PAXSON COMMUNICATIONS CORP
Form 10-Q
August 09, 2004

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FORM 10-Q

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

(MARK ONE)

[x] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED June 30, 2004

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 1-13452

PAXSON COMMUNICATIONS CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE (State or other jurisdiction of in corporation or organization)	59-3212788 (IRS Employer Identification No.)
601 Clearwater Park Road West Palm Beach, Florida (Address of principal executive offices)	33401 (Zip Code)

Registrant s Telephone Number, Including Area Code: (561) 659-4122

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 **[x]** **No** **[ ]**

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes **[x]** **No** **[ ]**

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of July 30, 2004:

Class of Stock	Number of Shares
Common stock-Class A, $0.001 par value per share	63,577,938
Common stock-Class B, $0.001 par value per share	8,311,639

PAXSON COMMUNICATIONS CORPORATION

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Amended and Restated Employment Agreement - Garcia
CEO Certification Pursuant to Section 302
CFO Certification Pursuant to Section 302
CEO Certification Pursuant to Section 906
CFO Certification Pursuant to Section 906

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Part I Financial Information

Item 1. Financial Statements

PAXSON COMMUNICATIONS CORPORATION

CONSOLIDATED BALANCE SHEETS
(in thousands except share data)

	June 30, 2004	December 31, 2003
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 104,844	$ 97,123
Short-term investments	6,991	12,948
Accounts receivable, net of allowance for doubtful accounts of $1,287 and $1,090, respectively	25,903	24,357
Program rights	32,841	41,659
Amounts due from Crown Media	14,591	13,883
Prepaid expenses and other current assets	4,388	4,406
Total current assets	189,558	194,376
Property and equipment, net	112,382	120,841
Intangible assets:		
FCC licenses	843,184	843,140
Other intangible assets, net	45,879	50,814
Program rights, net of current portion	30,635	28,640
Amounts due from Crown Media, net of current portion	4,063	11,540
Investments in broadcast properties	2,341	2,736
Assets held for sale	2,218	7,301
Other assets, net	24,802	24,289
Total assets	$ 1,255,062	$ 1,283,677
LIABILITIES, MANDATORILY REDEEMABLE AND CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Accounts payable and accrued liabilities	$ 41,554	$ 39,303
Accrued interest	14,669	14,875
Current portion of obligations for program rights	13,543	35,382
Current portion of obligations to CBS	19,075	19,556
Current portion of obligations for cable distribution rights	2,742	2,494

Deferred revenue	13,546	15,573
Current portion of bank financing	61	61
Total current liabilities	105,190	127,244
Obligations for program rights, net of current portion	3,353	7,902
Obligations to CBS, net of current portion	17,073	27,704
Obligations for cable distribution rights, net of current portion	180	283
Deferred revenue, net of current portion	6,898	6,898
Deferred income taxes	183,395	175,281
Senior secured notes, senior subordinated notes and bank financing, net of current portion	978,746	925,547
Mandatorily redeemable preferred stock	440,004	410,739
Other long-term liabilities	7,193	7,857
Total liabilities	1,742,032	1,689,455
Mandatorily redeemable and convertible preferred stock	707,240	684,067
Commitments and contingencies		
Stockholders deficit:		
Class A common stock, $0.001 par value; one vote per share; 215,000,000 shares authorized, 63,570,838 and 63,131,125 shares issued and outstanding	64	63
Class B common stock, $0.001 par value; ten votes per share; 35,000,000 shares authorized and 8,311,639 shares issued and outstanding	8	8
Common stock warrants and call option	66,663	66,663
Additional paid-in capital	540,908	540,377
Deferred stock option compensation	(13,057)	(17,167)
Accumulated deficit	(1,788,796)	(1,679,789)
Total stockholders deficit	(1,194,210)	(1,089,845)
Total liabilities, mandatorily redeemable and convertible preferred stock, and stockholders deficit	$ 1,255,062	$ 1,283,677

The accompanying notes are an integral part of the consolidated financial statements.

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PAXSON COMMUNICATIONS CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands except share and per share data)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2004	2003	2004	2003
	(Unaudited)		(Unaudited)	
NET REVENUES (net of agency commissions of $12,070, $11,012, $24,364 and $23,088, respectively)	$ 69,877	$ 65,860	$ 141,171	$ 136,462
EXPENSES:				
Programming and broadcast operations (excluding stock-based compensation of $241, $149, $620 and $953, respectively)	13,642	13,072	27,461	25,674
Program rights amortization	10,843	11,475	26,533	24,497
Selling, general and administrative (excluding stock-based compensation of $2,292, $948, $4,135, and $7,558, respectively)	33,322	26,786	63,536	53,889
Time brokerage and affiliation fees	1,101	1,101	2,202	2,202
Stock-based compensation	2,533	1,097	4,755	8,511
Adjustment of programming to net realizable value				1,066
Restructuring charges		32		11
Reserve for state taxes	467		597	
Depreciation and amortization	11,437	7,340	21,697	21,910
Total operating expenses	73,345	60,903	146,781	137,760
Gain on sale or disposal of broadcast and other assets, net	6,067	28,407	5,958	54,921
Operating income	2,599	33,364	348	53,623
OTHER INCOME (EXPENSE):				
Interest expense	(23,065)	(22,568)	(45,630)	(44,693)
Dividends on mandatorily redeemable preferred stock	(14,888)		(29,265)	
Interest income	711	795	1,474	1,673
Other (expense) income, net	(1)	11		263
Gain (loss) on extinguishment of debt	7		(6,286)	

