an agreement to acquire one AM and one FM (WKRT-AM and WIII-FM) radio stations licensed to Cortland, New York and serving the Ithaca, New York market for approximately \$4,000,000. This transaction is subject to FCC approval and we expect to close on this acquisition in the first quarter 2007.

***2006 Acquisition***

On August 7, 2006, we acquired one FM radio station (WCTU-FM) serving the Tazwell, Tennessee market for approximately \$779,000. This station has filed for FCC approval to relocate its tower to Weaverville, North Carolina (serving the Asheville, North Carolina market). When this relocation occurs, we will owe an additional \$3,350,000.

***2005 Acquisitions***

On November 22, 2005, we acquired one AM radio station (WVAX-AM) serving the Charlottesville, Virginia market for approximately \$151,000.

Effective June 1, 2005, we acquired two FM and two AM radio stations (WQNY-FM, WYXL-FM, WNYY-AM and WHCU-AM) serving the Ithaca, New York market for approximately \$13,610,000. We financed this transaction through funds generated from operations and additional borrowings of approximately \$11,000,000 under our Credit Agreement and the re-issuance of approximately \$2,602,000 of our Class A common stock. Final order from the FCC is still pending on this acquisition.

Effective January 1, 2005, we acquired one AM and two FM radio stations (WINA-AM, WWWV-FM and WQMZ-FM) serving the Charlottesville, Virginia market for approximately \$22,490,000, including approximately \$1,986,000 of our Class A common stock. We financed this transaction through funds generated from operations and additional borrowings of approximately \$19,750,000 under our Credit Agreement.

Effective January 1, 2005, we acquired one AM radio station (WISE-AM) serving the Asheville, North Carolina market for approximately \$2,192,000.

Effective January 1, 2005 we acquired a low power television station (KXTS-LP) serving the Victoria, Texas market for approximately \$268,000.

***Condensed Consolidated Balance Sheet of 2006 and 2005 Acquisitions:***

The following unaudited condensed balance sheets represent the estimated fair value assigned to the related assets and liabilities of the 2006 and 2005 acquisitions at their respective acquisition dates. In connection with the 2005 acquisitions, we issued Class A common stock of approximately \$4,588,000.

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**Saga Communications, Inc.****Condensed Consolidated Balance Sheet of 2006 and 2005 Acquisitions**

	<b>Acquisitions in</b>	
	<b>2006</b>	<b>2005</b>
	<b>(In thousands)</b>	
<b>Assets Acquired:</b>		
Current assets	\$	\$ 2,542
Property and equipment	10	4,783
Other assets:		
Broadcast licenses-Radio segment		18,909
Broadcast licenses-Television segment		157
Goodwill-Radio segment	769	12,479
Goodwill-Television segment		67
Other intangibles, deferred costs and investments		117
Total other assets	769	31,729
Total assets acquired	779	39,054
<b>Liabilities Assumed:</b>		
Current liabilities		2,737
Total liabilities assumed		2,737
Net assets acquired	\$ 779	\$ 36,317

***Pro Forma Results of Operations for Acquisitions and Dispositions (Unaudited)***

The following unaudited pro forma results of our operations for the three and nine months ended September 30, 2006 and 2005 assume the 2005 acquisitions occurred as of January 1, 2005. The 2006 acquisition and LMA are start up stations and therefore, have no pro forma revenue and expenses. The pro forma results give effect to certain adjustments, including depreciation, amortization of intangible assets, increased interest expense on acquisition debt and related income tax effects. The pro forma results have been prepared for comparative purposes only and do not purport to indicate the results of operations which would actually have occurred had the combinations been in effect on the dates indicated or which may occur in the future.



