

PAXSON COMMUNICATIONS CORP

Form 10-K

March 31, 2005

Table of Contents

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

FORM 10-K

(Mark One)

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2004

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from (No Fee Required)

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 incorporation or organization)

59-3212788

(I.R.S. 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**

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class

Class A Common Stock, \$0.001 par value

**Name of Exchange
on Which Registered**

American Stock Exchange

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 twelve months (or 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.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes No

The aggregate market value of common stock held by non-affiliates of the registrant was \$148,546,000 (based upon the \$3.25 per share closing price on the American Stock Exchange) on the last business day of the registrant's most recently completed second fiscal quarter (June 30, 2004). For purposes of this calculation, the registrant has assumed that its directors and executive officers are affiliates.

The number of shares outstanding of each of the registrant's classes of common stock, as of March 4, 2005 was: 61,244,433 shares of Class A Common Stock, \$0.001 par value, and 8,311,639 shares of Class B Common Stock, \$0.001 par value.

Documents Incorporated By Reference

Parts of the definitive Proxy Statement for the Registrant's Annual Meeting of Stockholders to be held on June 10, 2005.

TABLE OF CONTENTS

	<u>Page</u>	
<u>Item 1.</u>	<u>Business</u>	3
<u>Item 2.</u>	<u>Properties</u>	29
<u>Item 3.</u>	<u>Legal Proceedings</u>	30
<u>Item 4.</u>	<u>Submission of Matters to Vote of Security Holders</u>	30
<u>Item 5.</u>	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	31
<u>Item 6.</u>	<u>Selected Financial Data</u>	32
<u>Item 7.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	33
<u>Item 7A.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	47
<u>Item 8.</u>	<u>Financial Statements and Supplementary Financial Data</u>	47
<u>Item 9.</u>	<u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	47
<u>Item 9A.</u>	<u>Controls and Procedures</u>	47
<u>Item 9B.</u>	<u>Other Information</u>	49
<u>Item 10.</u>	<u>Directors and Executive Officers of the Registrant</u>	50
<u>Item 11.</u>	<u>Executive Compensation</u>	50
<u>Item 12.</u>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	50
<u>Item 13.</u>	<u>Certain Relationships and Related Transactions</u>	50
<u>Item 14.</u>	<u>Principal Accountant Fees and Services</u>	50
<u>Item 15.</u>	<u>Exhibits and Financial Statement Schedules</u>	50
	<u>Employment Agreement - Lowell W. Paxson</u>	
	<u>Employment Agreement - Anthony L. Morrison</u>	
	<u>Employment Agreement - Dean M. Goodman</u>	
	<u>Employment Agreement - Dean M. Goodman</u>	

Edgar Filing: PAXSON COMMUNICATIONS CORP - Form 10-K

Employment Agreement - Seth A. Grossman
Employment Agreement - Seth A. Grossman
Employment Agreement - Richard Garcia
Employment Agreement - Adam K. Weinstein
Subsidiaries of the Company
Consent of Ernst & Young LLP
Consent of PricewaterhouseCoopers LLP
Section 302 CEO Certification
Section 302 CFO Certification
Section 906 CEO Certification
Section 906 CEO Certification

Table of Contents

PART I

ITEM 1. Business

General

We are a network television broadcasting company which owns and operates the largest broadcast television station group in the United States, as measured by the number of television households in the markets our stations serve. We currently own and operate 60 broadcast television stations (including three stations we operate under time brokerage agreements), all of which carry PAX TV, including stations reaching all of the top 20 U.S. markets and 40 of the top 50 U.S. markets. We operate PAX TV, a network that provides programming seven days per week, 24 hours per day, and reaches approximately 95 million homes, or 87% of prime time television households in the U.S., through our broadcast television station group, and pursuant to distribution arrangements with cable and satellite distribution systems and our broadcast station affiliates. PAX TV's entertainment programming principally consists of shows originally developed by us and shows that have appeared previously on other broadcast networks which we have purchased the right to air. The balance of PAX TV's programming consists of long form paid programming (principally infomercials) and public interest programming. We have obtained audience ratings and share, market rank and television household data set forth in this report from the most recent information available from Nielsen Media Research. We do not assume responsibility for the accuracy or completeness of this data.

We presently derive our revenues from the sale of network long form paid programming, network spot advertising and station advertising:

Network Long Form Paid Programming. We sell air time for long form paid programming, consisting primarily of infomercials, during broadcasting hours when we are not airing PAX TV entertainment programming or public interest programming. Our network long form paid programming represented approximately 39.8% of our net revenue during the year ended December 31, 2004.

Network Spot Advertising. We sell commercial air time to advertisers who want to reach the entire nationwide PAX TV viewing audience with a single advertisement. Network spot advertising rates are significantly affected by audience ratings and our ability to reach audience demographics that are desirable to advertisers. Higher ratings generally enable us to charge higher rates to advertisers. Our network spot advertising revenue represented approximately 20.7% of our net revenue during the year ended December 31, 2004.

Station Advertising. We sell commercial air time to advertisers who want to reach the viewing audience in specific geographic markets in which we own and operate our television stations. These advertisers may be local businesses or regional or national advertisers who want to target their advertising in these markets. Station advertising rates are affected by ratings and local market conditions. Our station advertising sales represented approximately 39.5% of our net revenue during the year ended December 31, 2004 (including 22.8% of our net revenue during such year which was derived from local and national long form paid programming).

Beginning in January 2003, we modified our programming schedule by replacing entertainment programming during the hours of 1 p.m. to 5 p.m. and 11:30 p.m. to midnight, Monday through Friday, and 5 p.m. to 6 p.m. and 11 p.m. to midnight, Saturday and Sunday, with long form paid programming. As a result, the percentage of our net revenues derived from long form paid programming has increased from 46.4% in the year ended December 31, 2002, to 62.6% in the year ended December 31, 2004. We expect to continue to derive more than half of our net revenues from long form paid programming for the foreseeable future.

We have entered into joint sales agreements, or JSAs, with owners of broadcast stations in markets served by our stations. Our JSA partners' sales staff provides station spot and long form advertising sales management and representation for our stations and in 22 of our stations we have integrated and co-located our station operations with those of our JSA partners. As of March 4, 2005, 45 of our 60 owned and operated television stations operate under a JSA. In March 2005, we notified our JSA partners other than NBC that we were exercising our right to terminate the JSAs, effective June 30, 2005 and we began discussions with NBC as to the termination of each of our JSAs with NBC (covering 14 of our stations in 12 markets). We intend that by the beginning of July 2005, our local advertising sales efforts, including long form paid programming and spot advertisements, will be handled directly by our existing employees.

Our primary operating expenses include selling, general and administrative expenses, depreciation and amortization expenses, programming expenses, employee compensation and costs associated with cable and satellite distribution, ratings services and promotional advertising. Programming amortization is a significant expense and is

Table of Contents

affected by several factors, including the mix of syndicated and original programming and the frequency with which programs are aired.

Our business model differs from that of both traditional television networks and network-affiliated television station groups. Similar to traditional television networks, we provide advertisers with nationwide reach through our extensive television distribution system. Because we own and operate most of our distribution system, however, we receive advertising revenue from the entire broadcast day (consisting of both entertainment and long form paid programming), unlike traditional networks, which receive advertising revenue only from commercials aired during network programming hours and network-affiliated stations, which receive advertising revenue only from non-network commercials. In addition, because of the size and centralized operations of our station group, we are able to achieve economies of scale with respect to our programming, promotional, research, engineering, accounting and administrative expenses which we believe enable us to have lower per station expenses than those of a typical network-affiliated station.

Business Strategy

Our business operations presently do not provide sufficient cash flow to support our debt service and preferred stock dividend requirements. In September 2002, we engaged Bear, Stearns & Co. Inc. and in August 2003 we engaged Citigroup Global Markets Inc. to act as our financial advisors to assess our business plan, capital structure and future capital needs, and to explore strategic alternatives for our company. We terminated these engagements in March 2005 as no viable strategic transactions had been developed on terms that we believed would be in the best interests of all of our stockholders. While we continue to consider strategic alternatives that may arise, which may include the sale of all or part of our assets, finding a strategic partner for our company who would provide the financial resources to enable us to redeem, restructure or refinance our debt and preferred stock, or finding a third party to acquire our company through a merger or other business combination or through a purchase of our equity securities, our principal efforts are focused on improving our core business operations and increasing our cash flow.

Our principal business objective is to improve our cash flow and increase our financial flexibility, so that we may pursue refinancing alternatives with a view to reducing our cost of capital. We believe that if we are able to improve our cash flow and reduce our cost of capital, we will be able to improve our ability to take advantage of future opportunities to strengthen our business that may arise due to changes in the regulatory or business environment for broadcasters or other future developments in our industry. We seek to maintain an efficient operating structure and a flexible programming strategy as we implement changes to our business operations. In 2004, we entered into a consulting agreement with NBC Universal, Inc., or NBC, and committed significant resources to the development of a number of new original entertainment programs, which we launched on PAX TV at various times during the second half of the year. To date, these new programs have not served to materially improve our audience ratings or advertising revenues. We are not currently investing substantial additional amounts in new entertainment programming, and are evaluating other programming strategies and opportunities that might be available to us which could improve our cash flow.

In March 2005, we began the process of ending certain contractual relationships involving most of our stations which limit our ability to implement alternative programming and sales strategies and to take advantage of other opportunities that might be available to us. The termination of these relationships will allow us to eliminate a significant portion of the costs associated with the sales of local and national spot advertisements and long form paid programming. We plan to substantially reduce or eliminate our sales of spot advertisements that are based on audience ratings, which are presently sold for us by our JSA partners and NBC, and to focus our sales efforts on long form paid programming and non-rated spot advertisements. We intend that, by the beginning of July 2005, our local advertising sales efforts, including long form paid programming and spot advertisements, will be handled directly by our own employees.

As part of this process, in March 2005, we notified all of our JSA partners other than NBC that we were exercising our right to terminate the JSAs, effective June 30, 2005, we notified all of our network affiliates that we were exercising our right to terminate the affiliation agreements, effective June 30, 2005, and we notified NBC that we were removing, effective June 30, 2005, all of our stations from our national sales agency agreement with NBC, pursuant to which NBC sells national spot advertisements for 49 of our 60 stations.

In March 2005, we also began discussions with NBC as to the termination of our network sales agency agreement with NBC and each of our JSAs with NBC (covering 14 stations in 12 markets). We intend that, following resolution of these matters, our network advertising sales efforts will be handled directly by our own employees.

Table of Contents

In connection with the termination of the JSAs, we will have to either relocate up to 22 of our station master controls which are currently located in our JSA partner's facility or lease space from our JSA partner in order to keep our station master control located in our JSA partner's facility.

We are also reviewing all of the elements of our business operations as we seek to implement changes that we believe will improve our cash flow.

Operating Strategy

The principal components of our current operating strategy are:

Benefit from a Centralized, Efficient Operating Structure. We centralize many of the functions of our owned and operated stations, including promotions, advertising, research, engineering, accounting and sales traffic. Our stations average fewer than ten employees compared to an average of 90 employees at network-affiliated stations, and an average of 60 employees at independent stations in markets of similar size to ours. We employ a centralized programming strategy, which we believe enables us to keep our programming costs per station significantly lower than those of comparable stations. We provide programming for all of our stations and, except for local news and syndicated programming provided by JSA partners, each station offers substantially the same programming schedule.

Continue Airing Long Form Paid Programming. We air a substantial amount of long form paid programming as we believe this provides us with a stable revenue base. In January 2003, we increased our inventory of air time available for long form paid programming by approximately 42% by shifting 26.5 hours per week of non-prime time PAX TV network entertainment programming to long form paid programming. The portion of our net revenues which is derived from network advertising decreased to 20.7% for the year ended December 31, 2004 from 32.6% for the year ended December 31, 2002 and the portion of our net revenues which is derived from network and station long form paid programming increased to 62.6% for the year ended December 31, 2004 from 46.4% for the year ended December 31, 2002.

Maintain a Flexible Programming Strategy. An important element of our plan to improve our business operations and cash flow is to maintain a flexible programming strategy that allows us to take advantage of opportunities that may arise for us to improve our return on our broadcast airtime while refraining from incurring substantial programming costs. These opportunities may include selling blocks of time to third parties who would air sports, entertainment or other programming. We are not currently investing substantial additional amounts in the development of new original programming or the purchase of rights to our syndicated programming, and intend to substantially reduce or eliminate our sale of spot advertisements that are based on television audience ratings. The termination of our JSAs and network affiliation agreements is a component of our implementation of this programming strategy, as these agreements restrict our programming flexibility by requiring us to continue airing a certain amount of network entertainment programming and our ability to control our local advertising.

Expand and Improve PAX TV Distribution. We intend to continue to expand our television distribution system to reach as many U.S. television households as possible in a cost efficient manner. We will seek to replace the distribution lost by the termination of our network affiliation agreements through the negotiation of new, more flexible affiliation agreements and carriage agreements with cable systems in the affected markets, as and if such agreements can be concluded on cost efficient terms. We continue to improve the channel positioning of our broadcast television stations on local cable systems across the country, as we believe the ability to view our programming on one of the lower numbered channel positions (generally below channel 21) on a cable system improves the likelihood that viewers will watch our programming.

Provide Quality Entertainment Programming. We believe there is significant demand, including from adult demographic groups which are attractive to advertisers, for quality entertainment programming which is free of excessive violence, explicit sexual themes and foul language. We own or have the right to air a substantial amount of this type of programming which we will continue to air to the extent we continue to carry entertainment programming.

Exploit Our Broadcast Station Group's Digital Television Platform. Our owned and operated station group gives us a significant platform for digital broadcasting. We have completed the construction of digital broadcast facilities for 49 of our 60 owned and operated stations and intend to explore the most effective use of digital broadcast technology for each of our stations. We believe that we are able to provide a significant broadband platform on which to broadcast digital television, including multiple television networks. While future applications of this technology and the time frame within which the transition to digital broadcasting

Table of Contents

will be completed are uncertain, we believe that with our existing broadcast stations we are well positioned to take advantage of future digital broadcasting opportunities.

Joint Sales Agreements

We have been managing the local operations of 45 of our stations through JSAs, including JSAs between 41 of our stations and stations owned by NBC, or independently owned NBC affiliated stations. Generally, JSAs are for ten-year terms. Substantially all JSA partners have the right to terminate the JSA upon a sale by the JSA partner of its station that is the subject of the JSA. Each JSA typically provides for the JSA partner to serve as our exclusive sales representative to sell our station advertising, enabling our station to benefit from the strength of the JSA partner's sales organization and existing advertiser relationships. In about half of our JSA arrangements, we have co-located many of our station operations, including our station master control, with those of the JSA partner, seeking to reduce our costs through operating efficiencies and economies of scale, including the elimination of redundant owned and leased facilities and staffing. Our JSA partner may provide local news and syndicated programming, supplementing our station's programming lineup.

In March 2005, we notified all of our JSA partners other than NBC that we were exercising our right to terminate the JSAs, effective June 30, 2005 and began discussions with NBC as to the termination of each of the JSAs with NBC (covering 14 of our stations in 12 markets). We intend that, by the beginning of July 2005, our local advertising sales efforts, including long form paid programming and spot advertisements, will be handled directly by our own employees. In addition, in connection with the termination of the JSAs, we will have to either relocate up to 22 of our station master controls which are currently located in our JSA partner's facility or lease space from our JSA partner in order to keep our station master control located in our JSA partner's facility.

Distribution

We distribute PAX TV through a television distribution system comprised of our owned and operated broadcast television stations, cable television systems in various markets not served by a PAX TV station, satellite television providers and independently owned PAX TV affiliated broadcast stations. According to Nielsen our programming currently reaches 87% of U.S. television households (approximately 95 million homes).

We seek to reach as many U.S. television households as possible in a cost efficient manner. In evaluating opportunities to increase our television distribution, we consider factors such as the attractiveness of specific geographic markets and their audience demographics to potential television advertisers, the degree to which the increased distribution would improve our nationwide audience reach or upgrade our distribution in a market in which we already operate, and the effect of any changes in our distribution on our national ownership position under the Communications Act of 1934, as amended, which we refer to as the Communications Act, and the rules and regulations of the Federal Communications Commission, which we refer to as the FCC, restricting the ownership of attributable interests in television stations. We have increased the number of U.S. television households which can receive our programming by entering into agreements with cable system operators and satellite television providers under which they carry our programming on a designated channel of their cable system or satellite service.

Our Owned and Operated Television Stations. We currently own and operate 60 broadcast television stations (including three stations we operate under time brokerage agreements, or TBAs), all of which carry PAX TV, including stations reaching all of the top 20 U.S. markets and 40 of the top 50 U.S. markets. Our owned and operated station group reaches approximately 63% of U.S. prime time television households, according to Nielsen. Our ownership of the stations providing most of our television distribution enables us to receive advertising revenue from each station's entire broadcast day and to achieve operating efficiencies typically not enjoyed by network affiliated television stations. As nearly all of our owned and operated stations operate in the ultra high frequency, or UHF, portion of the broadcast spectrum, only half of the number of television households they reach are counted against the

national ownership cap under the Communications Act. By exercising our rights under the Communications Act to require cable television system operators to carry the broadcast signals of our owned and operated stations, we reach many more television households in each station's designated market area, or DMA, than we would if our stations were limited to transmitting their broadcast signals over the airwaves.

We operate three stations (WPXL, New Orleans; WPXX, Memphis; and WBNA, Louisville) pursuant to time brokerage agreements, or TBAs, with the station owners. Under these agreements, we provide the station with PAX TV programming and retain the advertising revenues from the sale of advertising time during substantially all of our PAX TV programming hours, in the case of WPXL and WPXX, and during half of our PAX TV programming hours, in the case of WBNA. We have options to acquire the New Orleans and Memphis stations and a right of first refusal to acquire the Louisville station. The owners of the two stations for which we have options have the right to require us to purchase these stations at any time after January 1, 2007 through December 31, 2008.

Table of Contents

The table below provides information about our owned and operated stations (including stations we operate pursuant to TBAs).