Insurance recoveries			1,100	
Gain on modification of program rights obligations	371	604	741	1,207
(Loss) income before income taxes	(34,266)	12,206	(77,518)	12,073
Income tax provision	(2,886)	(5,251)	(8,316)	(5,303)
Net (loss) income	(37,152)	6,955	(85,834)	6,770
Dividends and accretion on redeemable and convertible preferred stock	(11,624)	(23,968)	(23,173)	(47,230)
Net loss attributable to common stockholders	$ (48,776)	$ (17,013)	$ (109,007)	$ (40,460)
Basic and diluted loss per common share	$ (0.72)	$ (0.25)	$ (1.61)	$ (0.60)
Weighted average shares outstanding	68,134,814	67,658,154	67,837,758	67,231,239

The accompanying notes are an integral part of the consolidated financial statements.

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PAXSON COMMUNICATIONS CORPORATION

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS DEFICIT
For the Six Months Ended June 30, 2004 (Unaudited)
(in thousands)

	Common Stock Class A	Common Stock Class B	Common Stock Warrants and Call Option	Additional Paid-In Capital	Deferred Stock Option Compensation	Accumulated Deficit	Total Stockholders Deficit
Balance, December 31, 2003	$ 63	$ 8	$ 66,663	$ 540,377	$ (17,167)	$ (1,679,789)	$ (1,089,845)
Stock-based compensation					4,639		4,639
Deferred stock option compensation				529	(529)		
Stock options exercised	1			2			3
Dividends on redeemable and convertible preferred stock						(22,921)	(22,921)
Accretion on redeemable and convertible preferred stock						(252)	(252)
Net loss						(85,834)	(85,834)
Balance, June 30, 2004	$ 64	$ 8	$ 66,663	$ 540,908	$ (13,057)	$ (1,788,796)	$ (1,194,210)

The accompanying notes are an integral part of the consolidated financial statements.

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PAXSON COMMUNICATIONS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	For the Six Months Ended June 30,	
	2004	**2003**
	(Unaudited)	
Cash flows from operating activities:		
Net (loss) income	$ (85,834)	$ 6,770
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization	21,697	21,910
Stock-based compensation	4,755	8,511
Loss on extinguishment of debt	6,286	
Non-cash restructuring charges		11
Program rights amortization	26,533	24,497
Adjustment of programming to net realizable value		1,066
Payments for cable distribution rights		(1,500)
Program rights payments and deposits	(44,897)	(20,475)
Provision for (reduction of) doubtful accounts	347	(742)
Deferred income tax provision	8,114	4,937
Gain on sale or disposal of broadcast and other assets, net	(5,958)	(54,921)
Dividends and accretion on 14 1/4% mandatorily redeemable preferred stock	29,265	
Accretion on senior subordinated discount notes	23,856	21,182
Gain on modification of program rights obligations	(741)	(1,207)
Changes in assets and liabilities:		
(Increase) decrease in accounts receivable	(3,070)	5,466
Decrease in amounts due from Crown Media	6,769	5,900
Decrease (increase) in prepaid expenses and other current assets	679	(173)
Decrease in other assets	3,635	569
Increase in accounts payable and accrued liabilities	1,887	2,066
Decrease in accrued interest	(206)	(234)
Decrease in obligations to CBS	(10,371)	(4,315)
Net cash (used in) provided by operating activities	(17,254)	19,318
Cash flows from investing activities:		
Decrease in short-term investments	5,957	17,073
Deposits for programming letters of credit	(856)	
Purchases of property and equipment	(8,065)	(11,174)

Proceeds from sale of broadcast assets	9,988	77,465
Proceeds from sale of property and equipment	8	206
Other	(44)	(75)
Net cash provided by investing activities	6,988	83,495
Cash flows from financing activities:		
Borrowings of long-term debt	365,000	2,000
Repayments of long-term debt	(335,657)	(3,451)
Payments of loan origination costs	(11,432)	(689)
Payments of employee withholding taxes on exercise of common stock options		(2,335)
Proceeds from exercise of common stock options, net	3	129
Proceeds from stock subscription notes receivable	73	144
Net cash provided by (used in) financing activities	17,987	(4,202)
Increase in cash and cash equivalents	7,721	98,611
Cash and cash equivalents, beginning of period	97,123	25,765
Cash and cash equivalents, end of period	$ 104,844	$124,376

The accompanying notes are an integral part of the consolidated financial statements.