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## SAGA COMMUNICATIONS, INC.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
	(In thousands, except per share data)			
<b>Consolidated Results of Operations</b>				
Net operating revenue	\$ 35,791	\$ 35,961	\$ 104,727	\$ 106,358
Station operating expense	25,761	26,110	76,833	78,421
Corporate general and administrative	2,225	1,934	6,705	6,060
Operating income	7,805	7,917	21,189	21,877
Interest expense	2,375	2,082	7,007	5,731
Other (income) expense, net	(75)	(35)	(645)	1,488
Income taxes	2,241	2,430	6,050	6,073
Net income	\$ 3,264	\$ 3,440	\$ 8,777	\$ 8,585
Basic earnings per share	\$ .16	\$ .17	\$ .43	\$ .42
Diluted earnings per share	\$ .16	\$ .17	\$ .43	\$ .41

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
	(In thousands)			
<b>Radio Broadcasting Segment</b>				
Net operating revenue	\$ 31,402	\$ 32,263	\$ 92,100	\$ 95,253
Station operating expense	22,300	22,728	66,675	68,410
Operating income	\$ 9,102	\$ 9,535	\$ 25,425	\$ 26,843

	Three Months		Nine Months Ended	
	Ended		September 30,	
	September 30,	September 30,	2006	2005
	2006	2005	(In thousands)	
<b>Television Broadcasting Segment</b>				
Net operating revenue	\$ 4,389	\$ 3,698	\$ 12,627	\$ 11,105

Station operating expense	<b>3,461</b>	3,382	<b>10,158</b>	10,011
Operating income	<b>\$ 928</b>	\$ 316	<b>\$ 2,469</b>	\$ 1,094

*Reconciliation of pro forma segment operating income to pro forma consolidated operating income:*

	<b>Radio</b>	<b>Television</b>	<b>Corporate and Other (In thousands)</b>	<b>Consolidated</b>
<b>Three Months Ended September 30, 2006:</b>				
Net operating revenue	<b>\$ 31,402</b>	<b>\$ 4,389</b>	<b>\$</b>	<b>\$ 35,791</b>
Station operating expense	<b>22,300</b>	<b>3,461</b>		<b>25,761</b>
Corporate general and administrative			<b>2,225</b>	<b>2,225</b>
Operating income (loss)	<b>\$ 9,102</b>	<b>\$ 928</b>	<b>\$ (2,225)</b>	<b>\$ 7,805</b>

**Table of Contents****SAGA COMMUNICATIONS, INC.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	<b>Radio</b>	<b>Television</b>	<b>Corporate and Other (In thousands)</b>	<b>Consolidated</b>
<b>Three Months Ended September 30, 2005:</b>				
Net operating revenue	\$ 32,263	\$ 3,698	\$	\$ 35,961
Station operating expense	22,728	3,382		26,110
Corporate general and administrative			1,934	1,934
Operating income (loss)	\$ 9,535	\$ 316	\$ (1,934)	\$ 7,917

	<b>Radio</b>	<b>Television</b>	<b>Corporate and Other (In thousands)</b>	<b>Consolidated</b>
<b>Nine Months Ended September 30, 2006:</b>				
Net operating revenue	\$ 92,100	\$ 12,627	\$	\$ 104,727
Station operating expense	66,675	10,158		76,833
Corporate general and administrative			6,705	6,705
Operating income (loss)	\$ 25,425	\$ 2,469	\$ (6,705)	\$ 21,189

	<b>Radio</b>	<b>Television</b>	<b>Corporate and Other (In thousands)</b>	<b>Consolidated</b>
<b>Nine Months Ended September 30, 2005:</b>				
Net operating revenue	\$ 95,253	\$ 11,105	\$	\$ 106,358
Station operating expense	68,410	10,011		78,421
Corporate general and administrative			6,060	6,060
Operating income (loss)	\$ 26,843	\$ 1,094	\$ (6,060)	\$ 21,877

**7. Stock-Based Compensation*****Employee Stock Purchase Plan***

We have an employee stock purchase plan (ESPP) for all eligible employees. Each quarter, an eligible employee may elect to withhold up to 10 percent of his or her compensation, up to a maximum of \$5,000, to purchase shares of our stock at a price equal to 85% of the fair value of the stock as of the last day of such quarter. The ESPP will terminate on the earlier of the issuance of 1,562,500 shares pursuant to the ESPP or December 31, 2008. Approximately 19,217 and 18,190 shares were purchased under the ESPP during the nine months ended September 30, 2006 and 2005, respectively. Our ESPP is deemed non-compensatory under the provisions of FAS 123R.