Market Name	Market Rank (1)	Station Call Letters	Broadcast Channel	Total Market TV Households (2)	JSA Partner (3)
New York	1	WPXN	31	7,355,710	NBC
Los Angeles	2	KPXN	30	5,431,140	NBC
Chicago	3	WCPX	38	3,417,330	NBC
Philadelphia	4	WPPX	61	2,919,410	NBC
Boston	5	WPBX	68	2,391,840	
Boston	5	WDPX	58	2,391,840	
Boston	5	WPXG	21	2,391,840	
San Francisco	6	KKPX	65	2,359,870	NBC
Dallas	7	KPXD	68	2,292,760	NBC
Washington D.C.	8	WPXW	66	2,241,610	NBC
Washington D.C.	8	WWPX	60	2,241,610	NBC
Atlanta	9	WPXA	14	2,059,450	Gannett Co., Inc.
Detroit	10	WPXD	31	1,943,930	
Houston	11	KPXB	49	1,902,810	Belo Corp.
Seattle	12	KWPX	33	1,690,640	Belo Corp.
	13	WXPX	66	1,671,040	Media General, Inc.
Tampa					
Minneapolis	14	KPXM	41	1,665,540	Gannett Co., Inc.
Phoenix	15	KPPX	51	1,596,950	Gannett Co., Inc.
Cleveland	16	WVPX	23	1,556,670	Gannett Co., Inc.
Miami	17	WPXM	35	1,496,810	NBC
Denver	18	KPXC	59	1,401,760	Gannett Co., Inc.
	19	KSPX	29	1,315,030	Hearst-Argyle Television, Inc.
Sacramento					
	20	WOPX	56	1,303,150	Hearst-Argyle Television, Inc.
Orlando					
Portland, OR	24	KPXG	22	1,086,900	Belo Corp.
	25	WIPX	63	1,053,020	Dispatch Broadcast Group
Indianapolis					
Hartford	27	WHPX	26	1,017,530	NBC
Raleigh-Durham	29	WFPX	62	966,720	NBC
Raleigh-Durham	29	WRPX	47	966,720	NBC
Nashville	30	WNPX	28	916,170	
	31	KPXE	50	894,580	Scripps Howard Broadcasting Company
Kansas City					
	32	WPXE	55	886,770	Journal Broadcast Group, Inc.
Milwaukee					
Salt Lake City	36	KUPX	16	800,000	
San Antonio	37	KPXL	26	748,950	Clear Channel Broadcasting,

					Inc.
Grand Rapids	38	WZPX	43	732,600	LIN Television Corp.
	39	WPXP	67	729,010	Scripps Howard Broadcasting Company
West Palm Beach					
Birmingham	40	WPXH	44	717,300	NBC
	41	WPXV	49	707,750	LIN Television Corp.
Norfolk					
	43	WPXL	49	695,760	Hearst-Argyle Television, Inc.
New Orleans (4)(5)					
	44	WPXX	50	658,250	Raycom America, Inc.
Memphis (4)(5)					
	45	KOPX	62	655,250	The New York Times Company
Oklahoma City					
Buffalo	46	WPXJ	51	651,970	Gannett Co., Inc.
	48	WGPX	16	648,860	Hearst-Argyle Television, Inc.
Greensboro					
Providence	49	WPXQ	69	644,980	NBC
Louisville (4)(6)					
	50	WBNA	21	637,680	
	52	WPXC	21	613,000	Post-Newsweek Stations, Inc.
Jacksonville-Brunswick					
	53	WQPX	64	592,560	The New York Times Company
Wilkes Barre					
Albany	55	WYPX	55	555,640	
	59	WPXK	54	513,630	Raycom America, Inc.
Knoxville					
	60	KTPX	44	510,960	Scripps Howard Broadcasting Company
Tulsa					
Charleston, WV	62	WLPX	29	508,750	
Lexington	64	WUPX	67	481,120	
	67	WPXR	38	445,670	Media General, Inc.
Roanoke					
Honolulu	71	KPXO	66	417,120	
	73	KFPX	39	412,230	The New York Times Company
Des Moines					
	77	WSPX	56	395,400	Raycom America, Inc.
Syracuse					

Table of Contents

Market Name	Market Rank (1)	Station Call Letters	Broadcast Channel	Total Market TV Households (2)	JSA Partner (3)
Spokane	80	KGPX	34	384,060	KHQ, Incorporated
Cedar Rapids	88	KPXR	48	331,610	
Greenville-N. Bern	105	WEPX	38	270,200	
Greenville-N. Bern	105	WPXU	35	270,200	
Wausau	133	WTPX	46	181,780	

- (1) Market rank is based on the number of television households in the television market or Designated Market Area, or DMA, as used by Nielsen, effective as of September 2004.
- (2) Refers to the number of television households in the DMA as estimated by Nielsen, effective as of September 2004.
- (3) Indicates the company with which we have entered into a JSA for the station. In March 2005, we notified all of our JSA partners other than NBC that we were exercising our right to terminate the JSAs, effective June 30, 2005, and we began discussions with NBC as to the termination of each of the JSAs with NBC (covering 14 of our stations in 12 markets).
- (4) Station is independently owned and is operated by us under a time brokerage agreement.
- (5) We have the option to acquire the station and the current owner has the right to require us to purchase the station at anytime after January 1, 2007 through December 31, 2008.
- (6) We have a right of first refusal to acquire the station.

Cable and Satellite Distribution. In order to increase the distribution of our programming, we have entered into carriage agreements with the nation's largest cable multiple system operators, as well as with other cable system operators and satellite television providers. These cable and satellite system operators carry our programming on a designated channel of their service. These carriage agreements enable us to reach television households in markets not served by our owned or affiliated stations. Our carriage agreements with cable system operators generally require us to pay an amount based upon television households reached. Our carriage agreements with satellite television providers allow the satellite provider to sell and retain the advertising revenue from a portion of the non-network advertising time during PAX TV programming hours. Some of our carriage agreements with cable operators also provide this form of compensation to the cable operator. We do not pay compensation for reaching households in DMAs already served by our broadcast stations, even though the cable operator may provide our programming to these households, because we have exercised our must carry rights under the Communications Act. We believe that the ability to view our programming on one of the lower numbered channel positions (generally below channel 21) on a cable system improves the likelihood that viewers will watch our programming, and we have negotiated favorable channel positions with most of the cable system operators and satellite television providers with whom we have carriage agreements. Through cable and satellite distribution, we reach approximately 18% of U.S. prime time television households in DMAs not already served by a PAX TV station.

Our PAX TV Affiliated Stations. To increase the distribution of PAX TV, we have entered into affiliation agreements with stations in markets where we do not otherwise own or operate a broadcast station. These stations include full power and low power television stations. Each affiliation agreement gives the particular station the right

to broadcast PAX TV programming, or portions of it, in the station's market. Our affiliation agreements provide us with additional distribution of our PAX TV programming without the expense of acquiring a station or paying compensation to cable system operators in the markets reached. Under our affiliation agreements, we are not required to pay cash compensation to the affiliate, and the affiliate is entitled to sell and retain the revenue from all or a portion of the non-network advertising time during the PAX TV programming hours. We have affiliation agreements with respect to 47 television stations which reach approximately 6% of U.S. prime time television households.

In March 2005, we notified all of our affiliates that we were exercising our right to terminate the affiliation agreements, effective June 30, 2005. We will seek to replace the distribution lost by the termination of our network affiliation agreements through the negotiation of new, more flexible affiliation agreements and carriage agreements with cable systems in the affected markets, as and if such agreements can be concluded on cost efficient terms.

Programming

We operate PAX TV, a network that provides programming seven days per week, 24 hours per day. During our PAX TV entertainment programming hours, which are between 5:00 p.m. and 11:30 p.m., local time, Monday through Friday, and 6:00 p.m. and 11:00 p.m., Saturday and Sunday, we offer entertainment programs that are free of excessive violence, explicit sexual themes and foul language. Our PAX TV entertainment lineup consists of original

Table of Contents

shows, syndicated programs and a limited amount of entertainment and sports programming on a market-by-market basis.

During each programming season since our launch, we have developed original PAX TV entertainment programming, as our operating experience with PAX TV has shown that quality original programs can generate higher ratings and deliver a greater return to us, in terms of advertising revenues, than syndicated programs of comparable cost. By employing cost efficient development and production techniques, such as the development of program concepts without the use of pilots, and by entering into production arrangements with foreign production companies through which we are able to share production costs, gain access to lower cost production labor and participate in tax incentives, we have developed original entertainment programming for PAX TV at costs which we believe to be lower than those typically incurred by other broadcast networks for original entertainment programming. In addition, we attempt to pre-sell the foreign and other distribution rights to our original PAX TV programming and thereby recover a significant portion of the program's production costs, while retaining all of the domestic rights. Our agreements for syndicated programming generally entitle us to exclusive nationwide distribution rights over our entire television distribution system for a fixed cost, without regard to the number of households that receive our programming.

In March 2004 we entered into an agreement with NBC under which NBC consulted with us on the development, production and programming of scripted and unscripted television series, games shows and specials for the 2004-2005 broadcast season. We committed significant resources to this programming initiative, and the shows we developed were targeted largely to a younger audience demographic that is more attractive to advertisers than the audience demographic that has typically viewed our programming. We launched these shows on PAX TV at various times during the second half of 2004. To date, this programming initiative has not served to materially improve our audience ratings or advertising revenues. Our consulting agreement with NBC has expired and, although we continue to fund our remaining commitments to this programming initiative, we are not currently planning to invest significant additional resources in the development of new original programming. We plan to maintain a flexible programming strategy and to evaluate other programming opportunities that might be available to us which would improve our cash flow.

During hours when we are not broadcasting entertainment programming, our stations broadcast long form paid programming, consisting primarily of infomercials, which are shows produced at no cost to us to market and sell products and services through viewer direct response, and paid religious programming. Pursuant to an agreement with The Christian Network, Inc., or CNI, our broadcast stations carry CNI's programming between the hours of 1:00 a.m. and 6:00 a.m., seven days per week.

Under many of our JSAs, the JSA partner provides our station with local evening news broadcasts, which may be a rebroadcast of the JSA partner's news in a different time slot or a news broadcast produced for PAX TV. We do not expect these arrangements to continue after termination of our JSAs, as discussed above.

Ratings

The advertising revenues from our PAX TV entertainment programming are largely dependent upon the popularity of our programming, in terms of audience ratings, and the attractiveness of our PAX TV viewing audience to advertisers. Nielsen, one of the leading providers of national audience measuring services, has grouped all television stations in the country into approximately 210 DMAs that are ranked in size according to the number of television households, and periodically publishes data on estimated audiences for the television stations in the various DMAs. The estimates are expressed in terms of the percentage of the total potential audience in the market viewing a station (the station's Rating) and of the percentage of the audience actually watching television (the station's Share). Nielsen provides this data on the basis of total television households and selected demographic groupings in the DMA.

Some viewer demographic groups are more attractive to advertisers than others, such as adults of working age who typically have greater purchasing power than other viewer demographic groups. Many products and services are targeted to consumers with specific demographic characteristics, and a viewer demographic group containing a concentration of these types of consumers generally will be more attractive to advertisers. Based on our experiences with PAX TV, advertisers often will pay higher rates to advertise during programming that reaches demographic groups that are targeted by that advertiser. A component of our entertainment programming strategy is to air programming that will increase PAX TV's ratings among certain demographic groups that are most attractive to advertisers.

Table of Contents

Advertising

We offer advertisers the opportunity to reach PAX TV's nationwide viewing audience with a single infomercial or commercial, and to target specific geographic markets in which our programming is aired.

We sell airtime to advertisers for long form paid programming, consisting primarily of infomercials. This programming may appear on our nationwide PAX TV network or it may be aired only in specific geographic markets. Our national long form sales team sells network and regional paid programming time. Local paid programming may be sold by our national sales team or by the local sales team at each station.

We also sell commercial air time to advertisers who want to reach the entire nationwide PAX TV viewing audience with a single advertisement, which we refer to as network advertising. NBC serves as our exclusive sales representative to sell most of our network spot advertising. Network spot advertising represented approximately 21.0% of our net revenue during the year ended December 31, 2003 and 20.7% of our net revenue during the year ended December 31, 2004. The central programming signal through which we supply our programming to our stations and to cable and satellite viewers includes advertising, generally of a direct response nature, which reaches our cable and satellite viewers (during both PAX TV entertainment programming and other viewing hours) in markets not served by our stations during time that is otherwise allocated to station spot advertising, and which reaches viewers in local markets during unsold station spot advertising time. We include the revenue from this advertising in our network advertising revenues.

We also sell commercial air time to local and national advertisers who want to reach our viewing audience in specific geographic markets in which we operate, which we refer to as station advertising. These advertisers may be local businesses or regional or national advertisers who want to target their advertising in these markets. NBC provides national advertising sales services for a majority of our stations. In markets in which our stations are operating under JSAs, our JSA partner serves as our exclusive sales representative to sell our local station advertising. For stations for which NBC does not provide national account representation, our JSA partner performs this function. Our local sales force sells this advertising in markets without JSAs. Our station advertising represented approximately 38.3% of our net revenue during the year ended December 31, 2003 and 39.5% of our net revenue during the year ended December 31, 2004 (including 21.4% and 22.8%, respectively, of our net revenue during each such year which was derived from local and national long form paid programming).

In March 2005, we notified our JSA partners other than NBC that we were exercising our right to terminate the JSAs, effective June 30, 2005. We also notified NBC that we were exercising our right to remove, effective June 30, 2005, all of our stations from our national sales agency agreement, pursuant to which NBC sells national spot advertisements for 49 of our 60 stations. We also began discussions with NBC as to the termination of our network sales agency agreement with NBC and each of our JSAs with NBC (covering 14 of our stations in 12 markets). We plan to substantially reduce or eliminate our sales of spot advertisements that are based on audience ratings, and to focus our sales efforts on long form paid programming and non-rated spot advertisements. We intend to transfer our local advertising sales efforts to our own employees by the beginning of July 2005 and to transfer our network advertising sales efforts to our own employees following resolution of our discussions with NBC.

Our advertising rates are typically negotiated and based upon:

economic and market conditions;

the size of the market in which a station operates;

a program's popularity among the viewers that an advertiser wishes to attract;

the number of advertisers competing for a time slot;

the availability of alternative advertising media in the market area;

the demographic composition of the market served by the station;

development of projects, features and programs that tie advertiser messages to programming; and

quarterly sweeps performance ratings which measure household tuning and demographic audience estimates in all 210 Nielsen TV markets.

Table of Contents

NBC Relationship

On September 15, 1999, we entered into an investment agreement with 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 Mr. Paxson 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.

Series B Preferred Stock. Under the investment agreement, a wholly-owned subsidiary of NBC acquired \$415 million aggregate liquidation preference of our Series B preferred stock. This security accrues cumulative dividends and is convertible, subject to adjustment under the terms of the Series B preferred stock, into 31,896,032 shares of our Class A common stock at an initial conversion price of \$13.01 per share (\$18.83 per share as of December 31, 2004). On September 15, 2004, the rate at which dividends accrue on the Series B preferred stock was adjusted from the initial annual rate of 8% to an annual rate of 16.2% as required by the terms of the Series B preferred stock. The shares of Series B preferred stock are exchangeable, in whole or in part, at the option of the holders, into convertible debentures ranking on a parity with our other subordinated indebtedness subject, with respect to any exchange before January 1, 2007, to the exchange being permitted under the terms of our debt and preferred stock instruments. The maturity date of the convertible debentures into which the shares of Series B preferred stock are exchangeable is December 31, 2009.

We are involved in litigation with NBC in the Delaware Court of Chancery regarding the adjustment of the rate at which dividends accrue on our Series B preferred stock, as described below under *Forward Looking Statements and Associated Risks and Uncertainties*. The adjustment to the dividend rate on our Series B preferred stock could have adverse consequences for our business.

Warrant A and Warrant B. A wholly-owned subsidiary of NBC also acquired a warrant (*Warrant A*) to purchase up to 13,065,507 shares of Class A common stock at an exercise price of \$12.60 per share, and a warrant (*Warrant B*) to purchase from us up to 18,966,620 shares of Class A common stock at an exercise price equal to the average of the closing sale prices of the Class A common stock for the 45 consecutive trading days ending on the trading day immediately preceding the warrant exercise date, provided that the average price shall not be more than 17.5% higher or 17.5% lower than the six month trailing average closing sale price. The warrants are exercisable until September 2009, subject to various conditions and limitations. In addition:

Warrant B may not be exercised before the exercise in full of Warrant A; and

Warrant B may not be exercised to the extent that, after giving effect to the exercise, Mr. Paxson would no longer constitute our single majority stockholder unless Warrant B is exercised in full and at the same time NBC exercises its right to purchase all the shares of our Class B common stock held by Mr. Paxson.

Right to Purchase Class B Common Stock. Concurrently with entering into the Investment Agreement and issuing the Series B preferred stock and Warrants A and B to subsidiaries of NBC, a wholly-owned subsidiary of NBC entered into an agreement with Mr. Paxson 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. This right is exercisable through September 15, 2009, and may not be exercised before the exercise in full of Warrant A and Warrant B.

These shares of Class B common stock are entitled to ten votes per share on all matters submitted to a vote of our stockholders and are convertible into an equal number of shares of Class A common stock. The purchase price per share of Class B common stock is equal to the higher of:

the average of the closing sale prices of the Class A common stock for the 45 consecutive trading days ending on the trading day immediately preceding the exercise of NBC's call right, provided that the average price shall not be more than 17.5% higher or 17.5% lower than the six month trailing average closing sale prices; and

\$20.00 per share.

The owners of the shares that are subject to the call right have agreed not to transfer those shares before September 15, 2005, and not to convert those shares into any of our other securities, including shares of Class A common stock. NBC's exercise of the call right is subject to compliance with applicable provisions of the Communications Act and the rules and regulations of the FCC.

Optional Redemption by NBC. On November 13, 2003, NBC notified us that it was exercising its right under its investment agreement with us to demand that we redeem or arrange for a third party to acquire (the Redemption),

Table of Contents

by payment in cash, all 41,500 outstanding shares of our Series B Convertible Exchangeable Preferred Stock held by NBC. The aggregate redemption price payable in respect of the 41,500 preferred shares, including accrued dividends thereon, was approximately \$600.7 million as of December 31, 2004.

Between November 13, 2003 and November 13, 2004 we were unable to consummate the Redemption as the terms of our outstanding debt and preferred stock prohibited the Redemption and we did not have sufficient funds on hand to consummate the Redemption. We are involved in litigation with NBC in the Delaware Court of Chancery in which we are seeking a declaratory ruling that we are not obligated to consummate the Redemption and are not in default under our agreement with NBC by virtue of not having done so.

As we did not effect the Redemption by November 13, 2004, NBC generally is permitted to transfer, without restriction, any of our securities acquired by it, its right to acquire Mr. Paxson's Class B common stock, the contractual rights with respect to the NBC investment agreement and its other rights under the related transaction agreements, provided that Warrant A, Warrant B and the right to acquire Mr. Paxson's Class B common stock will expire, to the extent unexercised, 30 days after any such transfer. If NBC transfers any of our securities or its right to acquire Mr. Paxson's Class B common stock, the transferee will remain subject to the terms and conditions of such securities, including those limitations on exercise described above.

Default Redemption by NBC. NBC also has the right to require that we redeem any Series B preferred stock and Class A common stock issued upon conversion of the Series B preferred stock then held by NBC upon the occurrence of various events of default (a Default Redemption). If NBC exercises this right, we will have up to 180 days to consummate the redemption. If at any time during the 180 day redemption period, the terms of our outstanding debt and preferred stock do not prohibit the redemption and we have sufficient funds on hand to consummate the redemption, we must consummate the redemption at that time. NBC may not exercise Warrant A, Warrant B or its right to purchase shares of Class B common stock beneficially owned by Mr. Paxson during the 180 day redemption period.

Should we fail to effect a Default Redemption within 180 days after NBC has exercised its right to require us to redeem its securities, NBC will have 180 days within which to exercise Warrant A and Warrant B and its right to acquire Mr. Paxson's Class B common stock, and generally will be permitted to transfer, without restriction, any of our securities acquired by it, its right to acquire Mr. Paxson's Class B common stock, the contractual rights described below, and its other rights under the related transaction agreements, provided that Warrant A, Warrant B and the right to acquire Mr. Paxson's Class B common stock shall expire, to the extent unexercised, 30 days after any such transfer. If NBC does not effect any of these transactions within the 180 day period, we will have the right, for 30 days, to redeem NBC's securities. If we do not effect a redemption during this period, NBC will have the right to require us to effect, at our option, either a public sale or a liquidation of our company and may participate as a bidder in any such transaction. If the highest bid in any public sale of our company would be insufficient to pay NBC the redemption price of its securities, NBC will have a right of first refusal to purchase our company for the highest bid amount. If the highest bid in any public sale would be sufficient to pay NBC the redemption price of its securities, the investment agreement requires us to accept the bid. NBC will not be permitted to exercise Warrant A, Warrant B or its right to acquire Mr. Paxson's Class B common stock during the public sale or liquidation process.

Inability to Effect a Redemption. Our ability to effect any redemption is restricted by the terms of our outstanding debt and preferred stock. In order to be able to effect a redemption demanded by NBC, we would need not only to raise sufficient cash to fund payment of the redemption price, but also to obtain the consents of the holders of our outstanding debt and preferred stock or repay, redeem or refinance these securities in a manner that obviated the need to obtain the consents of the holders. Alternatively, we would need to identify a third party willing to purchase NBC's Series B preferred stock directly from NBC or to enter into a merger, acquisition or other transaction with us as a result of which NBC's Series B preferred stock would be redeemed or acquired.

Optional Redemption by the Company. We have the right, at any time, to redeem any or all of our outstanding Series B preferred stock at a redemption price per share equal to the higher of (i) the liquidation preference of \$10,000 per share plus accrued and unpaid dividends, and (ii) the product of 80% of the average of the closing sale prices of the Class A common stock for the ten consecutive trading days ending on the trading day immediately preceding our notice to NBC exercising the optional redemption, and the number of shares of Class A common stock into which a share of Series B preferred stock is convertible (approximately 768.58 shares of Class A common stock as of December 31, 2004).