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PAXSON COMMUNICATIONS CORPORATION

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

Paxson Communications Corporation (the Company), a Delaware corporation, was organized in 1993. The Company owns and operates television stations nationwide, and on August 31, 1998, launched PAX TV. PAX TV is the brand name for the programming that the Company broadcasts through its owned, operated and affiliated television stations, and through certain cable television system owners and satellite television providers. The financial information contained in the financial statements and notes thereto as of June 30, 2004 and for the three and six month periods ended June 30, 2004 and 2003 is unaudited. In the opinion of management, all adjustments necessary for the fair presentation of such financial information have been included. These adjustments are of a normal recurring nature. The consolidated financial statements include the accounts of the Company and its majority owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

The preparation of financial statements requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses during the reported period. The Company believes the most significant estimates involved in preparing the Company s financial statements include estimates related to the net realizable value of programming rights, barter revenue recognition, estimates used in accounting for leases and estimates related to the impairment of long-lived assets and FCC licenses. The Company bases its estimates on historical experience and various other assumptions it believes are reasonable. Actual results could differ from those estimates. The Company s significant accounting policies are described in Note 1. Nature of the Business and Summary of Significant Accounting Policies in the notes to the Company s consolidated financial statements included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2003 (the Fiscal 2003 Form 10-K).

Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. These financial statements, footnotes and discussions should be read in conjunction with the financial statements and related footnotes and discussions contained in the Fiscal 2003 Form 10-K, and the definitive proxy statement for the annual meeting of stockholders held May 21, 2004, both of which were filed with the United States Securities and Exchange Commission.

Certain reclassifications have been made to the prior year s financial statements to conform to the 2004 presentation.

The Company believes that unless its ratings and revenues improve significantly, its business operations are unlikely to provide sufficient cash flow to support the Company s debt service and preferred stock dividend requirements. The Company has engaged Bear Stearns & Co. Inc. and Citigroup Global Markets Inc. to act as its financial advisors and explore strategic alternatives for the Company. These strategic alternatives may include the sale of all or part of the Company s assets, finding a strategic partner for the Company who would provide the financial resources to enable the Company to redeem, restructure or refinance the Company s debt and preferred stock, or finding a third party to acquire the Company through a merger or other business combination or acquisition of the Company s equity securities. The Company s ability to pursue strategic alternatives is subject to various limitations and issues which the Company may be unable to control. See Forward-Looking Statements and Associated Risks and Uncertainties The outcome of our exploration of strategic alternatives is uncertain in our Fiscal 2003 Form 10-K.

In 1998, the Company began entering into cable distribution agreements for periods generally up to ten years in markets where the Company does not own a television station. Certain of these cable distribution agreements also

provided the Company with some level of promotional advertising to be run at the discretion of the cable operator, primarily during the first few years to support the launch of the Company s PAX TV network on the cable systems. The Company had been amortizing these assets on an accelerated basis. In the second quarter of 2003, the Company determined that it had over-amortized certain of these assets and recorded a $4 million reduction to amortization expense. The remaining unamortized cost, which had been amortized over seven years, commenced to be amortized over the remaining contractual life of the agreements.

2. RESTRUCTURING

During the fourth quarter of 2002, the Company adopted a plan to consolidate certain of its operations, reduce personnel and modify its programming schedule in order to significantly reduce the Company s cash operating expenditures. In connection with this plan, the Company recorded a restructuring charge of approximately $2.6 million in the fourth quarter of 2002, consisting of $2.2 million in termination benefits for 95 employees and $0.4 million for costs associated with exiting leased properties and consolidating certain operations. Through June 30, 2004, the Company has paid $2.1 million in termination benefits to 94 employees and paid $0.5 million of lease termination and other costs. The Company has accounted for these costs pursuant to the provisions of Statement of Financial Accounting Standards (SFAS) No. 146, Accounting for Costs Associated with Exit or Disposal Activities (SFAS 146), which the Company early adopted in the fourth quarter of 2002. SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred as opposed to when there is a commitment to a restructuring plan as set forth under EITF 94-3 Liability Recognition for Certain Employee Termination Benefits and other costs to Exit an Activity , which has been nullified by SFAS No. 146. As such, the Company will recognize additional restructuring costs as they are incurred.

The Company has substantially completed its Joint Sales Agreement (JSA) restructuring plan commenced in the fourth quarter of 2000, except for certain contractual lease obligations for closed locations, the majority of which expire in 2004.

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The following summarizes the activity in the Company s restructuring reserves for the six months ended June 30, 2004 and June 30, 2003, respectively (in thousands):

	Balance December 31, 2003	Amounts Charged (Credited) to Costs and Expenses	Cash Deductions	Balance June 30, 2004
Corporate Restructuring				

	Balance December 31, 2002	Amounts Charged (Credited) to Costs and Expenses	Cash Deductions	Balance June 30, 2003
Corporate Restructuring				

3. ASSETS HELD FOR SALE

The gain (loss) on sale of assets held for sale are included in the determination of the Company s operating income (loss) from its continuing operations in accordance with SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets (SFAS 144) since these assets do not constitute a component of the Company under SFAS 144. The Company generally maintains a geographic presence in the markets where assets have been sold by airing the PAX TV network through cable distribution agreements or the Company s other owned or operated stations in the designated market areas.

Assets held for sale consist of the following as of the date indicated (in thousands):

	June 30, 2004	December 31, 2003
Intangible assets, net	$	$ 3,499
Property and equipment, net	2,218	3,802
	$2,218	$ 7,301

In May 2004, the Company completed the sale of its television station KPXJ, serving the Shreveport, Louisiana market, for a cash purchase price of $10 million, resulting in a pre-tax gain of approximately $6.1 million.