***2005 Incentive Compensation Plan***

On May 9, 2005, our stockholders approved the 2005 Incentive Compensation Plan (the 2005 Plan ) which replaces our 2003 Stock Option Plan (the 2003 Plan ) as to future grants. The 2005 Plan extends through March 2015 and allows for the granting of restricted stock, restricted stock units, incentive stock options, nonqualified stock options, and performance awards to officers and a selected number of employees. The number of shares of Common Stock that may be issued under the 2005 Plan may not exceed 500,000 shares of Class B Common Stock, 1,500,000 shares of Class A Common Stock of which up to

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**SAGA COMMUNICATIONS, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

500,000 shares of Class A Common Stock may be issued pursuant to incentive stock options and 500,000 Class A Common Stock issuable upon conversion of Class B Common Stock. Awards denominated in Class A Common Stock may be granted to any employee under the 2005 Plan. However, awards denominated in Class B Common Stock may only be granted to Edward K. Christian, President, Chief Executive Officer, Chairman of the Board of Directors, and the holder of 100% of the outstanding Class B Common Stock of the Corporation. Stock options granted under the 2005 Plan may be for terms not exceeding ten years from the date of grant and may not be exercised at a price which is less than 100% of the fair market value of shares at the date of grant.

***2003 Stock Option Plan***

In 2003, we adopted the 2003 Plan, upon expiration of our 1992 Stock Option Plan (the 1992 Plan ) in December 2002, pursuant to which our key employees, including directors who are employees, were eligible to receive grants of options to purchase our Class A Common Stock or Class B Common Stock. Options granted under the 2003 Plan were either incentive stock options (within the meaning of Section 422A of the Internal Revenue Code of 1986) or non-qualified options. Options for Class A Common Stock could be granted to any employee of the Corporation. Options for Class B Common Stock could only be granted to Edward K. Christian, President, Chief Executive Officer, Chairman of the Board of Directors, and the holder of 100% of the outstanding Class B Common Stock of the Corporation. With the approval of the 2005 Plan, the 2003 Plan was terminated as to future grants, therefore the shares available for future grants under the 2003 Plan are no longer available.

***1997 Non-Employee Director Stock Option Plan***

In 1997, we adopted the 1997 Non-Employee Director Stock Option Plan (the Directors Plan ) pursuant to which our directors who are not our employees are eligible to receive options. Under the terms of the Directors Plan, on the last business day of January of each year during the term of the Directors Plan, in lieu of their directors' retainer for the previous year, each eligible director shall automatically be granted an option to purchase that number of our shares of Class A Common Stock equal to the amount of the retainer divided by the fair market value of our Common Stock on the last trading day of the December immediately preceding the date of grant less \$.01 per share. The option exercise price is \$.01 per share. Options granted under the Directors Plan are non-qualified stock options, shall be immediately vested and become exercisable at the written election of the director. The options expire on the earlier of (i) 10 years from the date of grant or (ii) the March 16th following the calendar year in which they first become exercisable. This plan expires on May 12, 2007.