If we elect to redeem a portion of our outstanding Series B preferred stock, we are required to declare and pay, in full, all of the accumulated and unpaid dividends on the Series B preferred stock. As of December 31, 2004, accumulated and unpaid dividends on the Series B preferred stock aggregated approximately \$185.7 million.

Table of Contents

Consent Rights. The investment agreement also provides that we must obtain the consent of NBC for various actions, including:

approval of annual budgets;

expenditures materially in excess of budgeted amounts;

material acquisitions of programming;

material amendments to our certificate of incorporation or bylaws;

material asset sales or purchases, including, in some cases, sales of our television stations;

business combinations where we would not be the surviving corporation or as a result of which we would experience a change of control;

issuances or sales of any capital stock, with some exceptions;

certain affiliate transactions;

stock splits or recombinations;

any increase in the size of our board of directors other than any increase resulting from provisions of our outstanding preferred stock of up to two additional directors; and

joint sales, joint services, time brokerage, local marketing or similar agreements as a result of which our stations with national household coverage of 20% or more would be subject to those agreements.

Miscellaneous Rights. In connection with its investment in us, we also granted NBC various rights with respect to our broadcast television operations, including:

the right to require the conversion of our television stations to NBC network affiliates, subject to various conditions;

a right of first refusal on proposed sales of television stations; and

the right to require our television stations to carry NBC network programming that is preempted by NBC network affiliates.

Stockholders Agreement. We also entered into a stockholders agreement with NBC, Mr. Paxson and entities controlled by Mr. Paxson under which we are permitted (but not required) to nominate persons named by NBC for election to our board of directors upon request by NBC if NBC determines that its nominees are permitted under the Communications Act and FCC rules to serve on our board. Mr. Paxson and his affiliates agreed to vote their shares of common stock in favor of the election of those persons as our directors. As part of the outcome of the proceedings that we initiated in 2001, which are described below, the FCC determined in 2002 that any NBC nominated director must not be an NBC employee and must be a person who would reasonably be expected to act independently on all matters. The stockholders agreement further provides that we will not, without the prior written consent of NBC, enter into certain agreements or adopt certain plans which would be breached or violated upon the acquisition of our securities by NBC or its affiliates or would otherwise restrict or impede the ability of NBC or its affiliates to acquire additional shares of our capital stock.

Registration Rights. We also granted NBC demand and piggyback registration rights with respect to the shares of Class A common stock issuable upon:

conversion of the Series B preferred stock;

conversion of the debentures for which the Series B preferred stock is exchangeable;

exercise of the warrants; or

conversion of the Class B common stock.

Operational Arrangements. In connection with these transactions, we entered into a number of business arrangements with NBC. As part of these arrangements and our relationship with NBC:

NBC provides network advertising sales, marketing and network research services for PAX TV;

NBC provides national advertising sales services for a majority of our stations; and

Table of Contents

NBC has provided some of its programming, including movies and sporting events, for broadcast on PAX TV.

We have entered into JSAs with NBC with respect to 14 of our stations serving 12 markets also served by an NBC owned and operated station, and with 27 independently owned NBC affiliated stations serving our markets. Under the JSAs, the NBC stations sell all non-network advertising of our stations and receive commission compensation for those sales, and each of our stations may carry one hour per day of NBC syndicated programming, subject to compliance with our entertainment programming content standards.

In March 2005, we notified NBC that we were removing, effective June 30, 2005, all of our stations from the national sales agency agreement pursuant to which NBC sells national spot advertisements for 49 of our 60 stations. In addition, we began discussions with NBC as to the termination of our network sales agency agreement with NBC and each of the JSAs with NBC.

Delaware Court of Chancery Proceedings. On August 19, 2004, NBC filed a complaint against us in the Court of Chancery of the State of Delaware seeking a declaratory ruling as to the meaning of the terms "Cost of Capital Dividend Rate" and "independent investment bank as used in the Certificate of Designation (the "Certificate of Designation") of our Series B preferred stock held by NBC. On September 15, 2004, the annual rate at which dividends accrue on the Series B preferred stock was reset from 8% to 16.2% in accordance with the procedure specified in the terms of the Series B preferred stock. We engaged CIBC World Markets Corp., a nationally recognized independent investment banking firm, to determine the adjusted dividend rate as of the fifth anniversary of the original issue date of the Series B preferred stock.

On October 14, 2004, we filed our answer and a counterclaim to NBC's complaint. Our answer largely denies the allegations of the NBC complaint and our counterclaim seeks a declaratory ruling that we are not obligated to redeem, and will not be in default under the terms of the agreement under which NBC made its initial \$415 million investment in us if we do not redeem, the Series B preferred stock on or before November 13, 2004. NBC delivered a notice of demand for redemption on November 13, 2003, and has since alleged, both through statements to the press and in its complaint filed in Delaware, that we are obligated to redeem, and will be in default if we do not redeem, NBC's investment on or before November 13, 2004.

We and NBC have filed briefs in the litigation and have each moved for judgment on the pleadings. The court heard oral argument on the respective motions on February 14, 2005 and has not yet issued its ruling.

Arbitration and FCC Proceedings. In December 2001, we commenced a binding arbitration proceeding against NBC in which we asserted that NBC breached its agreements with us and breached its fiduciary duty to us and to our shareholders. We asserted that NBC's proposed acquisition of Telemundo Communications Group, Inc. ("Telemundo Group") (which was completed in April 2002) violates the terms of the agreements governing the investment and partnership between us and NBC. In September 2002, the arbitrator ruled against us on all of our claims, denying us any of the relief we had sought with respect to what we believed to be NBC's wrongful actions. Accordingly, the provisions of our agreements with NBC remain in effect without change.

We also made two filings with the FCC, one of which requested a declaratory ruling as to whether conduct by NBC, including NBC's influence and apparent control over certain members of our board of directors selected by NBC (all of whom have since resigned from our board), caused NBC to have an attributable interest in us in violation of FCC rules or infringed upon our rights as an FCC license holder. The second FCC filing sought to deny FCC approval of NBC's acquisition of the Telemundo Group's television stations. In an opinion and order adopted April 9, 2002, the FCC granted approval of NBC's applications for consent to the transfer to NBC of control of the Telemundo Group television stations, denied our petition to deny these applications, and granted in part and denied in part our request for a declaratory ruling. The FCC found that the placement of NBC employees on our board and the subsequent actions of these persons in their capacity as our directors, including a finding that one such director was protecting NBC's

interests and not acting as an independent member of our board, resulted in NBC having an attributable interest in us in violation of the FCC's multiple ownership rules. The FCC determined that admonishment was the appropriate remedy and further inquiry was not necessary. The FCC further indicated that should NBC choose to exercise its rights to nominate new members of our board of directors, the FCC would require that such persons not be NBC employees or agents but persons who would reasonably be expected to act independently in all future matters concerning our company.

Table of Contents

Competition

We compete for audience and advertisers and our television stations are located in highly competitive markets and face strong competition on all levels.

Audience. Television stations compete for audience share principally on the basis of program popularity, as measured and reported by Nielsen Media Research, the primary audience measurement service used for buying and selling advertising time. Audience size, as reflected by Nielsen ratings, has a direct effect on advertising rates. Our PAX TV programming competes for audience share in all of our markets with the programming offered by other broadcast networks, local and national cable networks and non-network affiliated television stations. We believe our stations also compete for audience share in their respective markets on the basis of their channel positions on the cable systems which carry our programming, and that the ability to view our programming on the lower numbered channel positions (generally below channel 21) generally improves the likelihood that viewers will watch our programming.

Our stations also compete for audience share with other forms of entertainment programming, including home entertainment systems and direct broadcasting satellite video distribution services which transmit programming directly to homes equipped with special receiving antennas and tuners. Further advances in technology may increase competition for household audiences.

Advertising. PAX TV competes for advertising revenues principally with other broadcast and cable television networks and to some degree with other nationally distributed advertising media, such as print publications. Our television stations also compete for advertising revenues with other television stations in their respective markets, as well as with other advertising media, such as newspapers, radio stations, magazines, outdoor advertising, transit advertising, yellow page directories, direct mail and local cable systems. Competition for advertising dollars at the television station level occurs primarily within individual markets. Some national advertisers may be more interested in buying groups or markets, either on a regional basis that align to products distribution patterns, or among larger markets, such as the top 50, as those markets represent approximately two-thirds of the nation's television households. We believe owning and operating stations located primarily in the top 50 markets is more attractive to national advertisers with broad-based distribution of products and services. Generally, a television station in one market does not compete with stations in other market areas.

Federal Regulation of Broadcasting

The FCC regulates television broadcast stations under the Communications Act. The following is a brief summary of certain provisions of the Communications Act and the rules of the FCC.

License Issuance and Renewal. The Communications Act provides that a broadcast station license may be granted to an applicant if the public interest, convenience and necessity will be served thereby, subject to certain limitations. Television broadcast licenses generally are granted and renewed for a period of eight years. Interested parties including members of the public may file petitions to deny a license renewal application but competing applications for the license will not be accepted unless the current licensee's renewal application is denied. The FCC is required to grant a license renewal application if it finds that the licensee (1) has served the public interest, convenience and necessity; (2) has committed no serious violations of the Communications Act or the FCC's rules; and (3) has committed no other violations of the Communications Act or the FCC's rules which would constitute a pattern of abuse. Our licenses are subject to renewal at various times between 2004 and 2007.

General Ownership Matters. The Communications Act requires the prior approval of the FCC for the assignment of a broadcast license or the transfer of control of a corporation or other entity holding a license. In determining whether to approve such an assignment or transfer of control, the FCC considers, among other things, the financial

and legal qualifications of the prospective assignee or transferee, including compliance with rules limiting the common ownership of certain attributable interests in broadcast, cable and newspaper properties.

The FCC's multiple ownership rules may limit the acquisitions and investments that we may make or the investments that others may make in us. The FCC generally applies its ownership limits to attributable interests held by an individual, corporation, partnership or other association or entity. In the case of corporations holding or controlling broadcast licenses, the interests of officers, directors and those who, directly or indirectly, have the right to vote five percent or more of the corporation's stock are generally attributable. The FCC treats all partnership and limited liability company interests as attributable, except for those interests that are insulated under FCC rules and policies. For insurance companies, certain regulated investment companies and bank trust departments that hold stock for investment purposes only, stock interests become attributable with the ownership of 20% or more of the voting stock of the corporation holding or controlling broadcast licenses.

Table of Contents

The FCC treats as attributable debt and equity interests that, when combined, exceed 33% of a station licensee's total assets, which is defined as the total amount of debt and equity capital, if the party holding the equity and debt interests (1) supplies more than 15% of the station's total weekly programming or (2) has an attributable interest in another media entity, whether television, radio or newspaper, in the same market. Non-voting equity, loans, and insulated interests count toward the 33% equity/debt threshold. Non-conforming interests acquired before November 7, 1996, are permanently grandfathered for purposes of the equity/debt rules and thus do not constitute attributable ownership interests.

Television National Ownership Rule. On June 2, 2003, the FCC adopted new rules governing, among other things, national and local ownership of television broadcast stations and cross-ownership of television broadcast stations with radio broadcast stations and newspapers serving the same market. The new rules would change the regulatory framework within which television broadcasters hold, acquire and transfer broadcast stations. Numerous parties asked the FCC to reconsider portions of its decision and other parties sought judicial review. In September 2003, the U. S. Court of Appeals for the Third Circuit issued an order staying the effectiveness of the new media ownership rules, and in June 2004 the Third Circuit remanded the proceeding to the FCC with instructions to the FCC to better justify or modify its approach to setting the numerical limits. The stay remains in effect pending further review by the Third Circuit of the FCC's further action. Several parties have filed petitions for review by the Supreme Court which are currently pending.

Among other things, the FCC's new ownership rules would have increased the percentage of the nation's television households that may be served by television broadcast stations in which the same person or entity has an attributable interest from 35% to 45% of national television households. The Consolidated Appropriations Act of 2004 directed the FCC to increase this percentage to 39% of national television households and allows an entity that acquires licensees in excess of 39% two years to come into compliance with the new cap. The enactment of the 39% cap mooted the FCC's proposed 45% cap. This act also provides that the FCC shall conduct a quadrennial, rather than biennial, review of its ownership rules. The new rules also relax FCC restrictions on local television ownership and on cross-ownership of television stations with radio stations or newspapers in the same market. In general, these new rules would reduce the regulatory barriers to the acquisition of an interest in our television stations by various industry participants who already own television stations, radio stations, or newspapers.

In assessing compliance with the national ownership caps, the FCC counts each UHF station as serving only half of the television households in its market. This UHF Discount is intended to take into account that UHF stations historically have provided less effective coverage of their markets than VHF stations. All of our television stations are UHF stations and, without the UHF Discount, we would not meet the recently-enacted 39% ownership cap. In its June 2, 2003 decision, the FCC concluded that the future transition to digital television may eliminate the need for a UHF Discount. For that reason, the FCC provided that the UHF Discount will sunset i.e., expire for the top four broadcast networks (ABC, NBC, CBS, and Fox) on a market-by-market basis as the digital transition is completed, unless otherwise extended by the FCC. The FCC also announced, however, that it will examine in a future review whether to include in this sunset provision the UHF television stations owned by other networks and group owners, which would include our television stations. The Third Circuit opinion referred to above also held that the Consolidated Appropriations Act of 2004 mooted any argument on whether the FCC could maintain the UHF Discount.

In the last Congress, in addition to enacting the 39% cap, separate legislation was introduced to prohibit the application of the UHF Discount to UHF stations sold after June 2, 2003, to sunset the UHF Discount in 2008 for all UHF stations, to prohibit the cross ownership of newspapers and television stations in the same market and to nullify in their entirety the rule changes adopted by the FCC.

Television Duopoly Rule. The FCC's television duopoly rule permits a party to own two television stations without regard to signal contour overlap if each station is located in a separate designated market area, or DMA. A party may own two television stations in the same DMA so long as (1) at least eight independently owned and operating full-power commercial and non-commercial television stations remain in the market at the time of acquisition and (2) at least one of the two stations is not among the four top-ranked stations in the market based on audience share. Without regard to the number of independently owned television stations or media voices, the FCC permits television duopolies within the same DMA so long as the stations' Grade B service contours do not overlap. Satellite stations that are authorized to rebroadcast the programming of a parent station located in the same DMA are also exempt from the duopoly rule. In April 2002, the U.S. Court of Appeals for the District of Columbia Circuit reversed the FCC's decision establishing an eight media voice standard for same-market television duopolies. The court remanded the proceeding to the FCC to consider whether it should include in its definition of media voices other media (i.e., newspapers, radio, and cable). The court also suggested that, on remand, the FCC may decide to adjust the numerical limit of eight.

Table of Contents

On June 2, 2003 the FCC adopted new rules governing, among other things, the number of television stations a party may own in the same DMA. Under the new rules, a party would be permitted to have an attributable interest in up to two television stations in the same DMA, provided there were between five and 17 television stations in the DMA and provided that only one of the duopoly stations was among the top four television stations in the market in terms of audience share. Duopolies would not be permitted in markets with fewer than five television stations. In markets with 18 or more television stations, a party would be permitted to own up to three television stations in a DMA, only one of which may be among the top four in terms of audience share. The new rules would also eliminate the contour overlap rule for television. The media voice test would be eliminated and the number of television stations in a market would be calculated by counting all full-power commercial and noncommercial television stations located within a given DMA. Neither cable channels, Class A television stations, low power television stations, television translator stations nor dark or non-operational stations would be included in the count. Satellite television stations would also be excluded from the count, if the parent and satellite station were located within the same DMA. The effectiveness of these new rules has been stayed by the order of the U.S. Court of Appeals for the Third Circuit described above.

Television/Newspaper Radio/Television Cross Ownership. On June 2, 2003, the FCC removed the newspaper-broadcast and radio-television cross-ownership prohibitions and replaced them with a new set of cross-media limits. The FCC continued, however, to prohibit common ownership of daily newspapers and broadcast stations, and television/radio combinations in markets with three or fewer television stations. In markets having between four and eight television stations, the new rules would limit ownership to one of the following combinations: (1) a daily newspaper, one television station and up to half of the radio station limit for the market; (2) a daily newspaper, no television station and up to the radio station limit for the market; or (3) two television stations (if allowable under the new rules), no daily newspaper, and up to the radio station limit for the market. In markets having nine or more television stations the cross-media limits would be eliminated completely and only the new local television and local radio ownership rules would apply. Under the new rules, noncommercial television stations would be included in the station count. The effectiveness of these new rules has been stayed by the order of the U.S. Court of Appeals for the Third Circuit described above.

Television Time Brokerage and Joint Sales Agreements. Over the past few years, a number of television stations, including certain of our television stations, have entered into agreements commonly referred to as time brokerage agreements and joint sales agreements. Under these agreements, separately owned and licensed stations agree to function cooperatively subject to the requirements of antitrust laws and compliance with the FCC's rules and policies, including the requirement that each party maintain independent control over the programming and operations of its own station. The FCC's attribution and television duopoly rules apply to time brokerage agreements in which one station brokers more than 15% of the broadcast time per week of another station in the same DMA with an overlapping Grade B contour.

A joint sales agreement, or JSA, is an arrangement by which a brokering station provides advertising sales services, but not programming, for another station in the market. On August 7, 2004, the FCC commenced a rulemaking proceeding to consider whether to treat a television licensee's JSA to sell the advertising time of another television station in the same market as the equivalent of ownership of that station for purposes of the FCC's local television ownership rules. The FCC may adopt rules affecting these arrangements that could adversely affect our current station operations under existing JSAs. We cannot predict what rules the FCC will adopt or what effect any new rules are likely to have. In March 2005, we notified all of our JSA partners other than NBC that we were exercising our right to terminate the JSAs, effective June 2005.

Alien Ownership. Under the Communications Act, no FCC broadcast license may be held by a corporation of which more than one-fifth of its capital stock is owned or voted by aliens or their representatives or by a foreign government or its representative, or by any corporation organized under the laws of a foreign country (collectively

Aliens). Furthermore, the Communications Act provides that no FCC broadcast license may be granted to any corporation controlled by any other corporation of which more than one-fourth of its capital stock is owned of record or voted by Aliens if the FCC should find that the public interest would be served by the refusal of the license.

Dual Network Rule. FCC rules permit the combination of television broadcast networks, except for a combination of any two of the four major networks (ABC, CBS, Fox or NBC). The FCC retained the current rule in its June 2, 2003 report and order.

Programming and Operation. The Communications Act requires broadcasters to present programming that responds to community problems, needs and interests and to maintain records demonstrating its responsiveness. Stations also must follow rules that regulate, among other things, obscene and indecent broadcasts, sponsorship identification, the advertising of contests and lotteries and technical operations, including limits on radio frequency radiation.

Table of Contents

The FCC's rules limit the amount of advertising in television programming designed for children 12 years of age and under. The FCC effectively requires that television broadcast stations air specified amounts of programming during specified time periods that serve the educational and informational needs of children 16 years of age and under.

The Communications Act and FCC rules also regulate the broadcasting of political advertisements by television stations. Stations must provide reasonable access for the purchase of time by legally qualified candidates for federal office and equal opportunities for the purchase of equivalent amounts of comparable broadcast time by opposing candidates for the same elective office. Before primary and general elections, legally qualified candidates for elective office may be charged no more than the station's lowest unit charge for the same class of advertisement, length of advertisement and daypart.

The Bipartisan Campaign Reform Act of 2002 (BCRA) (also known as the McCain-Feingold campaign finance bill) modified the regulation of certain aspects of political campaign fundraising and expenditures, and imposed new restrictions on the broadcast of issue advertisements. Congress previously has considered and may in the future consider amending the political advertising laws by changing the statutory definition of lowest unit charge in a manner which would require television stations to sell time to federal political candidates at lower rates. We are unable to predict whether additional changes to the political broadcasting laws will be enacted, or what effect, if any, these changes might have upon our business.

Equal Employment Opportunity Requirements. Existing FCC rules require all broadcast station employment units with five or more full-time employees to comply with certain general and specific recruitment, outreach, and reporting requirements. All broadcast licensees must refrain from engaging in employment discrimination based on race, color, religion, national origin or sex (with a limited exception for religious broadcasters). The FCC is considering applying these rules to part-time positions.