Included in assets held for sale are certain broadcast towers with a carrying value of $2.2 million and $2.7 million as of June 30, 2004 and December 31, 2003, respectively, for which the Company is in the process of transferring title and assigning the leases to the buyer.

4. SENIOR SECURED NOTES, SENIOR SUBORDINATED NOTES AND BANK FINANCING

Senior secured notes, senior subordinated notes and bank financing consists of the following as of (in thousands):

	June 30, 2004	December 31, 2003
Senior Secured Floating Rate Notes due 2010, secured by all assets of the Company	$ 365,000	$
Senior Credit Facility		335,625
10 3/4% Senior Subordinated Notes due 2008	200,000	200,000
12 1/4% Senior Subordinated Discount Notes due 2009	496,263	496,263
Other	473	505
	1,061,736	1,032,393
Less: discount on 12 1/4% Senior Subordinated Discount Notes due 2009	(82,929)	(106,785)
Less: current portion	(61)	(61)
	$ 978,746	$ 925,547

On January 12, 2004, the Company completed a private offering of $365 million of senior secured floating rate notes (Senior Secured Notes). The Senior Secured Notes bear interest at the rate of LIBOR plus 2.75% per year and will mature on January 10, 2010. The Senior Secured Notes may be redeemed by the Company at any time at specified redemption prices and are secured by substantially all of the Company s assets. In addition, a substantial portion of the Senior Secured Notes are unconditionally guaranteed, on a joint and several senior secured basis, by all of the Company s subsidiaries. The indenture governing the Senior Secured Notes contains certain covenants which, among other things, restrict the incurrence of additional indebtedness, the payment of dividends, transactions with related parties, certain investments and transfers or sales of certain assets. The proceeds from the offering were used to repay in full the outstanding indebtedness under the Company s Senior Credit Facility, pre-fund letters of credit supported by the revolving credit portion of the Company s previously existing Senior Credit Facility and pay fees and expenses incurred in connection with the transaction. The refinancing resulted in a charge in the first quarter of 2004 in the amount of $6.3 million related to the debt issuance costs associated with the Senior Credit Facility.

At June 30, 2004, the Company was in compliance with its debt covenants and expects that it will continue to be in compliance with its debt covenants in the foreseeable future. If the Company failed to meet any of its debt covenants and the holders of the Company s debt did not grant a waiver or amend the covenants, the holders would have the right to declare an event of default and seek remedies including acceleration of all outstanding amounts due. Should an event of default be declared under any of the debt securities outstanding, this would cause a cross default to occur under the indentures governing the other series of debt securities, thus giving the trustee under each such indenture the right to accelerate repayments, and would give the holders of each of the Company s three outstanding series of preferred stock the right to elect two directors per series to the Company s Board of Directors. There can be no

assurance that the Company would be successful in obtaining alternative sources of funding to repay these obligations should these events occur.

5. MANDATORILY REDEEMABLE AND CONVERTIBLE PREFERRED STOCK

In May 2003, the Financial Accounting Standards Board (FASB) issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity (SFAS 150). This statement establishes standards for classifying and measuring as liabilities certain financial instruments that embody obligations of the issuer and have characteristics of both liabilities and equity. SFAS No. 150 requires liability classification for mandatorily redeemable equity instruments not convertible into common stock, such as the Company s 14 1/4% Junior Exchangeable Preferred Stock. SFAS No. 150 was effective immediately with respect to instruments entered into or modified after May 31, 2003 and as to all other instruments that exist as of the beginning of the first interim financial reporting period beginning after June 15, 2003. The Company adopted SFAS No. 150 effective July 1, 2003. Upon adoption, the Company recorded a deferred asset for the unamortized issuance costs and recorded a liability for the mandatorily redeemable preferred stock balance related to its 14 1/4% Junior Exchangeable Preferred Stock. In addition, the amortization of the issuance costs and the dividends related to the 14 1/4% Junior Exchangeable Preferred Stock are being recorded as interest expense beginning July 1, 2003, whereas these costs were recorded as dividends and accretion on redeemable preferred stock in prior periods. Restatement of prior periods is not permitted upon adoption of SFAS No. 150. The Company s 9 3/4% Series A Convertible Preferred Stock and 8% Series B Convertible Exchangeable Preferred Stock are not affected by the provisions of SFAS No. 150 because of their equity conversion features.

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The following represents a summary of the changes in the Company s mandatorily redeemable and convertible preferred stock during the six month period ended June 30, 2004 (in thousands):

	Convertible Preferred Stock 9 3/4%	Series B Convertible Exchangeable Preferred Stock 8%	Total
Mandatorily redeemable and convertible preferred stock:			
Balance at December 31, 2003	$126,584	$557,483	$684,067
Accretion	252		252
Accrual of cumulative dividends	6,321	16,600	22,921
Balance at June 30, 2004	$133,157	$574,083	$707,240
Aggregate liquidation Preference and accumulated dividends at June 30, 2004	$134,426	$574,083	$708,509
Shares authorized	17,500	41,500	59,000
Shares issued and outstanding	13,442	41,500	54,942
Accrued dividends	$	$159,083	$159,083