***Impact of the adoption of the SFAS 123R***

We adopted SFAS 123R using the modified prospective transition method beginning January 1, 2006. Accordingly, during the three and nine months ended September 30, 2006, we recorded stock-based compensation expense for awards granted prior to, but not yet vested, as of January 1, 2006, as if the fair value method required for pro forma disclosure under SFAS 123 were in effect for expense recognition purposes, adjusted for estimated forfeitures. For stock-based awards granted after January 1, 2006, we have recognized compensation expense based on the estimated grant date fair value method using the Black-Scholes valuation model. For these awards, we have recognized compensation expense using a straight-line amortization method. As SFAS 123R requires that stock-based compensation expense be based on awards that are ultimately expected to vest, stock-based compensation for the three and nine months ended September 30, 2006 has been reduced for estimated forfeitures. When estimating forfeitures, we consider voluntary termination behaviors as well as trends of actual option forfeitures. The compensation expense

recognized in corporate general and administrative expense of our results of operations for the three and nine months ended

**Table of Contents****SAGA COMMUNICATIONS, INC.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

September 30, 2006 were approximately \$229,000 and \$556,000, respectively. The associated future income tax benefit recognized for the three and nine months ended September 30, 2006 were approximately \$94,000 and \$228,000, respectively.

We calculated the fair value of the each option award on the date of grant using the Black-Scholes option pricing model. The following assumptions were used for each respective period:

	<b>2006 Grants</b>	<b>2005 Grants</b>
Weighted average grant date fair value per share	\$ 4.49	\$ 6.91
Expected volatility	37.19%	37.14%
Expected term of options (years)	7.8	7.6
Risk-free interest rate	4.27%	3.96%
Dividend yield	0%	0%
Forfeiture rate	2.47%	2.57%

The estimated expected volatility, expected term of options and estimated annual forfeiture rate were determined based on historical experience of similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant.

The following summarizes the stock option transactions for the 2005, 2003 and 1992 Plans for the nine months ended September 30, 2006:

	<b>Number of Options</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term (years)</b>	<b>Aggregate Intrinsic Value</b>
Outstanding at December 31, 2005	2,068,950	\$ 13.97	4.9	
Granted	506,138	9.00	9.7	
Exercised	(9,762)	5.83		
Forfeited/canceled	(7,946)	11.84		
Outstanding at September 30, 2006	2,557,380	\$ 13.03	5.2	\$ 6,788
Exercisable at September 30, 2006	1,844,145	\$ 13.98	3.6	\$ 6,788

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The following summarizes the non-vested stock option transactions for the 2005, 2003 and 1992 Plans for the nine months ended September 30, 2006:

	<b>Number of Options</b>		<b>Weighted Average Grant Date Fair Value</b>
Non-vested at December 31, 2005	268,786	\$	6.91
Granted	506,138		4.49
Vested	(53,743)		6.89
Forfeited/canceled	(7,946)		5.79
Non-vested at September 30, 2006	713,235	\$	5.20

**Table of Contents****SAGA COMMUNICATIONS, INC.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following summarizes the restricted stock transactions for the nine months ended September 30, 2006:

	<b>Shares</b>	<b>Weighted Average Grant Date Fair Value</b>
Outstanding at December 31, 2005	59,728	\$ 14.25
Granted	112,471	9.00
Vested	(11,936)	14.25
Forfeited	(1,765)	11.84
Non-vested and outstanding at September 30, 2006	158,498	\$ 10.55

For the three and nine months ended September 30, 2006, we had approximately \$93,000 and \$246,000, respectively, of total compensation expense related to restricted stock-based arrangements. At December 31, 2005, we recorded \$710,000 of unrecognized compensation cost on restricted stock as a deduction of stockholders' equity. On September 30, 2006, this amount was reclassified to additional paid-in capital in accordance with SFAS 123R.

The following summarizes the stock option transactions for the Directors Plans for the nine months ended September 30, 2006:

	<b>Number of Options</b>	<b>Weighted Average Price per Share</b>	<b>Aggregate Intrinsic Value</b>
Outstanding at December 31, 2005	12,193	\$ 0.008	
Granted	13,242	0.010	
Exercised	(3,122)	0.010	
Forfeited			
Outstanding and exercisable at September 30, 2006	22,313	\$ 0.009	\$ 172,500

***Pro forma Information for Periods Prior to the Adoption of SFAS 123R***

Prior to the adoption of SFAS 123R, we provided the disclosures required under SFAS No. 123, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosures. Employee stock-based compensation expense recognized under SFAS 123R was not reflected in our results of operations for the three and nine months ended September 30, 2005 for employee stock option awards as all options were granted with an exercise

price equal to the market value of the underlying common stock on the date of grant. Our ESPP was deemed non-compensatory under the provisions of APB No. 25. Forfeitures of awards were recognized as they occurred. Previously reported amounts have not been restated.