Cable Must Carry /Retransmission Consent Regulations. Under the Communications Act, every local commercial television broadcast station must elect once every three years to require a cable system to carry the station subject to certain exceptions, or to negotiate for retransmission consent to carry the station. A station's must carry rights are not absolute, and their exercise depends on variables such as the number of activated channels on a cable system, the location and size of a cable system, the amount of duplicative programming on the station, and the quality of the station's signal at the cable system's headend. Alternatively, if a broadcaster chooses to exercise retransmission consent rights, it can prohibit cable systems from carrying its signal or grant the cable system consent to retransmit the broadcast signal for a fee or other consideration. Our television stations have generally elected the must carry alternative. Our elections of retransmission or must carry status will continue until the next election period, which commences on January 1, 2006.

In a recently concluded rulemaking proceeding, the FCC determined that cable television systems are not required to carry both the analog and digital television signals of local television stations. In an initial order in the proceeding, the FCC concluded that broadcasters would not be entitled to mandatory carriage of both their analog and digital signals, and that a cable television system is required to carry a digital signal only if the broadcaster first surrenders the analog signal. Broadcasters with multiple digital video programming streams are required to designate a single, primary video stream eligible for mandatory carriage. Alternatively, television licensees may negotiate with cable television systems for carriage of their digital signal in addition to their analog signal under retransmission consent.

Under retransmission consent agreements, some of our television stations are also carried as distant signals on cable systems that are located outside of those stations' markets. Cable systems generally must remit a compulsory license royalty fee to the United States Copyright Office to carry television stations in distant markets. We have filed a request with the Copyright Office to change our stations' status under the compulsory license from independent to network signals. If the Copyright Office grants our request, certain cable systems may transmit our stations at reduced

royalty rates. We cannot determine when the Copyright Office will act on this request, or whether we will receive a favorable ruling.

Satellite Carriage of Television Broadcast Signals. Under the Satellite Home Viewer Improvement Act of 1999, which we refer to as SHVIA, a satellite carrier must obtain retransmission consent before carrying a television station, and a satellite carrier delivering the signal of any local television station is required to carry all television stations licensed to the carried station's DMA. SHVIA was recently extended for five years until the end of 2009. The FCC rules implementing SHVIA are similar to the must-carry and retransmission consent rules that apply to cable

Table of Contents

television systems. Our PAX TV signal currently is carried on satellite systems under agreements we negotiated with the satellite television providers, which allow the satellite provider to sell and retain the advertising revenues from a portion of the non-network advertising time during PAX TV programming hours and which require the carriage of some of our television stations in certain circumstances.

Digital Television Service. The FCC has adopted rules for the implementation of digital television, or DTV, service, a technology which is intended to improve the quality of television broadcast signals. The FCC allotted a second channel for DTV operations to each broadcaster who held a license or a construction permit for a full service television station on April 3, 1997. Each such licensee and permittee must return one of its two channels at the end of the DTV transition period currently scheduled to end on December 31, 2006 or when 85% of the service areas of the stations in a DMA as determined by Nielsen can receive digital signals. The transition period could be extended in certain areas depending generally on the level of DTV market penetration or if the FCC or Congress changes the schedule. Except for certain stations operating analog facilities in the 700 MHz spectrum band that have been allotted a digital channel in the 700 MHz spectrum band, the FCC has established a schedule by which broadcasters must begin DTV service absent extenuating circumstances that may affect individual stations.

Under the FCC's digital television transition rules a station will be in compliance with its build-out requirement, without constructing the full authorized facilities, so long as, by May 1, 2002, it constructed digital facilities capable of serving its community of license with a signal of requisite strength. The dates by which digital facilities replicating a station's analog service area must be constructed have been set by the FCC as July 1, 2005 and July 1, 2006 depending on market size and network affiliation. The FCC has authorized analog stations operating in the 700 MHz spectrum band that have entered into voluntary agreements with future users of the 700 MHz spectrum resulting in the surrender of the analog 700 MHz channel to continue broadcasting their analog signal on the channel assigned for digital service and to delay the institution of digital service until December 31, 2005, or later than December 31, 2005 if it can be demonstrated that less than 70% of the television households in the station's market are capable of receiving digital broadcast signals. Broadcasters given a digital channel allocation within the 700 MHz band may forego the use of that channel for digital service until December 31, 2005, or later than December 31, 2005, if it can be demonstrated that less than 70% of the television households in the station's market are capable of receiving digital broadcast signals. Broadcasters left with a single-channel allotment as a result of clearing the 700 MHz spectrum band will retain the interference protection associated with their digital television channel allotment for a period of 31 months after beginning to transmit in digital.

The FCC has adopted rules permitting DTV licensees to offer ancillary or supplementary services on their DTV channels, so long as such services are consistent with the FCC's DTV standards, do not derogate required DTV services, and are regulated in the same manner as similar non-DTV services. The FCC's rules require that DTV licensees pay a fee (based on revenues) for any subscription-based services that are provided. The FCC has commenced a proceeding to consider additional public interest obligations for television stations as they transition to digital broadcast television operation. The FCC is considering various proposals that would require DTV stations to use digital technology to increase program diversity, political discourse, access for disabled viewers and emergency warnings and relief. If these proposals are adopted, our stations may be required to increase their current level of public interest programming, which generally does not generate as much revenue from commercial advertisers.

Proposed Changes. Congress and the FCC have under consideration, and may in the future adopt, new laws, regulations and policies regarding a wide variety of matters that could, directly or indirectly, affect the operation, ownership and profitability of our company and our television broadcast stations. We cannot predict what other matters may be considered in the future, nor can we judge in advance what effect, if any, the implementation of any of these proposals or changes might have on our business.

Employees

As of December 31, 2004, we had 458 full-time employees and 43 part-time employees. None of our employees are represented by labor unions. We consider our relations with our employees to be good.

Seasonality

Seasonal revenue fluctuations are common within the television broadcasting industry and result primarily from fluctuations in advertising expenditures. We believe that generally television advertisers spend relatively more for long form paid programming in the first and fourth calendar quarters of each year, spend relatively less for long form paid programming in the second calendar quarter and spend the least for long form paid programming in the third calendar quarter. We believe that generally television advertisers spend relatively more for spot advertising in the second and fourth calendar quarters of each year, spend relatively less for spot advertising during the first calendar quarter and spend the least for spot advertising in the third calendar quarter.

Table of Contents

Trademarks and Service Marks

We have 36 registered trademarks and service marks (21 in the United States, nine in Mexico and six in Europe) and pending applications for registration of another eight trademarks and service marks (five in the United States, two in Mexico and one in Canada). We do not own any patents or have any pending patent applications.

Available Information

Our internet website address is www.pax.tv. We make available free of charge through our internet website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission.

Forward-Looking Statements and Associated Risks and Uncertainties

This Report contains forward-looking statements that reflect our current views with respect to future events. All statements in this Report other than those that are simply statements of historical facts are generally forward-looking statements. These statements are based on our current assumptions and analysis, which we believe to be reasonable, but are subject to numerous risks and uncertainties that could cause actual results to differ materially from our expectations. All forward-looking statements in this Report are made only as of the date of this Report, and we do not undertake to update these forward-looking statements, even though circumstances may change in the future.

Among the significant risks and uncertainties which could cause actual results to differ from those anticipated in our forward-looking statements or could otherwise adversely affect our business or financial condition are those described below.

We have a high level of indebtedness and are subject to restrictions imposed by the terms of our indebtedness and preferred stock.

We are highly leveraged. As of December 31, 2004 we had total indebtedness of \$1.0 billion, approximately \$365.4 million of which was senior secured indebtedness, and redeemable preferred stock with an aggregate redemption value of approximately \$1.2 billion (approximately \$1.1 billion of which was exchangeable, under certain circumstances, into senior subordinated indebtedness). We may incur limited amounts of additional indebtedness to finance capital expenditures and for certain other corporate purposes. Our ability to incur indebtedness is subject to restrictions in the terms of the indentures governing our senior secured notes and our senior subordinated notes, as well as the terms of our outstanding preferred stock. The level of our indebtedness and redeemable preferred stock has important consequences to us, including that our cash flow from operations must be dedicated to debt service and will not be available for other purposes. Many of our competitors currently operate on a less leveraged basis and may have significantly greater operating and financing flexibility than us. The indentures and the preferred stock contain covenants that restrict, among other things, our ability to incur additional indebtedness, incur liens, make investments, pay dividends or make other restricted payments, consummate asset sales, consolidate with any other person or sell, assign, transfer, lease, convey or otherwise dispose of all or substantially all of our assets. Currently, these covenants prevent us from incurring additional indebtedness other than limited amounts of certain types of permitted indebtedness (*e.g.*, purchase money indebtedness), although certain refinancings of existing debt are permitted. These restrictions could limit our ability to obtain future financing, make acquisitions or needed capital expenditures, withstand a future downturn in our business or the economy in general, conduct operations or otherwise take advantage of business opportunities that may arise. If we were unable to service our indebtedness or satisfy our dividend or redemption obligations with respect to our outstanding preferred stock, we would be forced to adopt an alternative strategy that may include actions such as reducing or delaying capital expenditures, selling assets,

restructuring or refinancing our indebtedness or seeking additional equity capital. There is no assurance that any of these strategies could be effected on satisfactory terms, if at all.

We have a history of operating losses and negative cash flow and we may not become profitable in the future.

We have incurred losses from continuing operations in each fiscal year since our inception. For the years ended December 31, 2004, 2003 and 2002, our earnings were insufficient to cover our combined fixed charges and preferred stock dividend requirements by approximately \$220.7 million, \$139.8 million and \$255.5 million, respectively. We expect to continue to experience net losses in the foreseeable future, principally due to interest charges on outstanding debt (and the debentures into which our outstanding preferred stock can be exchanged, if issued), dividends on outstanding preferred stock, and non-cash charges for depreciation and amortization expense related to fixed assets. Future net losses could be greater than those we have experienced in the past.

Our cash flow from operations has been insufficient to cover our operating expenses, debt service requirements and other cash commitments in each of our last five fiscal years. We have financed our operating cash requirements, as well as our capital needs, during these periods with the proceeds of asset sales and financing activities, including

Table of Contents

the issuance of preferred stock and additional borrowings. Our senior secured floating rate notes and our 10^{3/4}% senior subordinated discount notes require us to make cash interest payments on a current basis, and we are required to commence making semi-annual cash interest payments of approximately \$30.4 million under our 12^{1/4}% senior subordinated discount notes on July 15, 2006, and to make such payments on each January 15 and July 15 thereafter until these notes are repaid or refinanced. We may not be able to generate sufficient operating cash flow in the future to pay our debt service and preferred stock dividend requirements and may not be able to obtain sufficient additional financing to meet such requirements on terms acceptable to us, or at all.

We engaged Bear, Stearns & Co. Inc. in 2002 and Citigroup Global Markets Inc. in 2003 to act as our financial advisors to assess our business plan, capital structure and future capital needs, and to explore strategic alternatives for our company. We terminated these engagements in March 2005 as no viable strategic transactions had been developed on terms that we believed would be in the best interests of all of our stockholders. While we continue to consider strategic alternatives that may arise, which may include the sale of all or part of our assets, finding a strategic partner for our company who would provide the financial resources to enable us to redeem, restructure or refinance our debt and preferred stock, or finding a third party to acquire our company through a merger or other business combination or through a purchase of our equity securities, our principal efforts are focused on improving our core business operations and increasing our cash flow. See Forward-Looking Statements and Associated Risks and Uncertainties. Our ability to pursue strategic alternatives is subject to limitations and factors beyond our control.

PAX TV may not be successful as a broadcast television network.

We launched our PAX TV entertainment programming on August 31, 1998, and are now in our seventh network broadcasting season. Our own experiences, as well as the experiences of other new broadcast television networks during the past decade, indicate that it requires a substantial period of time and the commitment of significant financial, managerial and other resources to gain market acceptance of a new television network by viewing audiences and advertisers to a sufficient degree that the new network can attain profitability. Although we believe that our approach is unique among broadcast television networks, in that we own and operate stations reaching most of the television households that can receive PAX TV, our business model is unproven and to date has not been successful. PAX TV may not gain sufficient market acceptance to be profitable or otherwise be successful.

If the rates at which we are able to sell long form paid programming were to decline or the audience ratings of our entertainment programming were to continue to decline, our advertising revenue could decrease.

Advertising revenues constitute substantially all of our operating revenues. Our ability to generate advertising revenues depends upon our ability to sell our inventory of air time for long form paid programming at acceptable rates and, with respect to entertainment programming, to provide programming which attracts sufficient numbers of viewers in desirable demographic groups to generate audience ratings that advertisers will find attractive. Long form paid programming rates are dependent upon a number of factors, including our available inventory of air time, the viewing public's interest in the products and services being marketed through long form paid programming, and economic conditions generally. Our revenues from the sale of air time for long form paid programming may decline. Our entertainment programming has not attracted sufficient targeted viewership or achieved sufficiently favorable ratings to enable us to generate enough advertising revenues to be profitable. Our ratings declined following the increase in the amount of long form paid programming on PAX TV in January 2003 and generally have not improved over the past year, despite our new original programming initiative launched in consultation with NBC during the second half of 2004. Our ratings may continue to decline, which would adversely affect that portion of our advertising revenues derived from the sale of commercial spots during our entertainment programming. We incur production, talent and other ancillary costs to produce original entertainment programs. Our original entertainment programming may not generate advertising revenues in excess of our programming and other costs.

We may lose a portion of our television distribution platform.

In March 2005, we notified all of our PAX TV network affiliates that we were exercising our right to terminate our affiliation agreements with them, effective June 30, 2005. We will seek to replace the distribution lost by the termination of these agreements (consisting of approximately 6% of U.S. prime time television households) through the negotiation of new, more flexible affiliation agreements and carriage agreements with cable systems in the affected markets, as and if such agreements can be concluded on cost efficient terms. Our revenues may be reduced if we are unable to replace the lost distribution. A number of our carriage agreements with cable systems in markets where we do not own a television station place restrictions on the type of programming that we may broadcast on the local cable system. Should our programming be inconsistent with these restrictions, the cable systems may have the right to require us to distribute additional entertainment programming over these systems or the right to terminate their carriage agreements with us. Our financial results could be adversely affected if we were required to provide alternative programming to these cable systems or if we were to lose a portion of our distribution through the termination of these agreements.

Table of Contents

The results of operations of our stations which operated under joint sales agreements could be adversely affected by the termination of the JSAs.

The performance of our stations operating under JSAs depends to a substantial degree on the performance of our JSA partners, over which we have no control. We have entered into JSAs with respect to 45 of our television stations. Each JSA typically provides for our JSA partner to serve as our exclusive sales representative to sell our local station advertising and in 22 of our stations we have integrated and co-located our station operations with those of our JSA partners. In March 2005, we notified all of our JSA partners other than NBC that we were exercising our right to terminate the JSAs, effective June 30, 2005, and we began discussions with NBC as to the termination of each of the JSAs with NBC (covering 14 of our stations in 12 markets). Although we took this action in order to improve our operating results, we may incur significant costs to resume operating the stations ourselves, including the expense of re-establishing office and studio facilities separate from those of the JSA partners, or transferring performance of these functions to another broadcast television station operator. Our network and station revenues could also be adversely affected by the disruption of our advertising sales efforts that could result from the unwinding of the JSAs. The unwinding or termination of some or all of our JSAs could adversely affect the results of operations of our stations and could have a materially adverse effect upon us. In addition, we may incur significant costs in order to effectuate a termination of our JSAs with NBC.

Our network and national advertising sales could be adversely affected by the termination of our network and national sales agency agreements with NBC.

We have significant operating relationships with NBC which have been developed since NBC's investment in us in September 1999. NBC serves as our exclusive sales representative to sell most of our PAX TV network advertising and is the exclusive national sales representative for most of our stations. In March 2005, we notified NBC that we were removing, effective June 30, 2005, all of our stations from our national sales agency agreement with NBC, and we began discussions with NBC as to the termination of our network sales agency agreement with NBC. Although we took these actions in order to improve our operating results, we may incur significant costs to resume performing the advertising sales and other operating functions currently performed by NBC. Our network revenues could be adversely affected by the disruption of our advertising sales efforts that could result from the termination of our network sales agency agreement with NBC. The unwinding or termination of our network and national sales agency agreements with NBC could have a materially adverse effect upon us.

If advertisers have to pay higher residual payments to the members of the actors' guilds that they use in spot advertisements on our network, advertisers may reduce or discontinue their advertising on our network.

Approximately 21.0% of our 2003 net revenues and 20.7% of our 2004 revenues were derived from network commercial spot advertisements aired on PAX TV. We believe substantially all of our network spot advertisements were produced by advertisers or their advertising agencies using performers who are members of the Screen Actors Guild and the American Federation of Television and Radio Artists. When commercials are aired on broadcast and cable television networks, the performers are entitled to residual payments from the advertisers, which are determined under collective bargaining agreements between the guilds and the advertising community. Under the current guild agreements, the residual payments required to be paid by advertisers in connection with advertisements aired on cable networks are substantially lower than the residuals required to be paid in connection with advertising aired on broadcast networks. To date, we believe that a substantial portion of the network spot advertising time on PAX TV was purchased by advertisers under the assumption that the residual payment obligations incurred in connection with airing these spots were to be calculated under the rates applicable to cable networks, not those applicable to other broadcast networks. The current guild agreements include provisions establishing residual rates that are applicable to network advertisements aired on PAX TV and that are substantially lower than the rates applicable to broadcast networks but still higher, in most circumstances, than the rates applicable to cable networks. As a result of this

development, some advertisers have informed us that our network advertising spots are no longer as attractive as those of cable networks because of the relatively higher residual payments applicable to PAX TV. Because of these higher residual payments, some advertisers may be unwilling to purchase advertising time on PAX TV unless we lower our rates or otherwise provide financial compensation to them. We are unable to predict the magnitude of the effect of this development on our network spot advertising revenues.

We may be required to purchase our outstanding debt and preferred stock if we experience a change of control.

In the event of a change of control (as defined in the indentures governing our outstanding senior secured notes and senior subordinated notes), we will be required to offer to purchase all of the outstanding notes at a price equal to 101% (or 100% in the case of the senior secured notes, with respect to any change of control occurring on or after January 15, 2006) of the principal amount or accreted value, as the case may be, thereof. In the event of a change of control (as defined with respect to our outstanding preferred stock), we will be required to offer to

Table of Contents

purchase all of the shares of these preferred stocks then outstanding at 101% (100% for the Series A preferred stock) of the then effective liquidation preference thereof, plus accumulated and unpaid dividends. Generally, under these instruments a change of control will be deemed to have occurred if any person, other than Mr. Paxson and his affiliates or, with respect to the senior secured notes and senior subordinated notes, NBC and its affiliates, acquires control of a majority of the voting power of our outstanding capital stock or acquires more than one-third of the outstanding voting power and possesses voting power in excess of that possessed by Mr. Paxson and his affiliates (or, with respect to the senior secured notes and senior subordinated notes, NBC and its affiliates), or there is a merger and we are not the surviving corporation and our stockholders do not own at least a majority of the outstanding common stock of the surviving corporation. Our repurchase of our outstanding senior subordinated notes or the redemption of any of our preferred stock upon a change of control could also cause a default under the senior secured notes indenture. We can provide no assurance that in the event of a change of control, we will have access to sufficient funds or will be contractually permitted under the terms of our outstanding debt to repay our outstanding senior secured notes and senior subordinated notes or pay the required purchase price for any shares of preferred stock tendered by holders. Were this to occur, we could be required to seek third party financing to the extent we did not have sufficient available funds to meet our purchase obligations, and we can provide no assurance that we would be able to obtain this financing on favorable terms or at all.

NBC's exercise of its rights to exert significant influence upon our operations could adversely affect our business.