	Junior Exchangeable Preferred Stock 14 1/4%
Mandatorily redeemable preferred stock:	
Balance at December 31, 2003	$410,739
Accrual of cumulative dividends	29,265
Balance at June 30, 2004	$440,004
Aggregate liquidation preference at June 30, 2004	$440,004
Shares authorized	72,000
Shares issued and outstanding	43,230
Accrued dividends	$ 7,700

On September 15, 1999, we entered into an investment agreement with the National Broadcasting Company, Inc. (NBC) under which wholly-owned subsidiaries of NBC purchased shares of our Series B preferred stock and warrants

to purchase shares of our common stock for an aggregate purchase price of $415 million. At the same time, a wholly-owned subsidiary of NBC entered into an agreement with Lowell W. Paxson, our chairman and controlling stockholder, and entities controlled by Mr. Paxson, under which the NBC subsidiary was granted the right to purchase all, but not less than all, of the 8,311,639 shares of our Class B common stock beneficially owned by Mr. Paxson. We have also entered into a number of agreements with NBC. Under these agreements, NBC sells our network spot advertising and performs our network research and sales marketing functions. We have also entered into Joint Sales Agreements (JSA) with NBC with respect to most of our stations serving markets also served by an NBC owned and operated station, and with many independently owned NBC affiliated stations serving markets also served by our stations. During the six months ended June 30, 2004, we paid or accrued amounts due to NBC totaling approximately $11.0 million for commission compensation and cost reimbursements incurred under our agreements with NBC.

On November 13, 2003, NBC exercised its right to demand that the Company redeem, or arrange for a third party to acquire, all of the shares of the Company s Series B preferred stock held by NBC, at a price equal to the aggregate liquidation preference thereof plus accrued and unpaid dividends, which as of June 30, 2004, totaled $574.1 million. Should the Company fail to effect a redemption within one year after November 13, 2003, NBC will be permitted to transfer, without restriction, any of the Company s securities acquired by it, its right to acquire Mr. Paxson s Class B common stock, its contractual rights with respect to the Company s business, and its other rights under the related transaction agreements. The Company s ability to effect any redemption is restricted by the terms of the Company s outstanding debt and preferred stock. Further, the Company does not currently have sufficient funds to pay the redemption price for these securities. In order to comply with NBC s redemption demand, the Company expects that it would need to repay, refinance or otherwise restructure the majority of its outstanding indebtedness and preferred stock and raise sufficient liquidity to enable it to pay the required redemption price. Alternatively the Company would need to identify a third party willing to purchase those securities at the required redemption price. If the Company is unable to complete a redemption, NBC would have the right to transfer its interest in the Company, without the Company s consent, to a third party selected by NBC in its discretion, which could have a material adverse effect upon the Company.

On September 15, 2004, the rate at which dividends accrue on the Company s Series B preferred stock, all of which is held by NBC, will be adjusted to a market rate, determined by a nationally recognized independent investment banking firm chosen by the Company, at which the Series B preferred stock would trade at its liquidation preference. A material increase in the dividend rate on the Company s Series B preferred stock resulting from this adjustment could have material adverse consequences for the Company.

6. COMPREHENSIVE INCOME (LOSS)

The Company utilized an interest rate swap to manage the impact of interest rate changes on the Company s borrowings under its Senior Credit Facility which was refinanced in January 2004. The interest rate swap matured on October 15, 2003 and was not renewed. Under the interest rate swap, the Company agreed with the other party to exchange, at specified intervals, the difference between fixed-rate and floating-rate interest amounts calculated by reference to an agreed notional principal amount. Income or expense under these instruments was recorded on an accrual basis as an adjustment to the yield of the underlying exposures over the periods covered by the contracts. The Company has accounted for the swap as a cash flow hedge pursuant to SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities , as amended, with changes in the fair value included as a component of other comprehensive loss. At June 30, 2003, the fair value of the swap was a liability of approximately $1.8 million.

Other comprehensive income represents the unrealized gain on the Company s interest rate swap accounted for as a cash flow hedge.

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The components of comprehensive income (loss) are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Net (loss) income	$(37,152)	$6,955	$(85,834)	$6,770
Other comprehensive income:				
Unrealized gain on interest rate swap		801		1,359
Comprehensive (loss) income	$(37,152)	$7,756	$(85,834)	$8,129

7. INCOME TAXES

The Company has recorded a provision for income taxes based on its estimated annual effective income tax rate. For the three and six months ended June 30, 2004 and 2003, the Company has recorded a valuation allowance for its deferred tax assets (resulting from tax losses generated during the periods) net of those deferred tax liabilities which are expected to reverse in determinate future periods, as it believes it is more likely than not that it will be unable to utilize its remaining net deferred tax assets.

The Company structured the disposition of its radio division in 1997 and its acquisition of television stations during the period following this disposition in a manner that the Company believed would qualify these transactions as a like kind exchange under Section 1031 of the Internal Revenue Code and would permit the Company to defer recognizing for income tax purposes up to approximately $333 million of gain. The IRS has examined the Company s 1997 tax return and has issued the Company a 30-day letter proposing to disallow all of the Company s gain deferral. The Company filed a protest to this determination with the IRS appeals division, but cannot predict the outcome at this time, and may not prevail. In addition, the 30-day letter offered the Company an alternative position that, in the event the IRS is unsuccessful in disallowing all of the gain deferral, approximately $62 million of the $333 million gain deferral will be disallowed. The Company filed a protest to this alternative determination as well. The Company may not prevail with respect to this alternative determination. Should the IRS successfully challenge the Company s position and disallow all or part of its gain deferral, because the Company had net operating losses in the years subsequent to 1997 in excess of the amount of the deferred gain, the Company would not be liable for any tax deficiency, but could be liable for interest on the tax liability for the period prior to the carryback of its net operating losses. The Company has estimated the amount of interest for which it could be held liable to be approximately $17.1 million as of June 30, 2004 should the IRS succeed in disallowing all of the deferred gain. If the IRS were successful in disallowing only part of the gain under its alternative position, the Company estimates it would be liable for only a nominal amount of interest.