**Table of Contents****SAGA COMMUNICATIONS, INC.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The pro forma information for the three and nine months ended September 30, 2005 was as follows (in thousands, except per share amounts):

	<b>Three Months Ended September 30, 2005</b>	<b>Nine Months Ended September 30, 2005</b>
Net income, as reported	\$ 3,440	\$ 8,677
Add back: stock based compensation cost, net of tax	25	56
Less: pro forma stock based compensation cost determined under fair value method, net of tax	(463)	(1,387)
Pro forma net income	\$ 3,002	\$ 7,346
Pro forma earnings per share:		
Basic	\$ .15	\$ .36
Diluted	\$ .15	\$ .35

The fair value of our stock options was estimated as of the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions for the three and nine months ended September 30, 2005 and consistent with the requirements of SFAS 123: risk-free interest rate of 4.0%; a dividend yield of 0%; expected volatility of 30.1%; and a weighted average expected life of the options of 7 years, respectively.

**8. Long-Term Debt**

In May 2006, we amended our current credit agreement (the "Credit Agreement") to reduce the interest rate margin for LIBOR and the Agent bank's base rate; to reduce the bank's commitment fee percentage; to increase the total Revolving Commitments to \$200,000,000; and to extend the maturity date of the Revolving Commitments to July 29, 2012. Interest rates under the Credit Agreement are payable, at our option, at alternatives equal to LIBOR at the reset date (5.375% to 5.50% at September 30, 2006) plus 0.75% to 1.25% (4.563% at December 31, 2005, plus 0.75% to 1.625%) or the Agent bank's base rate plus 0% (0% to 0.375% at December 31, 2005). The spread over LIBOR and the base rate vary from time to time, depending upon our financial leverage. We also pay quarterly commitment fees of 0.25% to 0.375% per annum (0.375% to 0.625% per annum at December 31, 2005) on the unused portion of the Credit Agreement.

Our Credit Agreement is a \$200,000,000 reducing revolving line of credit maturing on July 29, 2012. Our indebtedness under the Credit Agreement is secured by a first priority lien on substantially all of our assets and of our subsidiaries, by a pledge of our subsidiaries' stock and by a guarantee of our subsidiaries. We have approximately \$64,150,000 of unused borrowing capacity under the Credit Agreement at September 30, 2006.

On March 31, 2008, the Revolving Commitments (as defined in the Credit Agreement) will be permanently reduced quarterly in amounts ranging from 3.125% to 12.5% of the total Revolving Commitments in effect on March 31, 2008. Any outstanding balance under the Credit Agreement will be due on the maturity date of July 29, 2012. In addition, the Revolving Commitments shall be further reduced by specified percentages of Excess Cash Flow (as defined in the Credit Agreement) based on leverage ratios.

**Table of Contents****SAGA COMMUNICATIONS, INC.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Long term debt consisted of the following:

	<b>September 30, 2006</b>	<b>December 31, 2005</b>
	<b>(In thousands)</b>	
Credit Agreement:		
Reducing revolver facility	\$ 135,850	\$ 147,850
Secured debt of affiliate	1,061	1,061
	136,911	148,911
Amounts paid within one year		7,000
	\$ 136,911	\$ 141,911

The impact of the Credit Agreement Amendment in May, 2006 on the future maturities of long-term debt at September 30, 2006 is as follows:

<b>Year Ending December 31,</b>	<b>(In thousands)</b>
2006	\$
2007	
2008	
2009	1,061
2010	35,850
Thereafter	100,000
	\$ 136,911

The Credit Agreement contains a number of financial covenants (all of which we were in compliance with at September 30, 2006) that, among other things, requires us to maintain specified financial ratios and impose certain limitations on us with respect to (i) the incurrence of additional indebtedness; (ii) acquisitions, except under specified conditions; (iii) the incurrence of additional liens, except those relating to capital leases and purchase money indebtedness; (iv) the disposition of assets; (v) the payment of cash dividends; and (vi) mergers, changes in business and management, investments and transactions with affiliates. The financial covenants become more restrictive over the life of the Credit Agreement. The Credit Agreement allows for the payment of dividends provided certain requirements are met.