As a result of our agreements with NBC, NBC is in a position to exert significant influence over our management and policies and to prevent us from taking actions which our management may otherwise desire to take. NBC may have interests that differ from those of our other stockholders and debtholders. We must obtain NBC's consent for:

approval of annual budgets;

expenditures materially in excess of budgeted amounts;

material acquisitions of programming;

material amendments to our certificate of incorporation or bylaws;

material asset sales or purchases, including sales of our television stations which are located in the top 20 DMAs;

business combinations where we would not be the surviving corporation or as a result of which we would experience a change of control;

issuances or sales of any capital stock, with some exceptions;

stock splits or recombinations;

any increase in the size of our board of directors other than an increase resulting from provisions of our outstanding preferred stock of up to two additional directors; and

joint sales, joint services, time brokerage, local marketing or similar agreements as a result of which our stations with national household coverage of 20% or more would be subject to those agreements.

We have not redeemed our securities held by NBC that NBC has demanded that we redeem and this could have adverse consequences for us.

On November 13, 2003, NBC exercised its right to demand that we redeem, or arrange for a third party to acquire, all of the shares of our 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 December 31, 2004, totaled \$600.7 million. Because we did not effect a redemption within one year after November 13, 2003, NBC is now permitted to transfer, without restriction, any of our securities acquired by it, its right to acquire Mr. Paxson's Class B common stock, its contractual rights with respect to our business, and its other rights under the related transaction agreements. As a result, we are unable to prevent NBC from transferring its interest in our company to a third party selected by NBC in its discretion, which could have a material adverse effect upon us.

We are involved in litigation with NBC regarding NBC's demand for redemption. NBC has asserted that we continue to be required to redeem all of the shares of our Series B preferred stock held by NBC. If a court were to grant a judgment against us requiring us to pay the redemption amount, it would have a material adverse effect upon us. Our ability to effect any redemption is restricted by the terms of our outstanding debt and preferred stock. Further, we do not currently have sufficient funds to pay the redemption price for these securities. If we were unable to satisfy any such judgment, we would be in default under the indentures governing our senior secured notes and senior subordinated notes. In order to comply with NBC's redemption demand, we would need to repay, refinance or

Table of Contents

otherwise restructure the majority of our outstanding indebtedness and preferred stock and raise sufficient liquidity to enable us to pay the required redemption price. Alternatively, we would need to find a third party willing to purchase those securities at the required redemption price. We believe it is unlikely that we would be able to accomplish any of these actions.

The adjustment to the dividend rate on our Series B preferred stock could have adverse consequences for our business.

On September 15, 2004, the rate at which dividends accrue on our Series B preferred stock, all of which is held by NBC, was adjusted to an annual rate of 16.2% from the initial annual rate of 8%. The rate was adjusted pursuant to the terms governing the Series B preferred stock. We retained CIBC World Markets Corp., a nationally recognized independent investment banking firm, in connection with the rate adjustment process. We are involved in litigation with NBC regarding the rate adjustment. NBC has asserted that CIBC does not constitute an independent investment banking firm, and that the dividend rate adjustment was not performed in the manner required by the terms of the Series B preferred stock. As described in greater detail above under Forward-Looking Statements and Associated Risks and Uncertainties We have a high level of indebtedness and are subject to restrictions imposed by the terms of our indebtedness and preferred stock, the increase in the dividend rate on our Series B preferred stock to 16.2% and any further increase resulting from the NBC litigation could have material adverse consequences for us. We are unable to predict whether we will be successful in the litigation with NBC and whether or to what degree the dividend rate on our Series B preferred stock may be increased further.

Our ability to pursue strategic alternatives is subject to limitations and factors beyond our control.

Our ability to pursue strategic alternatives to address the challenges facing our company, such as the sale of all or part of our assets, finding a strategic partner for our company who would provide the financial resources to enable us to redeem, restructure or refinance our debt and preferred stock, or finding a third party to acquire our company through a merger or other business combination or acquisition of our equity securities, is subject to various limitations and issues which we may be unable to control. A strategic transaction will, in most circumstances, require that we seek the consent of, or refinance, redeem or repay, NBC and the other holders of our preferred stock, as well as the holders of our senior and subordinated debt. FCC regulations may limit the type of strategic alternatives we may pursue and the parties with whom we may pursue strategic alternatives. In addition, our ability to pursue a strategic alternative will be dependent upon the attractiveness of our assets and business plan to potential transaction parties. Among other things, potential transaction parties may find unattractive our capital structure and high level of indebtedness, our carriage of the PAX TV programming and the overnight programming provided by The Christian Network, Inc., and certain of our television stations serving major television markets. Our relatively low tax basis in our television station assets (resulting in part from the Section 1031 like kind exchange discussed below) is a significant factor to be considered in structuring any potential transactions involving sales of a material portion of our television station assets, and may make certain types of transactions less attractive or not viable. Potential transaction parties may believe our stations and other assets to be less valuable than as shown in prior appraisals we have obtained. We may be prevented from consummating a strategic transaction due to any of these and other factors, or we may incur significant costs to terminate obligations and commitments with respect to, or receive less consideration in a strategic transaction as a result of, these and other factors. We have not been successful to date in our efforts to find or effectuate strategic alternatives for our company, and we may not be successful in doing so in the future.

We could be subject to a material tax liability if the IRS successfully challenges our position regarding the 1997 disposition of our radio division.

We structured the disposition of our radio division in 1997 and our acquisition of television stations during the period following this disposition in a manner that we believed would qualify these transactions as a like kind

exchange under Section 1031 of the Internal Revenue Code and would permit us to defer recognizing for income tax purposes up to approximately \$333 million of gain. The IRS has examined our 1997 tax return and has issued us a 30-day letter proposing to disallow all of our gain deferral. We have filed our protest to this determination with the IRS appeals division, but we cannot predict the outcome of this matter at this time, and we may not prevail. In addition, the 30-day letter offered 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. We have filed a protest to this alternative determination as well. We may not prevail with respect to this alternative determination. Should the IRS successfully challenge our position and disallow all or part of our gain deferral, because we had net operating losses in the years subsequent to 1997 in excess of the amount of the deferred gain, we would not be liable for any tax deficiency, but could be liable for state income taxes. We have estimated the amount of state income tax for which we could be liable as of December 31, 2004 to be approximately \$8.0 million should the IRS succeed in disallowing the entire deferred gain. In addition, we could be liable for interest on the tax liability for the period prior to the carryback of our net operating losses and for interest on any state income taxes that may be due. We have

Table of Contents

estimated the amount of federal interest and state interest, as of December 31, 2004, to be approximately \$18.0 million and \$4.0 million, respectively, should the IRS succeed in disallowing the entire deferred gain. The use of our net operating losses to offset any disallowed deferred gain would result in a benefit from income taxes. This matter is currently with the Appeals Office of the Internal Revenue Service.

We could be adversely affected by actions of the FCC, the Congress and the courts that could alter broadcast television ownership rules in a way that would materially affect our present operations or future business alternatives.

On June 2, 2003, the FCC adopted new rules governing, among other things, national and local ownership of television broadcast stations and cross-ownership of television broadcast stations with radio broadcast stations and newspapers serving the same market. The new rules would change the regulatory framework within which television broadcasters hold, acquire and transfer broadcast stations. Numerous parties asked the FCC to reconsider portions of its decision and other parties sought judicial review. In September 2003, the U.S. Court of Appeals for the Third Circuit issued an order staying the effectiveness of the new media ownership rules pending its review of the FCC's action. In June 2004, the Third Circuit remanded the proceeding to the FCC with instructions to the FCC to better justify or modify its approach to setting numerical limits. The stay remains in effect pending further review by the Third Circuit of the FCC's further actions on remand. Several parties have filed petitions for review by the Supreme Court which are currently pending.

Among other things, the FCC's new rules would have increased the percentage of the nation's television households that may be served by television broadcast stations in which the same person or entity has an attributable interest from 35% to 45% of national television households. The Consolidated Appropriations Act of 2004 directed the FCC to increase this percentage to 39% of national television households and allows an entity that acquires licensees serving in excess of 39% two years to come into compliance with the new cap. This act also provides that the FCC shall conduct a quadrennial, rather than biennial, review of its ownership rules. The new rules also relax FCC restrictions on local television ownership and on cross-ownership of television stations with radio stations or newspapers in the same market. In general, these new rules would reduce the regulatory barriers to the acquisition of an interest in our television stations by various industry participants who already own television stations, radio stations, or newspapers.

In assessing compliance with the national ownership caps, the FCC counts each UHF station as serving only half of the television households in its market. This UHF Discount is intended to take into account that UHF stations historically have provided less effective coverage of their markets than VHF stations. All of our television stations are UHF stations and, without the UHF Discount, we would not meet the recently enacted 39% ownership cap. In its June 2, 2003 decision, the FCC concluded that the future transition to digital television may eliminate the need for a UHF Discount. For that reason, the FCC provided that the UHF Discount will sunset, or expire, for the top four broadcast networks (ABC, NBC, CBS and Fox) on a market-by-market basis as the digital transition is completed, unless otherwise extended by the FCC. The FCC also announced, however, that it will examine in a future review whether to include in this sunset provision the UHF television stations owned by other networks and group owners, which would include our television stations. The Third Circuit stated that, barring legislative action, the FCC may decide the scope of its authority to modify or eliminate the UHF Discount outside of the Consolidated Appropriations Act of 2004 limitation. The Third Circuit opinion referred to above also held that the Consolidated Appropriations Act of 2004 mooted any argument on whether the FCC could maintain the UHF Discount.

Since the FCC's adoption of the new rules, in addition to the legislation enacting the 39% cap, separate legislation was introduced in the last Congress to prohibit the application of the UHF Discount to UHF stations sold after June 2, 2003, to sunset the UHF Discount in 2008 for all UHF stations, to prohibit the cross ownership of newspapers and television stations in the same market and to nullify in their entirety the rule changes adopted by the FCC. We cannot predict whether any pending legislation ultimately will be adopted or whether any petitions for reconsideration or further judicial review of the FCC's decision of June 2, 2003 will result in significant changes to the ownership rules.

A further rollback of the nationwide television ownership cap, the prohibition of newspaper and television cross ownership by Congress, any further limitation on the ability of a party to own two television stations without regard to signal contour overlap if each station is located in a separate designated market area, or action by the FCC or Congress affecting the availability of the UHF Discount, may adversely affect the opportunities we might have for sale of our television broadcast stations to those television group owners and major television broadcast networks that otherwise would be the most likely purchasers.

In August 2004, the FCC commenced a rulemaking proceeding to consider whether to treat a television licensee's joint sales agreement, or JSA, to sell the advertising time of another television station in the same market as the equivalent of ownership of that station for purposes of the FCC's local television ownership rules. We have entered into JSAs for 45 of our television stations, 41 of which are with NBC owned or affiliated stations in our markets. The

Table of Contents

FCC may adopt rules affecting these arrangements that could adversely affect our current station operations under existing JSAs. We cannot predict what rules the FCC will adopt or what effect any new rules are likely to have. In March 2005, we notified all of our JSA partners other than NBC that we were exercising our right to terminate the JSAs, effective June 30, 2005.

We are required by the FCC to abandon the analog broadcast service of 23 of our full power stations occupying the 700 MHz spectrum and may suffer adverse consequences if we are unable to secure alternative distribution on reasonable terms.

We hold FCC licenses for full power stations which are authorized to broadcast over either an analog or digital signal on channels 52-69 (the 700 MHz band), a portion of the broadcast spectrum that is currently allocated to television broadcasting by the FCC. As part of the nationwide transition from analog to digital broadcasting, the 700 MHz band is in the process of being transitioned to use by new wireless and public safety entities. A federal statute requires that, after December 31, 2006, or the date on which 85% of television households in a television market are capable of receiving digital services, incumbent broadcasters must surrender analog signals and broadcast only on their allotted digital frequency. Several members of Congress have advocated establishing December 31, 2006 as a firm date for the surrender of the analog spectrum without regard to whether the 85% capability threshold has been reached. The FCC is considering a proposal to extend the date for the surrender of the analog signals to December 31, 2008. In some cases, broadcasters, including our company, have been given a digital channel allocation within the 700 MHz band of spectrum. During this transition these new wireless and public safety entities are permitted to operate in the 700 MHz band provided they do not interfere with incumbent or allotted analog and digital television operations. In January 2003 the FCC commenced rulemaking proceedings in which it is considering aspects of the implementation of this 2006 statutory deadline for completion of the digital transition. Issues such as interference protection, rights of incumbent broadcasters and broadcasters ability to modify authorized facilities are being addressed in these proceedings. These proceedings remain pending. We cannot predict when we will abandon, by private agreement, or as required by law, the broadcast service of our stations occupying the 700 MHz spectrum. We could suffer adverse consequences if we are unable to secure alternative simultaneous distribution of both the analog and digital signals of those stations on reasonable terms and conditions. We cannot now predict the impact, if any, on our business of the abandonment of our broadcast television service in the 700 MHz spectrum.

Failure to achieve and maintain effective internal control over financial reporting in accordance with rules of the Securities and Exchange Commission promulgated under Section 404 of the Sarbanes-Oxley Act could result in a loss of investor confidence in our financial reports, which could in turn have a material adverse effect on our business and stock price.

Under rules of the Securities and Exchange Commission, or SEC, promulgated under Section 404 of the Sarbanes-Oxley Act of 2002, beginning with this Annual Report on Form 10-K for the fiscal year ending December 31, 2004, we are required to furnish a report by our management on our internal control over financial reporting. Our report must contain, among other matters, an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2004, including a statement as to whether or not our internal control over financial reporting is effective. In the course of our assessment of the effectiveness of our internal control over financial reporting as of December 31, 2004, we identified a material weakness in our internal control over financial reporting. This material weakness is described in Item 9A, Controls and Procedures, of this report. Although we believe that we have remediated this material weakness, we cannot assure you that this remediation has been successful or that additional deficiencies or weaknesses in our controls and procedures will not be identified. The material weakness already identified, as well as any other weaknesses or deficiencies, could harm our business and operating results, and could result in adverse publicity and a loss in investor confidence in the accuracy and completeness of our financial reports, which in turn could have a material adverse effect on our stock price, and, if such weaknesses are not properly remediated, could adversely affect our ability to report our financial results on a

timely and accurate basis.

Further, our internal control report must contain a statement that our auditors have issued an attestation report on management's assessment of our internal control. If our independent auditors are unable to attest that our management's report is fairly stated or are unable to express an opinion on our management's evaluation of the effectiveness of our internal control, investor confidence in the accuracy and completeness of our financial reports could be adversely affected, which in turn could have a material adverse effect on our stock price.

We cannot assure you that we will successfully exploit our broadcast station group's digital television platform.

We have completed construction of digital broadcasting facilities at 49 of our 60 owned and operated stations and are exploring the most effective use of digital broadcast technology for each of such stations. We cannot assure you, however, that we will derive commercial benefits from the exploitation of our digital broadcasting capacity. Although we believe that proposed alternative and supplemental uses of our analog and digital spectrum will continue

Table of Contents

to grow in number, the viability and success of each proposed alternative or supplemental use of spectrum involves a number of contingencies and uncertainties. We cannot predict what future actions the FCC or Congress may take with respect to regulatory control of these activities or what effect these actions would have on us.

We are dependent upon our senior management team and key personnel and the loss of any of them could materially and adversely affect us.

Our business depends upon the efforts, abilities and expertise of our executive officers and other key employees, including Mr. Paxson, our Chairman and Chief Executive Officer. We cannot assure you that we will be able to retain the services of any of our key executives. If any of these executive officers were to leave our employment, our operating results could be adversely affected.

We operate in a very competitive business environment.

We compete for audience share and advertising revenues with other providers of television programming. Our PAX TV entertainment programming competes for audience share and advertising revenues with the programming offered by other broadcast and cable networks, and also competes for audience share and advertising revenues in our stations' respective market areas with the programming offered by non-network affiliated television stations. Our ability to compete successfully for audience share and advertising revenues depends upon the popularity of our entertainment programming with viewing audiences in demographic groups that advertisers desire to reach. Our ability to provide popular programming depends upon many factors, including our ability to correctly gauge audience tastes and accurately predict which programs will appeal to viewing audiences, to produce original programs and purchase the right to air syndicated programs at costs which are not excessive in relation to the advertising revenue generated by the programming, and to fund marketing and promotion of our programming to generate sufficient viewer interest. Many of our competitors have greater financial and operational resources than we do which may enable them to compete more effectively for audience share and advertising revenues. All of the existing television broadcast networks and many of the cable networks have been operating for a longer period than we have been operating PAX TV, and therefore have more experience in network television operations than we have which may enable them to compete more effectively.

Our television stations also compete for audience share with other forms of entertainment programming, including home entertainment systems and direct broadcast satellite video distribution services which transmit programming directly to homes equipped with special receiving antennas and tuners. Further advances in technology may increase competition for household audiences. Our stations also compete for advertising revenues with other television stations in their respective markets, as well as with other advertising media, such as newspapers, radio stations, magazines, outdoor advertising, transit advertising, yellow page directories, direct mail and local cable systems. We cannot assure you that our stations will be able to compete successfully for audience share or that we will be able to obtain or maintain significant advertising revenue.

The television broadcasting industry faces continual technological change and innovation, the possible rise in popularity of competing entertainment and communications media, and governmental restrictions or actions of federal regulatory bodies, including the FCC and the Federal Trade Commission, any of which could have a material effect on our operations.

We may be adversely affected by changes in the television broadcasting industry or a general deterioration in economic conditions.

The financial performance of our television stations is subject to various factors that influence the television broadcasting industry as a whole, including:

the condition of the U.S. economy;

changes in audience tastes;

changes in priorities of advertisers;

new laws and governmental regulations and policies;

changes in broadcast technical requirements;

technological changes;

proposals to eliminate the tax deductibility of expenses incurred by advertisers;

Table of Contents

changes in the law governing advertising by candidates for political office; and

changes in the willingness of financial institutions and other lenders to finance television station acquisitions and operations.

We cannot predict which, if any, of these or other factors might have a significant effect on the television broadcasting industry in the future, nor can we predict what effect, if any, the occurrence of these or other events might have on our operations. Generally, advertising expenditures tend to decline during economic recession or downturn. Consequently, our revenues are likely to be adversely affected by a recession or downturn in the U.S. economy or other events or circumstances that adversely affect advertising activity. Our operating results in individual geographic markets also could be adversely affected by local regional economic downturns. Seasonal revenue fluctuations are common in the television broadcasting industry and result primarily from fluctuations in advertising expenditures by local retailers.

Our business is subject to extensive and changing regulation that could increase our costs, expose us to greater competition, or otherwise adversely affect the ownership and operation of our stations or our business strategies.

Our television operations are subject to significant regulation by the FCC under the Communications Act of 1934. A television station may not operate without the authorization of the FCC. Approval of the FCC is required for the issuance, renewal and transfer of station operating licenses. In particular, our business depends upon our ability to continue to hold television broadcasting licenses from the FCC, which generally have a term of eight years. Our station licenses are subject to renewal at various times between 2004 and 2007. Third parties may challenge our license renewal applications. Although we have no reason to believe that our licenses will not be renewed in the ordinary course, we cannot assure you that our licenses or the licenses owned by the owner-operators of the stations with which we have JSAs will be renewed. The non-renewal or revocation of one or more of our primary FCC licenses could have a material adverse effect on our operations.

The Communications Act of 1934 empowers the FCC to regulate other aspects of our business, in addition to imposing licensing requirements. For example, the FCC has the authority to:

determine the frequencies, location and power of our broadcast stations,

regulate the equipment used by our stations,

adopt and implement regulations and policies concerning the ownership and operation of our television stations, and

impose penalties on us for violations of the Communications Act of 1934 or FCC regulations.

Our failure to observe FCC or other rules and policies can result in the imposition of various sanctions, including monetary forfeitures or the revocation of a license.

Congress and the FCC currently have under consideration, and may in the future adopt, new laws, regulations, and policies regarding a wide variety of matters that could, directly or indirectly, affect the operation and ownership of our broadcast properties. Relaxation and proposed relaxation of existing cable ownership rules and broadcast multiple ownership and cross-ownership rules and policies by the FCC and other changes in the FCC's rules following passage of the Telecommunications Act of 1996 have affected and may continue to affect the competitive landscape in ways that could increase the competition we face, including competition from larger media, entertainment and telecommunications companies, which may have greater access to capital and resources. We are unable to predict the effect that any such laws, regulations or policies may have on our operations.

