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The $4 billion election:

A few media companies are set to feast on 2010 political ads

By Scott Cendrowski, reporter

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NEW YORK (Fortune) -- The midterm elections are nine months away, but it's not too early to begin handicapping them -- from a dollars and cents vantage point, that is.

A growing number of tight congressional races across the country and an energized Republican minority are already fueling political advertising. Industry analysts say ad spending will rival the presidential year of 2008. Wells Fargo Securities forecasts candidate and special interest spending to reach $3.3 billion in 2010 across TV and radio, an 11% rise from 2008. And the Supreme Court's ruling last month to allow corporate spending on political ads could add another $500 million.

"The foundation is there for this to be a blowout year in political ad spending," says Evan Tracey, president of Campaign Media Analysis Group, a Washington research firm. "You not only have what's going on in Washington -- the control of Congress in the balance, health care, and financial reform -- but a robust state climate, too."

Of 37 governor races across the country, for example, 21 states don't have an incumbent running, boosting primary spending as new candidates fight for position.

Local television stations, which historically have garnered some 60% of political ad dollars, are the biggest winners. Already diverse media companies like Meredith (MDP), Gannett (GCI, Fortune 500), and Media General (MEG) beat fourth quarter analyst expectations for their broadcast divisions and raised 2010 sales expectations, based on political spending and an overall improvement in advertising. Media General, which generates 41% of its sales from 19 television stations, last month raised its political ad revenue projections by 24%.

The questions for investors now are: Which broadcasting companies have stations in regions with tight races, such as Florida, Ohio, and Texas? And second, has the market already priced in the good news?

A recent study by boutique investment bank **M.C. Alcamo & Co. Inc.** in New York identifies those companies with the highest exposure to "toss-up" races in the U.S. House, Senate, and gubernatorial offices. Seventy-five percent of McGraw-Hill Companies' television stations are located in regions with tight races; CBS stations are in sixty-two percent; ABC's networks are in 60%.

But conglomerates like CBS (CBS, Fortune 500) and Disney (DIS, Fortune 500), which owns ABC, only earn a sliver of their sales from local stations, not enough to move the stocks.

Michael Alcamo, president of the investment bank, says smaller "pure-play" broadcasters, which generate 100% of their revenues from television, should benefit more. Eleven of Maryland-based Sinclair Broadcast Group's 58 stations, for example, are located in toss-up regions. "I think retail and institutional investors will start to notice that there's a lot of political advertising," says Alcamo, "and the stock prices may move on those expectations."

Many stocks have already risen on improving advertising. Shares of Belo Corp. (BLC), a broadcaster in Texas, are up nearly 400% in the past year; Gray Television (GTN) in Atlanta has gained 550% in that time.

But analyst Edward Atorino at Benchmark, who has covered broadcasters for two decades, is still bullish on the stocks. He expects Sinclair (SBGI) shares to gain 31% to $6 in the next year on a sharp rebound in political and automotive advertising. "They'll have a better than expected year, and they can begin to chip away at debt too," says Atorino. Sinclair's stations reach 22% of U.S. households and include a mix of CBS, NBC, and other affiliates.

Atorino also likes $132-million Nexstar Broadcasting Group (NXST). Of the broadcaster's 63 stations in Texas and the eastern half of the country, 32% are located in regions with tight races. The stock has risen more than 400% in the past year but still trades well below its historical valuation because of a high debt load -- almost 10 times Atorino's 2009 earnings estimate.

Finally, J.P. Morgan analyst Michael Meltz gives a note of caution. He says broadcasters will improve earnings this year on political spending and a healthier overall advertising market. But he doesn't recommend buying broadcasters that have run-up on recent positive news.

"We believe the stocks could continue to work well near term given earnings momentum," Meltz wrote yesterday in a report. But "expectations have ramped in recent weeks and we're not inclined to 'chase' the names at current levels." ■