**9. Segment Information**

We evaluate the operating performance of our markets individually. For purposes of business segment reporting, we have aligned operations with similar characteristics into two business segments: Radio and Television.

The Radio segment includes twenty-three markets, which includes all eighty-nine of our radio stations and five radio information networks. The Television segment includes three markets and consists of five television stations and four low power television ( LPTV ) stations. The Radio and Television segments derive their revenue from the sale of commercial broadcast inventory. The category Corporate general and administrative represents the income and expense not allocated to reportable segments.

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## SAGA COMMUNICATIONS, INC.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Radio	Television	Corporate and Other (In thousands)	Consolidated
<b>Three Months Ended September 30, 2006:</b>				
Net operating revenue	\$ 31,402	\$ 4,389	\$	\$ 35,791
Station operating expense	22,300	3,461		25,761
Corporate general and administrative			2,225	2,225
Operating income (loss)	\$ 9,102	\$ 928	\$ (2,225)	\$ 7,805
Depreciation and amortization	\$ 1,494	\$ 409	\$ 48	\$ 1,951

	Radio	Television	Corporate and Other (In thousands)	Consolidated
<b>Three Months Ended September 30, 2005:</b>				
Net operating revenue	\$ 32,263	\$ 3,698	\$	\$ 35,961
Station operating expense	22,728	3,382		26,110
Corporate general and administrative			1,934	1,934
Operating income (loss)	\$ 9,535	\$ 316	\$ (1,934)	\$ 7,917
Depreciation and amortization	\$ 1,812	\$ 446	\$ 50	\$ 2,308

	Radio	Television	Corporate and Other (In thousands)	Consolidated
<b>Nine Months Ended September 30, 2006:</b>				
Net operating revenue	\$ 92,100	\$ 12,627	\$	\$ 104,727
Station operating expense	66,675	10,158		76,833
Corporate general and administrative			6,705	6,705
Operating income (loss)	\$ 25,425	\$ 2,469	\$ (6,705)	\$ 21,189
Depreciation and amortization	\$ 4,569	\$ 1,215	\$ 144	\$ 5,928



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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto of Saga Communications, Inc. and its subsidiaries contained elsewhere herein and the audited financial statements and Management's Discussion and Analysis contained in our annual report on Form 10-K for the year ended December 31, 2005. The following discussion is presented on both a consolidated and segment basis. Corporate general and administrative expenses, interest expense, other (income) expense, and income tax expense are managed on a consolidated basis and are, therefore, reflected only in our discussion of consolidated results.

Our discussion of the results of operations of our operating segments focuses on their operating income because we manage our operating segments primarily on their operating income. We evaluate the operating performance of our markets individually. For purposes of business segment reporting, we have aligned operations with similar characteristics into two business segments: Radio and Television. The Radio segment includes twenty-three markets, which includes all eighty-nine of our radio stations and five radio information networks. The Television segment includes three markets and consists of five television stations and four LPTV stations.

**General**

We are a broadcast company primarily engaged in acquiring, developing and operating radio and television stations. We actively seek and explore opportunities for expansion through the acquisition of additional broadcast properties. We review acquisition opportunities on an ongoing basis.

For additional information with respect to acquisitions, see "Liquidity and Capital Resources" below.

**Radio Segment**

In our radio segment our primary source of revenue is from the sale of advertising for broadcast on our stations. Depending on the format of a particular radio station, there are a predetermined number of advertisements available to be broadcast each hour.