We believe that the success of our television operations depends to a significant extent upon access to households served by cable television systems. If the law requiring cable system operators to carry our signal were to change, we might lose access to cable television households, which could adversely affect our operations.

Under the 1992 Cable Act, each broadcast station is required to elect, every three years, to either require cable television system operators in their local market to carry their signals, which we refer to as must carry rights, or to prohibit cable carriage or condition it upon payment of a fee or other consideration. By electing the must carry rights, a broadcaster can demand carriage on a specified channel on cable systems within its market. These must carry rights are not absolute, and under some circumstances, a cable system may decline to carry a given station. Our television stations elected must carry on local cable systems for the three year election period which commenced January 1, 2003. The required election date for the next three year election period commencing January 1, 2006, will be October 1, 2005. If the law were changed to eliminate or materially alter must carry rights, our business could be adversely affected.

Table of Contents

The FCC has adopted rules to govern the obligations of cable television systems to carry local television stations during and following the transition from analog to digital television broadcasting. The FCC concluded that a television broadcast station would not be entitled to mandatory carriage of both the station's analog signal and its digital signal, and would not be entitled to mandatory carriage of its digital signal unless it first gives up its analog signal. Furthermore, the FCC concluded that a broadcaster with multiple digital programming streams will be required to designate the primary video stream eligible for mandatory carriage. Broadcasters operating with both analog and digital signals nevertheless could negotiate with cable television systems for carriage of their digital signal. We cannot predict what effect those rules will have on our business.

We cannot assure you that we would actually be able to realize, in any sale, liquidation, merger or other transaction involving our assets, the estimated values of such assets set forth in any appraisal.

We have had appraisals of certain of our assets, including our broadcast television stations, prepared by independent valuation firms from time to time. Each appraisal was prepared in accordance with certain procedures and methodologies set forth therein. In general, appraisals represent the analysis and opinion of each of the appraisers as of their respective dates, subject to the assumptions and limitations set forth in the appraisal. An appraisal may not be indicative of the present or future values of our assets upon liquidation or resale. Although appraisals are based upon a number of estimates and assumptions that are considered reasonable by the appraiser issuing such appraisal, these estimates and assumptions are subject to significant business, economic, competitive and regulatory uncertainties and contingencies, many of which are beyond our control or the ability of the appraisers to accurately assess and estimate, and are based upon assumptions with respect to future business decisions and conditions which are subject to change. The opinions of value set forth in any appraisal and the actual values of the assets appraised therein will vary, and those variations may be material. We cannot assure you that we would actually be able to realize, in any sale, liquidation, merger or other transaction involving our assets, the estimated values of such assets set forth in any appraisal.

The occurrence of extraordinary events may substantially decrease the use of and demand for advertising and may decrease our revenues.

Because our programming consists principally of entertainment programming and long form paid programming which markets and sells products and services, the occurrences of extraordinary events which generally divert attention from entertainment programming in favor of news based programming or which negatively affect the United States economy generally and reduce the demand for the products and services marketed through long form paid programming, may adversely affect the market for television advertising and our revenues.

Our Class A common stock may be delisted from the American Stock Exchange.

Our Class A common stock is listed on the American Stock Exchange, which we refer to as AMEX. If we were unable to satisfy AMEX's maintenance criteria for the continued listing of our Class A common stock, our Class A common stock may be delisted from trading on AMEX. If our Class A common stock were delisted from trading on AMEX, then trading, if any, would thereafter be conducted in the over-the-counter market in the so-called "pink sheets" or on the "Electronic Bulletin Board" of the National Association of Securities Dealers, Inc. and consequently an investor could find it more difficult to dispose of, or to obtain accurate quotations as to the price of, our Class A common stock.

Item 2. Properties

Our corporate headquarters is located in West Palm Beach, Florida. We have a satellite up-link facility through which we supply our central programming feed, including PAX TV, to satellite transmitters which relay the signal to our stations. Our satellite up-link facility is located in Clearwater, Florida.

Each of our stations has a facility in the market in which it operates at which the central programming feed is received and retransmitted in its market. Each of our stations broadcasts its signal from a transmission tower or antenna situated on a transmitter site. Each station also has an office and studio and related broadcasting equipment. For about half of our stations with respect to which we have entered into JSAs, we have vacated the leased studio and office facilities of our stations and co-located our operations with those of our JSA partner. In connection with the termination of our JSAs, we will have to either relocate up to 22 of our station master controls which are currently located in our JSA partner's facility or lease space from our JSA partner in order to keep our station master control located in our JSA partner's facility. We generally lease our broadcast transmission towers and own substantially all of the equipment used in our broadcasting operations. Our tower leases have expiration dates that range generally from two to twenty years. We do not anticipate any difficulties in renewing those leases that expire within the next several years or in leasing other space, if required.

Table of Contents

Our antenna, transmitter and other broadcast equipment for our New York television station (WPXN) were destroyed upon the collapse of the World Trade Center on September 11, 2001. We are currently broadcasting from a tower located on the Empire State Building in Manhattan. We are continuing to evaluate several alternatives to improve our signal through transmission from other locations. We expect, however, that it could take several years to replace the signal we enjoyed at the World Trade Center location with a comparable signal. We have property and business interruption insurance coverage to mitigate the losses sustained, although the extent of coverage of such insurance is currently being litigated.

We believe our existing facilities are adequate for our current and anticipated future needs. No single property is material to our overall operations.

Item 3. Legal Proceedings

On August 19, 2004, NBC filed a complaint against us in the Court of Chancery of the State of Delaware seeking a declaratory ruling as to the meaning of the terms "Cost of Capital Dividend Rate" and "independent investment bank" as used in the Certificate of Designation (the "Certificate of Designation") of our Series B preferred stock held by NBC. On September 15, 2004, the annual rate at which dividends accrue on the Series B preferred stock was reset from 8% to 16.2% in accordance with the procedure specified in the terms of the Series B preferred stock. We engaged CIBC World Markets Corp., a nationally recognized independent investment banking firm, to determine the adjusted dividend rate as of the fifth anniversary of the original issue date of the Series B preferred stock.

On October 14, 2004, we filed our answer and a counterclaim to NBC's complaint. Our answer largely denies the allegations of the NBC complaint and our counterclaim seeks a declaratory ruling that we are not obligated to redeem, and will not be in default under the terms of the agreement under which NBC made its initial \$415 million investment in us if we do not redeem, the Series B preferred stock on or before November 13, 2004. NBC delivered a notice of demand for redemption on November 13, 2003, and has since alleged, both through statements to the press and in its complaint filed in Delaware, that we are obligated to redeem, and will be in default if we do not redeem, NBC's investment on or before November 13, 2004. The aggregate redemption price payable in respect of the 41,500 shares of Series B preferred stock held by NBC, including accrued dividends thereon, was approximately \$600.7 million as of December 31, 2004.

We and NBC have filed briefs in the litigation and have each moved for judgment on the pleadings. The court heard oral argument on the respective motions on February 14, 2005 and has not yet issued its ruling. An adverse outcome in this litigation would have a material adverse effect on us. See "Forward Looking Statements and Associated Risks and Uncertainties." We have not redeemed our securities held by NBC that NBC has demanded that we redeem and this could have adverse consequences for us and . The adjustment to the dividend rate on our Series B preferred stock could have adverse consequences for our business.

Our antenna, transmitter and other broadcast equipment for our New York television station (WPXN) were destroyed upon the collapse of the World Trade Center on September 11, 2001. We filed property damage, business interruption and extra expense insurance claims with our insurer, Zurich American Insurance Company, or Zurich. To date, Zurich has paid us \$7.7 million in respect of our claims for property damage, business interruption and extra expense, which are substantially in excess of this amount. In March 2003, Zurich filed an action against us in the U.S. District Court for the Southern District of New York seeking a declaratory ruling as to certain aspects of the insurance policy which we purchased from it. This action remains pending. Were we to prevail on our insurance claims against Zurich, the recovery could have a material effect on our cash position.

We are involved in other litigation from time to time in the ordinary course of our business. We believe the ultimate resolution of these matters will not have a material effect on our financial position or results of operations or cash flows.

Item 4. Submission of Matters to Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of the period covered by this report.

Table of Contents**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities****Market Information**

Our Class A common stock is listed on the American Stock Exchange under the symbol PAX. The following table sets forth, for the periods indicated, the high and low sales price per share for our Class A common stock.

	2004		2003	
	High	Low	High	Low
First Quarter	\$ 4.60	\$ 3.51	\$ 2.65	\$ 1.91
Second Quarter	4.00	2.15	6.99	2.18
Third Quarter	3.30	1.30	6.48	3.70
Fourth Quarter	1.74	0.90	6.07	3.62

On March 4, 2005, the closing sale price of our Class A common stock on the American Stock Exchange was \$1.29 per share. As of that date, there were approximately 471 holders of record of the Class A common stock.

Dividends

We have not paid cash dividends and do not intend for the foreseeable future to declare or pay any cash dividends on any classes of common stock and intend to retain earnings, if any, for the future operation and expansion of our business. Any determination to declare or pay dividends will be at the discretion of our board of directors and will depend upon our future earnings, results of operations, financial condition, capital requirements, contractual restrictions under our debt instruments, considerations imposed by applicable law and other factors deemed relevant by our board of directors. In addition, the terms of the indentures governing our outstanding senior secured notes and senior subordinated notes and our outstanding preferred stock contain restrictions on the declaration of dividends with respect to our common stock.

Issuer Purchases of Equity Securities

In October 2004, we completed an exchange offer pursuant to which 3,197,250 restricted shares of Class A common stock were exchanged for options to purchase an equal number of shares of Class A common stock, at an exercise price of \$0.01 per share and with identical vesting provisions as the original awards. The restricted shares were originally issued to certain employees and directors in connection with an October 2003 grant. This exchange did not result in any additional stock-based compensation expense. The number of shares of Class A common stock issued and outstanding at the time of exchange was reduced by the number of restricted shares exchanged.

Equity Compensation Plan Information

As of December 31, 2004, the following shares of Class A common stock were authorized for issuance under equity compensation plans:

Weighted-Average

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans [excluding Securities Reflected in Column(a)]
Equity compensation plans approved by security holders (1)	5,336,713	\$ 0.49	3,444,603
Equity compensation plans not approved by security holders (1)	522,500	\$ 3.04	
Total	5,859,213	\$ 0.71	3,444,603

-
- (1) In October 2004, we completed an exchange offer pursuant to which 3,197,250 restricted shares of Class A common stock were exchanged for options to purchase an equal number of shares of Class A common stock, at an exercise price of \$0.01 per share and with identical vesting provisions as the original awards. The restricted

Table of Contents

shares were originally issued to certain employees and directors in connection with the October 2003 grant. This exchange did not result in any additional stock-based compensation expense. The number of shares of Class A common stock issued and outstanding at the time of exchange was reduced by the number of restricted shares exchanged. A narrative description of the material terms of these plans is set forth in Note 11 STOCK INCENTIVE PLANS, to our consolidated financial statements which are set forth elsewhere in this report.

Item 6. Selected Financial Data

The following table sets forth our consolidated financial data as of and for each of the years in the five year period ended December 31, 2004. This information is qualified in its entirety by, and should be read in conjunction with, the consolidated financial statements and the notes thereto which are included elsewhere in this report. The following data, insofar as it relates to each of the years presented, has been derived from annual financial statements, including the consolidated balance sheets at December 31, 2004 and 2003, and the related consolidated statements of operations and of cash flows for each of the three years in the period ended December 31, 2004, and notes thereto appearing elsewhere herein.

(in thousands, except per share data)

	For the Years Ended December 31,				
	2004	2003	2002	2001	2000
Statement of Operations Data:					
Net revenues	\$ 276,630	\$ 270,939	\$ 276,921	\$ 265,326	\$ 271,892
Operating (loss) income	(12,419)	44,195	(69,906)	(150,129)	(155,946)
Net loss	(187,972)	(76,213)	(336,186)	(205,545)	(169,176)
Net loss attributable to common stockholders (a)	(245,735)	(146,317)	(446,285)	(352,201)	(381,980)
Basic and Diluted Loss Per Common Share: (b)					
Net loss	\$ (3.61)	\$ (2.14)	\$ (6.88)	\$ (5.46)	\$ (6.01)
Weighted average shares outstanding basic and diluted	68,139	68,390	64,849	64,509	63,515
Balance Sheet Data:					
Cash and cash equivalents	\$ 82,047	\$ 97,123	\$ 25,765	\$ 83,858	\$ 51,363
Working capital	77,422	67,132	19,188	57,871	74,298
Total assets	1,224,305	1,283,677	1,276,619	1,409,840	1,552,603
Total debt	1,004,093	925,608	900,101	529,180	405,476
Total mandatorily redeemable preferred stock	471,355	410,739	354,498	589,958	574,587
Total mandatorily redeemable convertible preferred stock	740,745	684,067	638,603	574,202	505,802
Total common stockholders deficit	(1,327,341)	(1,089,845)	(958,267)	(515,520)	(175,503)
Other Data:					
Cash flows (used in) provided by operating activities	\$ (9,717)	\$ 32,916	\$ (75,428)	\$ (60,772)	\$ (76,036)
Cash flows (used in) provided by investing activities	(23,647)	60,929	(7,689)	48,477	(12,784)
Cash flows provided by (used in) financing activities	18,288	(22,487)	25,024	44,790	14,994
Program rights payments and deposits	67,682	34,239	116,243	130,566	128,288

Edgar Filing: PAXSON COMMUNICATIONS CORP - Form 10-K

Payments for cable distribution rights	123	4,347	9,286	14,418	10,727
Purchases of property and equipment	15,845	26,732	31,177	35,213	25,110

- a) Includes dividends and accretion on redeemable preferred stock.
- b) Because of losses from continuing operations, the effect of stock options and warrants is antidilutive. Accordingly, our presentation of diluted earnings per share is the same as that of basic earnings per share.

Table of Contents

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

Overview:

We are a network television broadcasting company which owns and operates the largest broadcast television station group in the U.S., as measured by the number of television households in the markets our stations serve. We currently own and operate 60 broadcast television stations (including three stations we operate under time brokerage agreements), which reach all of the top 20 U.S. markets and 40 of the top 50 U.S. markets. We operate PAX TV, a network that provides programming seven days per week, 24 hours per day, and reaches approximately 95 million homes, or 87% of prime time television households in the U.S., through our broadcast television station group, and pursuant to distribution arrangements with cable and satellite distribution systems and our broadcast station affiliates. PAX TV's entertainment programming principally consists of shows originally developed by us and shows that have appeared previously on other broadcast networks which we have purchased the right to air. The balance of PAX TV's programming consists of long form paid programming (principally infomercials) and public interest programming.

Our primary operating expenses include selling, general and administrative expenses, depreciation and amortization expenses, programming expenses, employee compensation and costs associated with cable and satellite distribution, ratings services and promotional advertising. Programming amortization is a significant expense and is affected by several factors, including the mix of syndicated versus lower cost original programming as well as the frequency with which programs are aired.

Our business operations presently do not provide sufficient cash flow to support our debt service and preferred stock dividend requirements. In September 2002, we engaged Bear, Stearns & Co. Inc. and in August 2003 we engaged Citigroup Global Markets Inc. to act as our financial advisors to assess our business plan, capital structure and future capital needs, and to explore strategic alternatives for our company. We terminated these engagements in March 2005 as no viable strategic transactions had been developed on terms that we believed would be in the best interests of all of our stockholders. While we continue to consider strategic alternatives that may arise, which may include the sale of all or part of our assets, finding a strategic partner for our company who would provide the financial resources to enable us to redeem, restructure or refinance our debt and preferred stock, or finding a third party to acquire our company through a merger or other business combination or through a purchase of our equity securities, our principal efforts are focused on improving our core business operations and increasing our cash flow. See *Forward-Looking Statements and Associated Risks and Uncertainties*. Our ability to pursue strategic alternatives is subject to limitations and factors beyond our control.

Financial Performance:

Net revenues in 2004 increased 2.1% to \$276.6 million compared to \$270.9 million in 2003.

Operating loss was \$12.4 million in 2004 compared to operating income of \$44.2 million in 2003. Included in the 2004 results is a charge of \$4.6 million to adjust certain programming to net realizable value resulting from a change in estimated future advertising revenues expected to be generated by certain programming as a result of a change in expected usage of such programming, a \$4.0 million adjustment to recognize additional lease expense for lease arrangements that provide for escalating lease payments (of which approximately \$3.1 million pertained to periods prior to 2004), a \$1.7 million amortization expense charge for certain leasehold improvements to adjust their amortization period to the shorter of their useful lives or the lease terms, a \$3.0 million reduction in music license fees resulting from the conclusion of a dispute and the commencement of a new agreement with a music license organization and \$3.3 million of insurance recoveries related to our World Trade Center litigation.

Operating income for 2003 included gains of \$51.9 million primarily from sales of television station assets.

Net loss attributable to common stockholders was \$245.7 million in 2004 compared to a net loss attributable to common stockholders of \$146.3 million in 2003. The net loss attributable to common stockholders for 2004 includes all of the items described above, \$1.1 million in costs incurred in connection with a required adjustment of the dividend rate on our Series B preferred stock held by NBC, increased dividends of \$20.7 million including the increase resulting from the aforementioned rate adjustment, a loss on extinguishment of debt of \$6.3 million resulting from the refinancing of our senior credit facility in January 2004 and a \$4.9 million adjustment to recognize additional provision for income taxes resulting from a change in the estimated state income tax rate that we expect to incur at the time of reversal of our deferred taxes (of which approximately \$4.5 million pertained to periods prior to 2004). The net loss attributable to common

Table of Contents

stockholders for 2003 included a benefit from income taxes of \$4.7 million resulting from the sale of television stations.

Cash flow from operating activities decreased \$42.6 million to a negative \$9.7 million in 2004 compared to \$32.9 million of cash provided by operating activities in 2003.

Balance Sheet:

Our cash, cash equivalents and short-term investments decreased during the year by \$22.0 million to \$88.0 million as of December 31, 2004. Our total debt, which primarily comprises three series of notes, increased \$78.5 million during the year to \$1.0 billion as of December 31, 2004. Additionally, we have three series of mandatorily redeemable preferred stock currently outstanding with a carrying value of \$1.2 billion as of December 31, 2004. Two series of the notes require us to make periodic cash interest payments on a current basis. Interest on the third series of notes accretes until July 2006, at which time we will be obligated to make cash interest payments on a current basis. All series of preferred stock accrue dividends but do not require current cash dividend payments. None of these instruments matures or requires mandatory principal repayments until the fourth quarter of 2006.

During 2003 and 2004, we issued letters of credit to support our obligation to pay for certain original programming. The settlement of such letters of credit generally occurs during the first quarter of the year. As a result of this strategy, our programming payments may be higher in the first quarter of the year compared to the other three quarters of the year.

Sources of Cash:

Our principal sources of cash in 2004 were:

revenues from the sale of network long form paid programming, network spot advertising, station long form paid programming and station spot advertising; and

\$10.0 million in proceeds from the sale of broadcast assets, consisting of one television station.

We expect our principal sources of cash in 2005 to consist of revenues from the sale of network long form paid programming, network spot advertising, station long form paid programming and station spot advertising. We are also exploring the sale of certain broadcast station assets, which if completed during 2005 would generate additional cash.

Key Company Performance Indicators:

We use a number of key performance indicators to evaluate and manage our business. One of the key indicators related to the performance of our long form paid programming is long form advertising rates. These rates can be affected by the number of television outlets through which long form advertisers can air their programs, weather patterns which can affect viewing levels, and new product introductions. We monitor early indicators such as how new products are performing and our ability to increase or decrease rates for given time slots.

Program ratings are one of the key indicators related to our network spot business. As more viewers watch our programming, our ratings increase which can increase our revenues. The commitments we obtain from advertisers in the up front market are a leading indicator of the potential performance of our network spot revenues. As the year progresses, we monitor pricing in the scatter market to determine where network spot advertising rates are trending. Cost-per-thousand (CPMs) refers to the price of reaching 1,000 television viewing households with an advertisement. CPM trends and comparisons to competitors CPMs can be used to determine pricing power and the appeal of the audience demographic that we are delivering to advertisers.