8. PER SHARE DATA

Basic and diluted loss per common share was computed by dividing net loss less dividends and accretion on redeemable and convertible preferred stock by the weighted average number of common shares outstanding during the period. The effect of stock options and warrants is antidilutive. Accordingly, basic and diluted loss per share is the

same for all periods presented.

As of June 30, 2004 and 2003, the following securities, which could potentially dilute earnings per share in the future, were not included in the computation of earnings per share, because to do so would have been antidilutive (in thousands):

	June 30,	
	2004	**2003**
Stock options outstanding	2,555	3,764
Class A common stock warrants and restricted Class A common stock outstanding	35,598	32,032
Class A common stock reserved for issuance under convertible securities	40,298	39,526
	78,451	75,322

9. STOCK-BASED COMPENSATION

Employee stock options are accounted for using the intrinsic value method. Stock-based compensation to non-employees is accounted for using the fair value method. When options are granted to employees, a non-cash charge representing the difference between the exercise price and the quoted market price of the common stock underlying the vested options on the date of grant is recorded as stock-based compensation expense with the balance deferred and amortized over the remaining vesting period.

In October 2003, the Company granted 3,598,750 options under the Company s 1998 Stock Incentive Plan, as amended (the Plan), to purchase one share of the Company s Class A common stock at an exercise price of $0.01 per share to certain employees and directors. The options provided for a one business day exercise period. All holders of the options exercised their options and received shares of Class A common stock that are subject to restrictions on transfer and a risk of forfeiture (restricted stock). The restricted stock issued upon the exercise of the options included 2,278,000 shares which will vest in their entirety at the end of a five year period. Of the remaining shares of restricted stock issued upon the exercise of the options, 1,000,750 shares will vest ratably over a three year period and 320,000 shares will vest ratably over a five year period. The award resulted in non-cash stock-based compensation expense of approximately $18.2 million, which will be recognized on a straight-line basis over the vesting period. For the three and six months ended June 30, 2004, the Company recognized approximately $2.4 million and $3.8 million, respectively, in stock-based compensation expense in connection with these grants. Approximately $2.7 million will be recognized during the third and fourth quarters of 2004, and $10.2 million will be recognized between 2005 and 2008.

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In January 2003, the Company consummated a stock option exchange offer under which the Company issued to holders who tendered their eligible options in the exchange offer new options under the Plan to purchase one share of the Company s Class A common stock for each two shares of Class A common stock issuable upon the exercise of tendered options, at an exercise price of $0.01 per share. The terms of the new options provided for a one business day exercise period. All holders who tendered their eligible options in the exchange offer exercised their new options promptly after the issuance of those new options. Approximately 5.5 million options issued under the Company s stock option plans and 1.8 million additional non-qualified options were tendered in the exchange offer and approximately 2.6 million new shares of Class A common stock were issued upon exercise of the new options, net of approximately 1.0 million shares of Class A common stock withheld, in accordance with the Plan s provisions, at the holders elections to cover withholding taxes and the option exercise price totaling approximately $2.4 million. The stock option exchange resulted in a fixed non-cash stock-based compensation expense of approximately $8.7 million, of which approximately $0.5 million and $7.4 million related to vested and unvested shares was recognized in the three and six months ended June 30, 2003, respectively, $1.2 million of the remaining compensation expense was recognized during the remainder of 2003 and $0.1 million was recognized in the first quarter of 2004. The stock-based compensation expense was recognized on a straight-line basis over the one year vesting schedule of the modified award. In addition, the remaining deferred stock compensation expense totaling approximately $2.5 million at December 31, 2002 associated with the tendered options was recognized on a straight-line basis over the one year vesting schedule of the modified award ($0.6 million and $1.1 million was recognized in the three and six months ended June 30, 2003, respectively, $1.2 million of the remaining compensation expense was recognized during the remainder of 2003, and $0.2 million was recognized in the first quarter of 2004). As of June 30, 2004, there were 193,750 shares of restricted stock issued upon the exercise of options issued in the January 2003 exchange that had not vested as a result of elections to defer vesting made by the holders.