Most advertising contracts are short-term, and generally run only for a few weeks. Most of our revenue is generated from local advertising, which is sold primarily by each radio market's sales staff. For the nine months ended September 30, 2006 and 2005, approximately 85% of our gross radio segment revenue was from local advertising. To generate national advertising sales, we engage an independent advertising sales representative firm that specializes in national sales for each of our broadcast markets.

Our revenue varies throughout the year. Advertising expenditures, our primary source of revenue, generally have been lowest during the winter months, which include the first quarter of each year.

Our net operating revenue, and the resulting station operating expenses, and operating income varies from market to market based upon the related market's rank or size which is based upon population and the available radio advertising revenue in that particular market.

Our financial results are dependent on a number of factors, the most significant of which is our ability to generate advertising revenue through rates charged to advertisers. The rates a station is able to charge are, in large part, based on a station's ability to attract audiences in the demographic groups targeted by its advertisers. In a number of our

markets this is measured by periodic reports generated by independent national rating services. In the remainder of our markets it is measured by the results advertisers obtain through the actual running of an advertising schedule. Advertisers measure these results based on increased demand for their goods or services and/or actual revenues generated from such demand. Various factors affect the rate a station can charge, including the general strength of the local and national economies, population growth, ability to provide popular programming, local market competition, target marketing capability of radio compared to other advertising media and signal strength. Because reaching a large and demographically attractive audience is crucial to a station's financial success, we endeavor to develop strong listener loyalty. When we acquire and/or begin to operate a station or group of stations we generally increase programming

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and advertising and promotion expenses to increase our share of our target demographic audience. Our strategy sometimes requires levels of spending commensurate with the revenue levels we plan on achieving in two to five years. During periods of economic downturns, or when the level of advertising spending is flat or down across the industry, this strategy may result in the appearance that our cost of operations are increasing at a faster rate than our growth in revenues, until such time as we achieve our targeted levels of revenue for the acquired station or group of stations.

The number of advertisements that can be broadcast without jeopardizing listening levels (and the resulting ratings) is limited in part by the format of a particular radio station. Our stations strive to maximize revenue by constantly managing the number of commercials available for sale and adjusting prices based upon local market conditions and ratings. While there may be shifts from time to time in the number of advertisements broadcast during a particular time of the day, the total number of advertisements broadcast on a particular station generally does not vary significantly from year to year. Any change in our revenue, with the exception of those instances where stations are acquired or sold, is generally the result of inventory sell out ratios and pricing adjustments, which are made to ensure that the station efficiently utilizes available inventory.

Our radio stations employ a variety of programming formats. We periodically perform market research, including music evaluations, focus groups and strategic vulnerability studies. Our stations also employ audience promotions to further develop and secure a loyal following. We believe that the diversification of formats on our radio stations helps to insulate us from the effects of changes in musical tastes of the public on any particular format.

The primary operating expenses involved in owning and operating radio stations are employee salaries, depreciation, programming expenses, solicitation of advertising, and promotion expenses.

During the nine month periods ended September 30, 2006 and 2005 and the years ended December 31, 2005 and 2004, our Columbus, Ohio; Manchester, New Hampshire; Milwaukee, Wisconsin; and Norfolk, Virginia markets, when combined, represented approximately 70%, 73%, 75% and 73%, respectively, of our consolidated operating income. An adverse change in any of these radio markets or our relative market position in those markets could have a significant impact on our operating results as a whole. A decrease in the total available radio advertising dollars in the Columbus, Ohio and Norfolk, Virginia markets has resulted in a decline in our revenue and related operating income in our radio stations there. We are also experiencing ratings softness in each of these markets. None of our television markets represented more than 15% or more of our consolidated operating income. The following tables describe the percentage of our consolidated operating income represented by each of these markets:

	<b>Percentage of Consolidated Operating</b>	<b>Percentage of Consolidated Operating</b>
&n		