In order to evaluate our local market performance, we examine ratings as well as our cost per point, which is the price we charge an advertiser to reach one percent of the total television viewing households in a station's DMA, as measured by Nielsen. We also examine the percentage of the market advertising revenue that our local stations are receiving compared to the share of the market ratings that we are delivering. The economic health of a particular region or certain industries that are concentrated in a particular region can affect the amount being spent on local television advertising.

Factors Expected to Affect our Performance in 2005:

We do not anticipate that we will generate sufficient cash flows from operating activities to cover our anticipated capital expenditures for the year ending December 31, 2005. Accordingly, our total cash, cash equivalents and short-term investments as of December 31, 2004 is expected to decrease during the course of 2005.

Table of Contents

We have begun discussions with NBC as to the termination of our network sales agency agreement with NBC and each of our JSAs with NBC (covering 14 of our stations in 12 markets), and we expect that the performance of our business during 2005 will be affected by the costs of terminating these arrangements, including the possible disruption of our network advertising sales efforts resulting from the transfer of this function from NBC to our own employees.

In connection with the termination of our JSAs, we will have to either relocate up to 22 of our station master controls which are currently located in our JSA partner's facility or lease space from our JSA partner in order to keep our station master control located in our JSA partner's facility. We expect that the performance of our business during 2005 will be affected by the terms on which we are able to effect such relocation or leasing.

The U.S. economic environment also affects the performance of our business, since our business is dependent in part on cyclical advertising rates. An improving economy, led by increases in consumer confidence, could benefit us by leading advertisers to increase their spending.

Outlook for 2005:

We expect 2005 to be a challenging year for us. Our principal business objective is to improve our cash flow and increase our financial flexibility, so that we may pursue refinancing alternatives with a view to reducing our cost of capital. We believe that if we are able to improve our cash flow and reduce our cost of capital, we will be able to improve the degree to which our operating business supports our capital structure and improve our ability to avail ourselves of future opportunities to strengthen our business that may arise due to changes in the regulatory or business environment for broadcasters or other future developments in our industry.

In 2005 we will seek to maintain an efficient operating structure and a flexible programming strategy as we implement changes to our business operations. We do not expect to invest substantial additional amounts in new entertainment programming, and are evaluating other programming strategies and opportunities that might be available to us which would improve our cash flow. In March 2005, we notified all of our JSA partners other than NBC that we were exercising our right to terminate the JSAs, effective June 30, 2005, we notified all of our affiliates that we were exercising our right to terminate the affiliation agreements, effective June 30, 2005, and we notified NBC that we were removing, effective June 30, 2005, all of our stations from the national sales agency agreement pursuant to which NBC sells national spot advertisements for 49 of our 60 stations. In addition, we began discussions with NBC as to the termination of our network sales agency agreement with NBC and each of our JSAs with NBC (covering 14 stations in 12 markets). We are also reviewing all of the elements of our business operations.

In order for us to improve revenues in 2005, we would need to market and air programming that attracts additional viewers, increase our CPMs through delivery of more attractive viewing demographics or realize increases in long form paid programming rates. As long form programming is not currently in a high growth cycle, we expect that our revenues in this segment for 2005 will be relatively unchanged when compared to 2004. As we do not expect to invest substantial additional amounts in new entertainment programming during 2005, we expect that our revenues from network spot and station spot advertising for 2005 will be relatively unchanged or may decrease when compared to 2004. We expect that we will experience a decrease in certain operating expenses during 2005 as a result of our strategy of reducing our programming and other operating expenses, offset by costs to exit certain arrangements and increased utility costs to broadcast our digital television signal and other contractual increases in certain operating expenses. During 2005, we also do not anticipate that we will have the benefit of a reduction in expenses related to certain beneficial legal settlements, similar to those that we received during the years ended December 31, 2004 and 2003.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of financial statements requires us 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 reporting period. We believe the most significant estimates involved in preparing our financial statements include estimates related to the net realizable value of our programming rights, barter revenue recognition, estimates used in accounting for leases and estimates related to the impairment of long-lived assets and FCC licenses. We base our estimates on historical experience and various other assumptions we believe are reasonable. Actual results could differ from those estimates.

We consider the accounting policies described below to be critical since they have the greatest effect on our

Table of Contents

reported financial condition and results of operations and they require significant estimates and judgments.

We carry programming rights assets on our balance sheet at the lower of unamortized cost or net realizable value. We record our program rights and related liabilities at the contractual amounts when the programming is available to air. Our original programming generally is amortized on a straight line or accelerated method over three to four years based on expected usage. Our syndicated programming rights are amortized over the licensing agreement term using the greater of the straight line per run or straight line over the license term method. We periodically evaluate the net realizable value of our program rights based on anticipated future usage of programming and the anticipated future ratings and related advertising revenues. We evaluate the net realizable value of our programming rights by aggregating the program costs and related estimated future revenues for each programming daypart. If estimated future revenues are insufficient to recover the unamortized cost of the programming assets in each daypart, we record an adjustment to write down the value of our assets to net realizable value. We also evaluate whether future revenues will be sufficient to recover the cost of programs we are committed to purchase in the future, and if estimated future revenues are insufficient, we accrue a loss related to our programming commitments. Our estimates of future advertising revenues are based upon our actual revenues generated currently, adjusted for estimated revenue growth assumptions. If market conditions were to deteriorate, we may not achieve our estimated future revenues, which could result in future write downs to net realizable value and accrued losses on programming commitments.

We have made judgments and estimates in connection with some of our leasing transactions regarding the estimated useful lives of the assets subject to lease, as well as the discount rates used to estimate the present value of future lease payments. These judgments and estimates have led us to conclude that these leases should be accounted for as operating leases. Had we used different judgments and estimates, these leases may have been classified as capital leases. The terms of our senior notes indenture, senior subordinated notes indentures and outstanding preferred stock restrict our ability to incur indebtedness, including our ability to enter into capital leases.

We review our long-lived assets for possible impairment whenever events or changes in circumstances indicate that, based on estimated undiscounted future cash flows, the carrying amount of the assets may not be fully recoverable. If our analysis indicates that a possible impairment exists, we are required to then estimate the fair value of the asset determined either by third party appraisal or estimated discounted future cash flows. In addition, our FCC licenses are tested for impairment at least annually by comparing the estimated fair values with the recorded amount on an aggregate basis as a single unit of accounting since we operate PAX TV as a single asset, a consolidated distribution platform. We believe that we have made reasonable estimates and judgments in determining whether our long-lived assets and FCC licenses have been impaired. If, however, there were a material change in our determination of fair values or if there were a material change in the conditions or circumstances influencing fair value, we could be required to recognize an impairment charge. In addition, it is possible that the estimated life of certain long-lived assets will be reduced significantly in the near term because of the anticipated industry migration from analog to digital broadcasting. If and when we become aware of such a reduction of useful lives, depreciation expense will be adjusted prospectively to ensure assets are fully depreciated upon migration.

We recognize revenues as commercial spots and long form paid programming are aired and ratings guarantees to advertisers are achieved. We recognize a liability for shortfalls in ratings guarantees based on information obtained from third party sources and by using our judgment and best estimates.

We carry accounts receivable at the amount we believe to be collectible. We use our judgment and best estimates in determining the amount of accounts receivable we believe to be uncollectible. The amounts of accounts receivable that ultimately become uncollectible could vary materially from our estimates.

We have entered into agreements with cable system operators to improve channel positioning on certain cable systems. For agreements with specified termination dates, we amortize amounts paid over the term of the agreement

using the straight line method. For agreements with no specified termination date, we amortize amounts paid on a straight line basis over their estimated useful lives.

We depreciate property and equipment over their estimated useful lives using the straight line method. We periodically evaluate the potential time frame in which certain equipment may become obsolete as a result of the FCC mandated conversion from analog to digital to determine whether accelerated depreciation is necessary. We have not determined whether accelerated depreciation should be used to depreciate any of our property and equipment and we continue to depreciate our property and equipment over their estimated useful lives.

We account for employee stock-based compensation using the intrinsic value method.

Table of Contents

We have investments in certain broadcast properties, including purchase options in entities owning television stations. We review our investments in broadcast properties for possible impairment whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. If our analysis indicates that a possible impairment exists, we are required to estimate the fair value of the asset based either on a third party appraisal or estimated discounted future cash flows. We believe we have made reasonable estimates and judgments in determining whether our investments in broadcast properties are impaired.

We structured the disposition of our radio division in 1997 and our acquisition of television stations during the period following this disposition in a manner that we believed would qualify these transactions as a like kind exchange under Section 1031 of the Internal Revenue Code and would permit us to defer recognizing for income tax purposes up to approximately \$333 million of gain. The IRS has examined our 1997 tax return and has issued us a 30-day letter proposing to disallow all of our gain deferral. We have filed our protest to this determination with the IRS appeals division, but we cannot predict the outcome of this matter at this time, and we may not prevail. In addition, the 30-day letter offered 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. We have filed a protest to this alternative determination as well. We may not prevail with respect to this alternative determination. Should the IRS successfully challenge our position and disallow all or part of our gain deferral, because we had net operating losses in the years subsequent to 1997 in excess of the amount of the deferred gain, we would not be liable for any tax deficiency, but could be liable for state income taxes. We have estimated the amount of state income tax for which we could be liable as of December 31, 2004, to be approximately \$8.0 million should the IRS succeed in disallowing the entire deferred gain. In addition, we could be liable for interest on the tax liability for the period prior to the carryback of our net operating losses and for interest on any state income taxes that may be due. As of December 31, 2004, we have estimated the amount of federal interest and state interest to be approximately \$18.0 million and \$4.0 million, respectively, should the IRS succeed in disallowing the entire deferred gain. The use of our net operating losses to offset any disallowed deferred gain would result in a benefit from income taxes. This matter is currently with the Appeals Office of the Internal Revenue Service.

Results of Continuing Operations

The following table sets forth net revenues, the components of operating expenses with percentages of net revenues, and other operating data for the periods presented (in thousands):

	Years Ended December 31					
	2004	%	2003	%	2002	%
Net revenues	\$ 276,630	100.0	\$ 270,939	100.0	\$ 276,921	100.0
Expenses:						
Programming and broadcast operations	56,472	20.4	51,954	19.2	51,204	18.5
Program rights amortization	53,616	19.4	51,082	18.9	77,980	28.2
Selling, general and administrative	121,835	44.0	110,976	41.0	132,305	47.8
Business interruption insurance proceeds					(1,617)	(0.6)
Time brokerage and affiliation fees	4,466	1.6	4,403	1.6	4,079	1.5
Stock-based compensation	8,501	3.1	12,766	4.7	3,810	1.4
Adjustment of programming to net realizable value	4,645	1.7	1,066	0.4	41,270	14.9
Restructuring (credits) charges	(5)		48		2,173	0.8
Reserve for state taxes	691	0.2	3,055	1.1		
Depreciation and amortization	43,664	15.8	42,983	15.9	58,529	21.1

Edgar Filing: PAXSON COMMUNICATIONS CORP - Form 10-K

Total operating expenses	293,885	106.2	278,333	102.7	369,733	133.5
Gain on sale or disposal of broadcast and other assets, net	4,836	1.7	51,589	19.0	22,906	8.3
Operating (loss) income	\$ (12,419)	(4.5)	\$ 44,195	16.3	\$ (69,906)	(25.2)
Other Data:						
Cash flows (used in) provided by operating activities	\$ (9,717)		\$ 32,916		\$ (75,428)	
Cash flows (used in) provided by investing activities	(23,647)		60,929		(7,689)	
Cash flows provided by (used in) financing activities	18,288		(22,487)		25,024	
Program rights payments and deposits	67,682		34,239		116,243	
Payments for cable distribution rights	123		4,347		9,286	
Purchases of property and equipment	15,845		26,732		31,177	

Table of Contents

Years Ended December 31, 2004 and 2003

Net revenues increased 2.1% to \$276.6 million for the year ended December 31, 2004 versus \$270.9 million for the year ended December 31, 2003. This increase is primarily attributable to increased revenues from long form paid programming.

Programming and broadcast operations expenses were \$56.5 million during the year ended December 31, 2004, compared with \$52.0 million in 2003. Programming and broadcast operations expenses reflects a \$3.0 million reduction in music license fees during the third quarter of 2004 resulting from the conclusion of a dispute and the commencement of a new agreement with a music license organization offset by higher tower rent and utilities costs in connection with our digital television build-out and higher personnel costs. In the fourth quarter of 2004, we recorded an adjustment in the amount of \$3.7 million in order to recognize additional lease expense for lease arrangements that provide for escalating lease payments of which approximately \$2.9 million pertained to periods prior to 2004.

Program rights amortization expense was \$53.6 million during the year ended December 31, 2004 compared with \$51.1 million in 2003. The increase is primarily attributable to increased amortization associated with new original and syndicated programming in 2004 when compared to 2003.

Selling, general and administrative expenses were \$121.8 million during the year ended December 31, 2004 compared with \$111.0 in 2003. The increase was primarily attributable to higher personnel costs and increased advertising spending. During 2004 we received \$3.3 million of insurance proceeds pursuant to a property and business interruption insurance claim in connection with the destruction of our antenna, transmitter and other broadcast equipment upon the collapse of the World Trade Center on September 11, 2001. We are in litigation with our former insurance carrier concerning the extent of our property and business interruption coverage. We offset the insurance proceeds we received in 2004 against expenses we incurred in 2004 in connection with this litigation. During 2004, we determined that we had not recorded certain state taxes for purchases in jurisdictions in which we have operations, resulting in a charge of \$0.8 million which is reflected in selling, general and administrative expenses in 2004. A significant portion of the state taxes recorded pertain to periods prior to 2004. During the first quarter of 2003, we received approximately \$2.2 million from NBC to settle a pending dispute regarding digital television signal interference at our television station WPXM, serving the Miami-Fort Lauderdale, Florida market. This settlement was recorded as a reduction of our selling, general and administrative expenses. Additionally, in the second quarter of 2003, we reduced our bad debt reserve by approximately \$1.5 million as a result of our shift in 2003 to more prepaid long form advertising.

During the third quarter of 2004, we recognized a charge of \$4.6 million to reduce certain programming rights to their net realizable value. This charge resulted from a change in the estimated future advertising revenues expected to be generated by certain programming as a result of a change in expected usage of such programming. During the year ended December 31, 2003, we recognized an adjustment of programming to net realizable value totaling \$1.1 million resulting from our decision to no longer air an original game show production.

In 2004 and 2003, we recorded a reserve for state taxes in the amount of \$0.7 million and \$3.1 million, respectively, in connection with a tax liability related to certain states in which we have operations. The amount reserved for 2003 included prior periods.

Depreciation and amortization expense was \$43.7 million during the year ended December 31, 2004 compared with \$43.0 million in 2003. During the fourth quarter of 2004, we recorded additional amortization expense of \$1.7 million for certain leasehold improvements to adjust their amortization period to the shorter of their useful lives or the lease terms. Approximately \$1.6 million pertained to periods prior to 2004. During 2004, we determined that we had not recorded certain state taxes for purchases in jurisdictions in which we have operations, resulting in a

charge of \$1.4 million and a corresponding increase in property and equipment and accrued liabilities. We recorded a \$0.4 million depreciation charge related to the aforementioned increase in property and equipment. A significant portion of the state taxes recorded pertain to periods prior to 2004. In addition, in 2004 we recorded a \$0.5 million impairment charge in connection with a purchase option for a television station. During 2003, we determined that we had over-amortized certain cable and satellite distribution rights assets, which resulted in a \$6.9 million reduction in amortization expense. The aforementioned 2003 reduction in amortization expense was partially offset by an impairment charge of \$5.4 million recorded as depreciation and amortization related to a purchase option for a television station. This impairment existed in periods prior to 2003. In 1998, we began entering into cable distribution agreements for periods generally up to ten years in markets where we do not own a television station. Certain of these cable distribution agreements also provided us with some level of promotional advertising to be run

Table of Contents

at the discretion of the cable operator, primarily during the first few years to support the launch of the PAX TV network on the cable systems. We had been amortizing these assets on an accelerated basis, which gave effect to the advertising component included in these agreements. The remaining unamortized cost, which was being amortized over seven years, will be amortized over the remaining contractual life of the agreements.

In May 2004, we completed the sale of our television station KPXJ, serving the Shreveport, Louisiana market, for \$10.0 million resulting in a pre-tax gain of approximately \$6.1 million.

In October 2003, we granted 3,598,750 options under our 1998 Stock Incentive Plan, as amended (the Plan), to purchase one share of our 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 were subject to vesting, restrictions on transfer and a risk of forfeiture. The shares of restricted stock issued upon the exercise of the options included 2,278,000 shares which were to vest in their entirety at the end of a five year period. Of the remaining restricted stock, 1,000,750 shares were to vest ratably over a three year period and 320,000 shares were to vest ratably over a five year period. The option grants resulted in non-cash stock based compensation expense, which will be recognized on a straight-line basis over the vesting period. For the years ended December 31, 2004 and 2003, we recognized approximately \$7.1 million and \$1.5 million, respectively, in stock based compensation expense in connection with these grants. Approximately \$3.2 million will be recognized in 2005, and \$6.1 million will be recognized between 2006 and 2008.

In October 2004, we completed an exchange offer pursuant to which 3,197,250 restricted shares of Class A common stock were exchanged for options to purchase an equal number of shares of Class A common stock, at an exercise price of \$0.01 per share and with identical vesting provisions as the original awards. The restricted shares were originally issued to certain employees and directors in connection with the October 2003 grants. This exchange did not result in any additional stock-based compensation expense. The number of shares of Class A common stock issued and outstanding at the time of exchange was reduced by the number of restricted shares exchanged.

In January 2003, we consummated a stock option exchange offer under which we granted to holders who tendered their eligible options in the exchange offer new options under the Plan to purchase one share of our Class A common stock for each two shares of our 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 our stock option plans and 1.8 million additional nonqualified 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 non-cash stock-based compensation expense of approximately \$8.7 million, of which approximately \$8.6 million related to vested and unvested shares issued upon exercise of the new options was recognized in the year ended December 31, 2003 and the remaining amount was recognized in 2004. In addition, the remaining deferred stock compensation expense associated with the original stock option awards totaling approximately \$2.5 million at December 31, 2002 associated with tendered options was recognized using the straight-line method over the vesting period of the modified awards (\$2.3 million recognized in the year ended December 31, 2003 and \$0.2 million was recognized in 2004). As of December 31, 2004, there were 40,000 shares of restricted stock issued upon the exercise of options in the January 2003 exchange that had not vested as a result of elections to defer vesting made by the holders.

Interest expense for the year ended December 31, 2004 increased to \$94.2 million from \$92.2 million in 2003. The increase is primarily due to higher accretion on our 12 1/4 % senior subordinated discount notes. Dividends on mandatorily redeemable preferred stock were \$60.6 million compared to \$27.5 million in 2003. This increase resulted

from the classification of our 14 1/4% Junior Exchangeable Preferred Stock as interest expense beginning July 1, 2003 in accordance with SFAS 150.

Interest income for the year ended December 31, 2004 decreased to \$2.8 million from \$3.4 million in 2003. The decrease is primarily due to lower interest income on amounts due from Crown Media.

On January 12, 2004, we completed a private offering of \$365.0 million of senior secured floating rate notes. The proceeds from the offering were used to repay in full the outstanding indebtedness under our senior credit facility. The refinancing resulted in a charge in the first quarter of 2004 in the amount of \$6.3 million related to the unamortized debt issuance costs associated with the senior credit facility.

Table of Contents

Years Ended December 31, 2003 and 2002

Net revenues decreased 2.2% to \$270.9 million for the year ended December 31, 2003 versus \$276.9 million for the year ended December 31, 2002. This decrease is primarily attributable to the sale of certain television stations.

Programming and broadcast operations expenses were \$51.9 million during the year ended December 31, 2003, compared with \$51.2 million in 2002. This increase is primarily due to higher tower rent and utilities expense in connection with our digital television build-out.

Program rights amortization expense was \$51.1 million during the year ended December 31, 2003 compared with \$78.0 million in 2002. The decrease is primarily due to the modification of our programming schedule in January 2003 whereby we replaced daytime entertainment programming with long form paid programming for which we have no programming cost and due to the sub-licensing of *Touched By An Angel* to Crown Media described below.