Had compensation expense for the Company s option plans been determined using the fair value method, the Company s net loss and net loss per share would have been as follows (in thousands except per share data):

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2004	**2003**	**2004**	**2003**
Net loss attributable to common stockholders:				
As reported	$(48,776)	$(17,013)	$(109,007)	$(40,460)
Add: Stock-based compensation expense included in reported net loss	2,533	1,097	4,755	8,511
Deduct: Total stock-based compensation expense determined under the fair value method	(2,539)	(1,364)	(4,975)	(9,267)
Pro forma net loss attributable to common Stockholders	$(48,782)	$(17,280)	$(109,227)	$(41,216)
Basic and diluted net loss per share:				
As reported	$ (0.72)	$ (0.25)	$ (1.61)	$ (0.60)
Pro forma	(0.72)	(0.26)	(1.61)	(0.61)

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model assuming a dividend yield of zero, expected volatility range of 50% to 79%, risk free interest rates of 2.6% to 6.9% and weighted average expected option terms of one day to 7.5 years.

10. SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information and non-cash operating and financing activities are as follows (in thousands):

	For the Six Months Ended June 30,	
	2004	**2003**
	(Unaudited)	
Supplemental disclosures of cash flow information:		
Cash paid for interest	$18,413	$21,079
Cash paid for income taxes	$ 176	$ 107
Non-cash operating and financing activities:		
Dividends accrued on redeemable and convertible preferred stock	$22,921	$46,385
Discount accretion on redeemable and convertible securities	$ 252	$ 845
Stock option exercise proceeds and withholding taxes remitted through withholding of shares received upon exercise	$	$ 2,359
Repayment of stock subscription notes receivable through offset of deferred and other compensation	$ 37	$ 615
Stock options granted and exercised for consulting services	$	$ 465

11. NEW ACCOUNTING PRONOUNCEMENTS

In December 2003, the FASB issued FASB Interpretation No. 46 (revised December 2003) Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin (ARB) No. 51 (FIN 46). FIN 46 clarifies the application of ARB No. 51 to certain entities in which the equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. Application of FIN 46 is required in financial statements of public entities that have interests in variable interest or potential variable interest entities commonly referred to as special-purpose entities for periods ending after December 31, 2003. Application by public entities for all other types of entities is required in financial statements for periods ending after March 15, 2004. The adoption of FIN 46 did not have any effect on the Company s financial position, results of operations or cash flows.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity (SFAS 150). This statement establishes standards for classifying and measuring as liabilities certain financial instruments that embody obligations of the issuer and have characteristics of both liabilities and equity. SFAS 150 requires liability classification for mandatorily redeemable equity instruments not convertible into common stock, such as the Company s 14 1/4% Junior Exchangeable Preferred Stock. SFAS 150 was effective immediately with respect to instruments entered into or modified after May 31, 2003 and as to all other instruments that exist as of the beginning of the first interim financial reporting period beginning after June 15, 2003. The Company adopted SFAS 150 effective July 1, 2003. Upon adoption, the Company recorded a deferred asset for the unamortized issuance costs and recorded a liability for the mandatorily redeemable preferred stock balance related to its 14 1/4% Junior Exchangeable Preferred Stock. In addition, the amortization of the issuance costs and the dividends related to the 14 1/4% Junior Exchangeable Preferred Stock are being recorded as interest expense beginning July 1, 2003 versus the recording of these costs as dividends and accretion on redeemable preferred stock in prior periods. Restatement of prior periods was not permitted upon adoption of SFAS 150. The Company s 9 3/4% Series A Convertible Preferred Stock and 8% Series B Convertible Exchangeable Preferred Stock are not affected by the provisions of SFAS 150 because of their equity conversion features.

12. CONDENSED CONSOLIDATING FINANCIAL INFORMATION

Paxson Communications Corporation (the Parent Company) and its wholly owned subsidiaries are joint and several guarantors under the Company s debt obligations. There are no restrictions on the ability of the guarantor subsidiaries or the Parent Company to issue dividends or transfer assets to any other subsidiary guarantors. The accounts of the Parent Company include network operations, network sales, programming and other corporate departments. The accounts of the wholly owned subsidiaries primarily include the television stations owned and operated by the Company.

The accompanying unaudited condensed consolidated financial information has been prepared and presented pursuant to SEC Regulation S-X Rule 3-10 Financial statements of guarantors and issuers of guaranteed securities registered or being registered. This information is not intended to present the financial position, results of operations and cash flows of the individual companies or groups of companies in accordance with generally accepted accounting principles.

CONDENSED CONSOLIDATING BALANCE SHEETS (UNAUDITED)

	As of June 30, 2004 (in thousands)	
	Consolidating	**Consolidated**

	Parent Company	Wholly Owned Subsidiaries	Adjustments	Group
Assets				
Current assets	$ 177,862	$ 11,696	$	$ 189,558
Receivable from wholly owned subsidiaries	891,601		(891,601)	
Intangible assets, net	56,600	832,463		889,063
Investment in and advances to wholly owned subsidiaries	47,513		(47,513)	
Property, equipment and other assets, net	66,604	109,837		176,441
Total assets	$ 1,240,180	$ 953,996	$ (939,114)	$ 1,255,062
Liabilities, Mandatorily Redeemable and Convertible Preferred Stock and Stockholders Deficit				
Current liabilities	$ 97,438	$ 7,752	$	$ 105,190
Deferred income taxes	183,395			183,395
Senior secured notes, senior subordinated notes and bank financing, net of current portion	978,746			978,746
Notes payable to Parent Company		891,601	(891,601)	
Mandatorily redeemable preferred stock	440,004			440,004
Other long-term liabilities	27,567	7,130		34,697
Total liabilities	1,727,150	906,483	(891,601)	1,742,032
Mandatorily redeemable and convertible preferred stock	707,240			707,240
Commitments and contingencies				
Stockholders deficit	(1,194,210)	47,513	(47,513)	(1,194,210)
Total liabilities, mandatorily redeemable and convertible preferred stock, and stockholders deficit	$ 1,240,180	$ 953,996	$ (939,114)	$ 1,255,062