Selling, general and administrative expenses were \$111.0 million during the year ended December 31, 2003 compared with \$132.3 in 2002. The decrease is primarily a result of cost cutting measures including headcount reductions in connection with the fourth quarter 2002 restructuring activities described below, lower legal expenses primarily resulting from completion, in 2002, of the NBC arbitration matter and a charge recorded in 2002 in connection with the postponement of the 700 MHz spectrum auction. In addition, during the first quarter of 2003, we received approximately \$2.2 million from NBC to settle a pending dispute regarding digital television signal interference at our television station WPXM, serving the Miami-Fort Lauderdale, Florida market. This settlement was recorded as a reduction of our selling, general and administrative expenses. Additionally, we reduced our bad debt reserve by approximately \$1.5 million because of the decrease in our receivables that resulted from our shift in 2003 to more prepaid long form advertising.

During the year ended December 31, 2003, we recognized an adjustment of programming to net realizable value totaling \$1.1 million resulting from our decision to no longer air an original game show production.

In 2003, we recorded a reserve for state taxes related to current and prior periods in the amount of \$3.1 million in connection with a tax liability related to certain states in which we have operations.

Depreciation and amortization expense was \$43.0 million during the year ended December 31, 2003 compared with \$58.5 million in 2002. This decrease is due to the sale of broadcast assets and our determination to amortize our remaining cable distribution rights over the remaining term of the underlying agreements. In 1998, we began entering into cable distribution agreements for periods generally up to ten years in markets where we do not own a television station. Certain of these cable distribution agreements also provided us 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 PAX TV network on the cable systems. We had been amortizing these assets on an accelerated basis, which gave effect to the advertising component included in these agreements. The remaining unamortized cost, which was being amortized over seven years, will be amortized over the remaining contractual life of the agreements. In 2003, we determined that we had previously over-amortized certain of these assets and recorded a \$6.9 million reduction of amortization expense. The decrease in depreciation and amortization expense was offset, in part, by an impairment charge in the amount of \$5.4 million recorded in 2003 in connection with a purchase option on a television station. This impairment existed in periods prior to 2003.

In May 2003, we completed the sale of our television station KAPX, serving the Albuquerque, New Mexico market, for \$20.0 million resulting in a pre-tax gain of approximately \$12.3 million. In April 2003, we completed the sale of our television stations WMPX, serving the Portland-Auburn, Maine market, and WPXO, serving the St. Croix, U.S. Virgin Islands market, for an aggregate of \$10.0 million resulting in a pre-tax gain of approximately \$3.1 million.

In April 2003, we completed the sale of our limited partnership interest in television station WWDP, serving the Boston, Massachusetts market, for approximately \$13.8 million resulting in a pre-tax gain of approximately \$9.9 million. In February 2003, we completed the sale of our television station KPXF, serving the Fresno, California market, for \$35.0 million resulting in a pre-tax gain of approximately \$26.6 million.

In October 2003, we granted 3,598,750 options under our 1998 Stock Incentive Plan, as amended (the Plan), to purchase one share of our 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 Class A common stock subject to vesting restrictions. The awards included retention grants totaling 2,278,000 shares which will vest in their entirety at the end of a five year period. Of the remaining awards, 1,000,750 will vest ratably over a three year period and 320,000 will vest ratably over a five year period. The option grants resulted in non-cash stock based compensation expense, which will be recognized on a straight-line basis over the vesting period of the awards. For the year ended December 31, 2003, we recognized approximately \$1.5 million in stock based compensation expense in connection with these grants.

Table of Contents

In January 2003, we consummated a stock option exchange offer under which we granted to holders who tendered their eligible options in the exchange offer new options under the Plan to purchase one share of our Class A common stock for each two shares of our 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 our stock option plans and 1.8 million non-qualified options issued in addition to the options granted under our stock option plans 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 non-cash stock-based compensation expense of approximately \$8.7 million, of which approximately \$8.6 million related to vested and unvested shares issued upon exercise of the new options was recognized in the year ended December 31, 2003 and the remaining amount was recognized in 2004. In addition, the remaining deferred stock compensation expense associated with the original stock option awards totaling approximately \$2.5 million at December 31, 2002 associated with tendered options was recognized using the straight-line method over the vesting period of the modified awards (\$2.3 million recognized in the year ended December 31, 2003).

Interest expense for the year ended December 31, 2003 increased to \$92.2 million from \$85.2 million in 2002. The increase is primarily due to higher accretion on our 12 1/4 % senior subordinated discount notes. Dividends on mandatorily redeemable preferred stock resulted from the classification of our 14 1/4% Junior Exchangeable Preferred Stock as a liability in accordance with SFAS 150.

Interest income for the year ended December 31, 2003 increased to \$3.4 million from \$2.4 million in 2002. The increase is primarily due to higher average cash and short-term investment balances in 2003 resulting from the proceeds of asset sales.

Restructuring Activities

During the fourth quarter of 2002, we adopted a plan to consolidate certain of our operations, reduce personnel and modify our programming schedule in order to significantly reduce our cash operating expenditures. In connection with this plan, we 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 in costs associated with exiting leased properties and the consolidation of certain operations. Through December 31, 2004, we have paid \$2.1 million in termination benefits to 94 employees and paid \$0.5 million of lease termination and other costs. We have accounted for these costs pursuant to SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities which we early adopted in the fourth quarter of 2002. SFAS No. 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 under SFAS No. 146. As such, we will recognize additional restructuring costs as they are incurred.

Income Taxes

Upon adoption of SFAS No. 142 on January 1, 2002, we no longer amortize our FCC license intangible assets. Under previous accounting standards, these assets were being amortized over 25 years. Although the provisions of SFAS 142 stipulate that indefinite-lived intangible assets and goodwill are not amortized, we are required under FASB Statement No. 109, Accounting for Income Taxes (SFAS 109), to recognize deferred tax liabilities and assets for temporary differences related to the FCC license intangible assets and the tax-deductible portion of these assets. Prior

to the adoption of SFAS 142, we considered our deferred tax liabilities related to the FCC license intangible assets as a source of future taxable income in assessing the realization of our deferred tax assets. Because indefinite-lived intangible assets and goodwill are no longer amortized for financial reporting purposes under SFAS 142, the related deferred tax liabilities will not reverse until some indeterminate future period should the FCC license intangible assets become impaired or be disposed of. Therefore, the reversal of deferred tax liabilities related to FCC license intangible assets is no longer considered a source of future taxable income in assessing the realization of deferred tax assets. As a result of this accounting change, we were required to record an increase in our deferred tax asset valuation allowance resulting in a deferred tax liability of \$168.6 million during the year ended December 31, 2002. In addition, we continue to record increases in our valuation allowance based on increases in the deferred tax liabilities and assets for temporary differences related to the FCC license intangible assets.

We structured the disposition of our radio division in 1997 and our acquisition of television stations during the

Table of Contents

period following this disposition in a manner that we believe would qualify these transactions as a like kind exchange under Section 1031 of the Internal Revenue Code and would permit us to defer recognizing for income tax purposes up to approximately \$333 million of gain. The IRS has examined our 1997 tax return and has issued to us a 30-day letter proposing to disallow all of our gain deferral. We have filed our protest to this determination with the IRS appeals division, but cannot predict the outcome of this matter at this time, and may not prevail. In addition, the 30-day letter offered us 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. We filed a protest to this alternative determination as well. We may not prevail with respect to this alternative determination. Should the IRS successfully challenge our position and disallow all or part of our gain deferral, because we had net operating losses in the years subsequent to 1997 in excess of the amount of the deferred gain, we would not be liable for any tax deficiency, but could be liable for state income taxes. We have estimated the amount of state income tax for which we could be liable as of December 31, 2004 to be approximately \$8.0 million should the IRS succeed in disallowing the entire deferred gain. In addition, we could be liable for interest on the tax liability for the period prior to the carryback of our net operating losses and for interest on any state income taxes that may be due. We have estimated the amount of federal interest and state interest, as of December 31, 2004, to be approximately \$18.0 million and \$4.0 million, respectively, should the IRS succeed in disallowing the entire deferred gain. The use of our net operating losses to offset any disallowed deferred gain would result in a benefit from income taxes. This matter is currently with the Appeals Office of the Internal Revenue Service.

Liquidity and Capital Resources

Our primary capital requirements are to fund capital expenditures for our television properties, programming rights payments and debt service payments. Our primary sources of liquidity are our cash on hand and our net working capital. As of December 31, 2004, we had \$88.0 million in cash and cash equivalents and short-term investments and we had working capital of approximately \$77.4 million. During the year ended December 31, 2004, our cash and cash equivalents and short-term investments decreased by approximately \$22.0 million primarily due to net cash used in operating activities, deposits on programming letters of credit and purchases of property and equipment. We believe that our cash on hand and net working capital will provide the liquidity necessary to meet our obligations and financial commitments through the next twelve months. Our 12¹/₄% senior subordinated discount notes require us to commence making semi-annual cash interest payments of approximately \$30.4 million on July 15, 2006 and on each January 15 and July 15 thereafter. We believe that we will need to improve our operating cash flow over the next twelve months in order to be able to meet this obligation. Should we be unable to do so, or if our financial results are not as anticipated, we may be required to seek to sell broadcast assets or raise additional funds through the offering of equity securities in order to generate sufficient cash to meet our liquidity needs. During the first quarter of 2005 we have identified certain broadcast assets that we will seek to sell in order to improve our liquidity position. We can provide no assurance that we will be successful in selling these or any other assets or raising additional funds that we may require.

We are involved in litigation with NBC regarding NBC's demand for redemption of our Series B preferred stock. NBC has asserted that we continue to be required to redeem all of the shares of our Series B preferred stock held by NBC. If a court were to grant a judgment against us requiring us to pay the redemption amount of the Series B preferred stock, it would have a material adverse effect upon us. Our ability to effect any redemption is restricted by the terms of our outstanding debt and preferred stock. Further, we do not currently have sufficient funds to pay the redemption price of these securities. If any such judgment were entered, and we were unable to satisfy it, we would be in default under the indentures governing our senior secured notes and senior subordinated notes. In order to redeem NBC's preferred stock, we would need to repay, refinance or otherwise restructure our outstanding indebtedness and preferred stock and raise sufficient liquidity to enable us to pay the required redemption price. It is unlikely that we would be able to accomplish these actions and redeem NBC's preferred stock were this to occur.

Cash (used in) provided by operating activities was approximately \$(9.7) million, \$32.9 million and \$(75.4) million for the years ended December 31, 2004, 2003 and 2002, respectively. These amounts reflect cash generated or used in connection with the operation of PAX TV, including the related programming rights and cable distribution rights payments and interest payments on our debt. The decrease for the year ended December 31, 2004 is due to increased programming payments in the period.

Cash (used in) provided by investing activities was approximately \$(23.6) million, \$60.9 million and \$(7.7) million for the years ended December 31, 2004, 2003 and 2002, respectively. These amounts include proceeds from the sale of broadcast assets, capital expenditures and short-term investments. During the third quarter of 2004, we purchased the television production and distribution facility that we had been leasing from The Christian Network, Inc. for an aggregate purchase price of approximately \$1.7 million. We use this facility as our network operations center and to originate our PAX TV network signal. In May 2004, we received \$10.0 million in proceeds from the sale of our television station KPXJ, serving the Shreveport, Louisiana market.

Table of Contents

During the year ended December 31, 2003, we raised \$83.3 million in proceeds from the sale of broadcast assets. These asset sales included the sale of our television station KPXF, serving the Fresno, California market, to Univision Communications, Inc. for \$35.0 million, which we completed in February 2003; the sale of our television stations WMPX, serving the Portland-Auburn, Maine market, and WPXO, serving the St. Croix, U.S. Virgin Islands market for an aggregate purchase price of \$10.0 million, which we completed in April 2003; the sale of our limited partnership interest in television station WWDP, serving the Boston, Massachusetts market, for approximately \$13.8 million, which we completed in April 2003; and the sale of our television station KAPX, serving the Albuquerque, New Mexico market, for approximately \$20.0 million, which we completed in May 2003. We realized aggregate pre-tax gains of approximately \$51.9 million on these 2003 sales. As of December 31, 2004, there were \$24.6 million of outstanding letters of credit all of which we have pre-funded and which are reflected as deposits for programming letters of credit in the accompanying consolidated balance sheets. As of December 31, 2003, there were \$16.6 million of outstanding letters of credit supported by the revolving credit portion of our previously existing senior credit facility. We have options to purchase the assets of two television stations serving the Memphis and New Orleans markets for an aggregate purchase price of \$36.0 million. We have paid \$4.0 million for the options to purchase these stations. The owners of these stations also have the right to require us to purchase these stations at any time after January 1, 2007 through December 31, 2008. These stations are currently operating under TBAs with us.

Cash provided by (used in) financing activities was \$18.3 million, \$(22.5) million and \$25.0 million for the years ended December 31, 2004, 2003 and 2002, respectively. These amounts include the proceeds from borrowings and proceeds from stock option exercises, net of principal repayments. Also included are payments of employee withholding taxes on option exercises in connection with the January 2003 stock option exchange offer.

Capital expenditures, which consist primarily of digital conversion costs and purchases of broadcast equipment for our television stations, were approximately \$15.8 million in 2004, \$26.7 million in 2003 and \$31.2 million in 2002. The FCC mandated that each licensee of a full power broadcast television station that was allotted a second digital television channel in addition to the current analog channel, complete the construction of digital facilities capable of serving its community of license with a signal of requisite strength by May 2002. Those digital stations that were not operating by the May 2002 date requested extensions of time from the FCC which have been granted with limited exceptions. Despite the current uncertainty that exists in the broadcasting industry with respect to standards for digital broadcast services, planned formats and usage, we have complied and intend to continue to comply with the FCC's timing requirements for the construction of digital television facilities and the broadcast of digital television services. We have commenced our migration to digital broadcasting in certain of our markets and will continue to do so throughout the required time period. We currently own or operate 49 stations broadcasting in digital (in addition to broadcasting in analog). With respect to our remaining stations, we have received construction permits from the FCC and will be completing the build-out on three stations during 2005, we are awaiting construction permits from the FCC with respect to seven of our television stations and one of our television stations has not received a digital channel allocation and therefore will not be converted until the end of the digital transition. Because of the uncertainty as to standards, formats and usage, we cannot currently predict with reasonable certainty the amount or timing of the expenditures we will likely have to make to complete the digital conversion of our stations. We currently anticipate, however, that we will spend at least an additional \$8 million in 2005 to complete the conversion of each of our stations that has received a construction permit and a digital channel allocation. We expect to fund these expenditures from cash on hand.

During 2002, we sold our television station WPXB, serving the Merrimack, New Hampshire market, to NBC for \$26.0 million and realized a pre-tax gain of approximately \$24.5 million.

On January 12, 2004, we completed a private offering of \$365.0 million of senior secured floating rate notes. The senior notes bear interest at the rate of LIBOR plus 2.75% per year and will mature on January 10, 2010. We may redeem the senior notes at any time at specified redemption prices. The senior notes are secured by a first priority lien

on substantially all of our 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 our subsidiaries. The proceeds from the offering were used to repay in full the outstanding indebtedness under our previously existing senior credit facility described below, pre-fund letters of credit supported by the revolving credit portion of our previously existing senior credit facility and pay fees and expenses incurred in connection with the transaction.

In January 2002, we completed an offering of senior subordinated discount notes due in 2009. Gross proceeds of the offering totaled approximately \$308.3 million and were used to refinance our 12 1/2% exchange debentures due 2006, which were issued in exchange for the outstanding shares of our 12 1/2% exchangeable preferred stock on January 14, 2002, and to pay costs related to the offering. The notes were sold at a discounted price of 62.132% of the principal amount at maturity, which represents a yield to maturity of 12 1/4%. We will be required to commence making semi-annual cash interest payments of approximately \$30.4 million under our 12 1/4% senior subordinated discount notes on July 15, 2006, and to make interest payments on each January 15 and July 15 thereafter until these

Table of Contents

notes are repaid or refinanced. The senior subordinated discount notes are guaranteed by our subsidiaries. We recognized a loss due to early extinguishment of debt totaling approximately \$17.6 million in the first quarter of 2002 resulting primarily from the redemption premium and the write-off of unamortized debt costs associated with the repayment of the 121/2% exchange debentures.

The terms of the indentures governing our senior secured and senior subordinated notes contain covenants which, among other things, limit our ability to incur additional indebtedness, other than refinancing indebtedness, restrict our ability to pay dividends or redeem our outstanding capital stock, restrict our ability to make certain investments or to enter into transactions with affiliates, restrict our ability to incur liens or merge or consolidate with any other person, require us to pay all material taxes prior to delinquency, require any asset sales we may conduct to comply with certain requirements, including as to the use of asset sale proceeds, restrict our ability to sell interests in our subsidiaries, and require us, in the event we experience a change of control, to make an offer to purchase the notes outstanding under such indentures on specified terms. Events of default under the indentures include the failure to pay interest within 30 days of the due date, the failure to pay principal when due, a default under any other debt in an amount greater than \$10.0 million, the entry of a monetary judgment against us in an amount greater than \$10.0 million which remains unsatisfied for 60 days, the failure to perform any covenant or agreement under the indentures which continues for 60 days after we receive notice of default from the indenture trustee or holders of at least 25% of the outstanding notes, and the occurrence of certain bankruptcy events. For a complete statement of our obligations under these indentures, you should refer to the indentures themselves which are filed as exhibits to this report. The certificates of designation of two of our outstanding series of preferred stock contain restrictions on our ability to incur additional indebtedness, other than refinancing indebtedness, pay dividends or redeem our outstanding capital stock, make certain investments or enter into transactions with affiliates, and sell preferred stock in our subsidiaries, and require us, in the event we experience a change of control, to make an offer to purchase the outstanding shares of preferred stock on specified terms. Our third outstanding series of preferred stock contains restrictions on our ability to pay dividends or redeem our outstanding capital stock, make certain investments or enter into transactions with affiliates, and requires us, in the event we experience a change of control, to make an offer to purchase the outstanding shares of preferred stock on specified terms. For a complete statement of our obligations under our three outstanding series of preferred stock, you should refer to the certificates of designation of each series which are filed as exhibits to this report.

We structured the disposition of our radio division in 1997 and our acquisition of television stations during the period following this disposition in a manner that we believe would qualify these transactions as a like kind exchange under Section 1031 of the Internal Revenue Code and would permit us to defer recognizing for income tax purposes up to approximately \$333 million of gain. The IRS has examined our 1997 tax return and has issued to us a 30-day letter proposing to disallow all of our gain deferral. We have filed our protest to this determination with the IRS appeals division, but cannot predict the outcome of this matter at this time, and may not prevail. In addition, the 30-day letter offered us 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. We filed a protest to this alternative determination as well. We may not prevail with respect to this alternative determination. Should the IRS successfully challenge our position and disallow all or part of our gain deferral, because we had net operating losses in the years subsequent to 1997 in excess of the amount of the deferred gain, we would not be liable for any tax deficiency, but could be liable for state income taxes. We have estimated the amount of state income tax for which we could be liable as of December 31, 2004 to be approximately \$8.0 million should the IRS succeed in disallowing the entire deferred gain. In addition, we could be liable for interest on the tax liability for the period prior to the carryback of our net operating losses and for interest on any state income taxes that may be due. We have estimated the amount of federal interest and state interest, as of December 31, 2004, to be approximately \$18.0 million and \$4.0 million, respectively, should the IRS succeed in disallowing the entire deferred gain. The use of our net operating losses to offset any disallowed deferred gain would result in a benefit from income taxes. This matter is currently with the Appeals Office of the Internal Revenue Service.

Contractual Obligations and Commitments

As of December 31, 2004, we were obligated under the terms of our indentures, programming contracts, cable distribution agreements, operating lease agreements and employment agreements to make future payments as follows (in thousands):

	2005	2006	2007	2008	2009	Thereafter	Total
Senior secured and senior subordinated Notes	\$ 64	\$ 71	\$ 79	\$ 200,086	\$ 496,358	\$ 365,048	\$ 1,061,706
Obligations for program rights and program rights commitments	43,776	1,703					45,479
Obligations to CBS	17,726	9,191					26,917