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CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended June 30, 2004 (in thousands)			
	Parent Company	Wholly Owned Subsidiaries	Consolidating Adjustments	Consolidated Group
Net revenues	$ 42,965	$26,912	$	$ 69,877
EXPENSES:				
Programming and broadcast operations	3,267	10,375		13,642
Program rights amortization	10,843			10,843
Selling, general and administrative	18,006	15,316		33,322
Stock-based compensation	2,533			2,533
Other operating expenses	467	1,101		1,568
Depreciation and amortization	3,379	8,058		11,437
Total operating expenses	38,495	34,850		73,345
Gain on sale or disposal of broadcast and other assets, net	1,001	5,066		6,067
Operating income (loss)	5,471	(2,872)		2,599
OTHER INCOME (EXPENSE):				
Interest expense	(22,994)	(71)		(23,065)
Dividends on mandatorily redeemable preferred stock	(14,888)			(14,888)
Other income (expense), net	1,082	(1)		1,081
Gain on extinguishment of debt	7			7
Equity in losses of consolidated subsidiaries	(2,944)		2,944	
Loss before income taxes	(34,266)	(2,944)	2,944	(34,266)
Income tax provision	(2,886)			(2,886)
Net loss	(37,152)	(2,944)	2,944	(37,152)
Dividends and accretion on redeemable and convertible preferred stock	(11,624)			(11,624)

Net loss attributable to common stockholders	$(48,776)	$ (2,944)	$ 2,944	$(48,776)

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CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS (UNAUDITED)

	Six Months Ended June 30, 2004 (in thousands)			
	Parent Company	Wholly Owned Subsidiaries	Consolidating Adjustments	Consolidated Group
Net revenues	$ 87,487	$53,684	$	$ 141,171
EXPENSES:				
Programming and broadcast operations	6,835	20,626		27,461
Program rights amortization	26,533			26,533
Selling, general and administrative	33,120	30,416		63,536
Stock-based compensation	4,755			4,755
Other operating expenses	597	2,202		2,799
Depreciation and amortization	6,606	15,091		21,697
Total operating expenses	78,446	68,335		146,781
Gain on sale or disposal of broadcast and other assets, net	881	5,077		5,958
Operating income (loss)	9,922	(9,574)		348
OTHER INCOME (EXPENSE):				
Interest expense	(45,524)	(106)		(45,630)
Dividends on mandatorily redeemable preferred stock	(29,265)			(29,265)
Other income, net	3,315			3,315
Loss on extinguishment of debt	(6,286)			(6,286)
Equity in losses of consolidated subsidiaries	(9,681)		9,681	
Loss before income taxes	(77,519)	(9,680)	9,681	(77,518)
Income tax provision	(8,315)	(1)		(8,316)
Net loss	(85,834)	(9,681)	9,681	(85,834)
Dividends and accretion on redeemable and convertible preferred stock	(23,173)			(23,173)

Net loss attributable to common stockholders	$(109,007)	$ (9,681)	$ 9,681	$(109,007)

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CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended June 30, 2004 (in thousands)			
	Parent Company	Wholly Owned Subsidiaries	Consolidating Adjustments	Consolidated Group
Net cash (used in) provided by operating activities	$ (22,850)	$ 5,596	$ —	$ (17,254)
Cash flows used in investing activities:				
Decrease in short term investments	5,957			5,957
Deposits for programming letters of credit	(856)			(856)
Purchases of property and equipment	(2,511)	(5,554)		(8,065)
Proceeds from sale of broadcast assets	9,988			9,988
Proceeds from sale of broadcast towers and property and equipment	8			8
Other		(44)		(44)
Net cash provided by (used in) investing activities	12,586	(5,598)	—	6,988
Cash flows from financing activities:				
Borrowings of long-term debt	365,000			365,000
Repayments of long-term debt	(335,657)			(335,657)
Payments of loan origination costs	(11,432)			(11,432)
Proceeds from exercise of common stock options, net	3			3
Proceeds from stock subscription notes receivable	73			73
Net cash provided by financing activities	17,987		—	17,987
Increase (decrease) in cash and cash equivalents	7,723	(2)		7,721
Cash and cash equivalents, beginning of period	97,090	33		97,123

Cash and cash equivalents, end of period	$ 104,813	$ 31	$	$ 104,844

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CONDENSED CONSOLIDATING BALANCE SHEETS (UNAUDITED)

	As of December 31, 2003			
	(in thousands)			
	Parent Company	Wholly Owned Subsidiaries	Consolidating Adjustments	Consolidated Group
Assets				
Current assets	$184,612	$ 9,764	$	$194,376
Receivable from wholly owned subsidiaries	892,601		(892,601)	
Intangible assets, net	61,486	832,468		893,954
Investment in and advances to wholly owned subsidiaries	58,045		(58,045)	
Property, equipment and other assets, net	71,404	123,943		