PAXSON COMMUNICATIONS CORP
Form 10-Q
November 09, 2005

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(MARK ONE)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE QUARTERLY PERIOD ENDED September 30, 2005
OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE TRANSITION PERIOD FROM ___________________________ TO
____

Commission File Number 1-13452

PAXSON COMMUNICATIONS CORPORATION
(Exact name of registrant as specified in its charter)

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

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).
YES x NO o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of October 31, 2005:

Class of Stock	Number of Shares
Common stock-Class A, $0.001 par value per share	64,582,424
Common stock-Class B, $0.001 par value per share	8,311,639

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PART I Financial Information

Item 1. Financial Statements

PAXSON COMMUNICATIONS CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands except share data)

	September 30, 2005 (Unaudited)	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 99,148	$ 82,047
Short-term investments		5,993
Accounts receivable, net of allowance for doubtful accounts of $431 and $648, respectively	11,133	24,961
Program rights	27,223	38,853
Amounts due from Crown Media	2,336	9,885
Deposits for programming letters of credit		24,603
Prepaid expenses and other current assets	3,940	3,119
Total current assets	143,780	189,461
Property and equipment, net	94,322	103,540
Intangible assets:		.
FCC license intangible assets	845,592	843,777
Other intangible assets, net	35,743	40,448
Program rights, net of current portion	9,753	19,581
Amounts due from Crown Media, net of current portion		1,655
Investments in broadcast properties	2,129	2,205
Assets held for sale	2,227	2,227
Other assets, net	17,944	21,411
Total assets	$ 1,151,490	$ 1,224,305
LIABILITIES, MANDATORILY REDEEMABLE AND CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Accounts payable and accrued liabilities	$ 36,533	$ 40,500
Accrued interest	15,512	16,073
Accrued restructuring charges	12,933	
Current portion of obligations for program rights	4,739	18,436
Current portion of obligations to CBS	10,353	17,726
Current portion of obligations for cable distribution rights	2,729	2,896
Deferred revenue	10,217	16,344
Current portion of senior secured and senior subordinated notes	69	64
Total current liabilities	93,085	112,039
Accrued restructuring charges, net of current portion	9,549	

Obligations for program rights, net of current portion	121	1,703
Obligations to CBS, net of current portion	1,774	9,191
Deferred revenue, net of current portion	6,898	6,898
Deferred income taxes	171,909	194,706
Senior secured and senior subordinated notes, net of current portion	1,045,036	1,004,029
Mandatorily redeemable preferred stock	522,612	471,355
Other long-term liabilities	12,129	10,980
Total liabilities	1,863,113	1,810,901
Mandatorily redeemable and convertible preferred stock	854,563	740,745
Commitments and contingencies (See Notes to Unaudited Consolidated Financial Statements)		
Stockholders deficit:		
Class A common stock, $0.001 par value; one vote per share; 215,000,000 shares authorized, 64,578,674 and 60,545,269 shares issued and outstanding	65	61
Class B common stock, $0.001 par value; one vote per share; 35,000,000 shares authorized and 8,311,639 shares issued and outstanding	8	8
Class C non-voting common stock, $0.001 par value, 77,500,000 shares authorized, no shares issued and outstanding		
Common stock warrants and call option	66,663	66,663
Additional paid in capital	541,739	542,138
Deferred stock-based compensation	(6,306)	(10,687)
Accumulated deficit	(2,168,355)	(1,925,524)
Total stockholders deficit	(1,566,186)	(1,327,341)
Total liabilities, mandatorily redeemable and convertible preferred stock, and stockholders deficit	$ 1,151,490	$ 1,224,305

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

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	2004	2005	2004
NET REVENUES (net of agency commissions of $10,086, $10,505, $32,456 and $34,869, respectively)	$ 59,355	$ 65,872	$ 190,935	$ 207,043
EXPENSES:				
Programming and broadcast operations (excluding depreciation and amortization shown separately below and stock-based compensation of $125, $111, $438 and $731, respectively)	13,956	11,111	42,204	38,572
Program rights amortization	16,104	12,190	49,479	38,723
Selling, general and administrative (excluding depreciation and amortization shown separately below and stock- based compensation of $724, $1,128, $2,473 and $5,263, respectively	13,354	27,455	72,141	91,588
Depreciation and amortization	8,973	10,527	28,044	32,224
Insurance recoveries			(15,652)	
Time brokerage and affiliation fees	1,145	1,119	3,435	3,321
Stock-based compensation (excluding restructuring charges of $1,120 for the nine months ending September 30, 2005)	849	1,239	2,911	5,994
Adjustment of programming to net realizable value		4,645		4,645
Restructuring charges (credits)	24,345	(5)	28,592	(5)
Total operating expenses	78,726	68,281	211,154	215,062
(Loss) gain on disposal of broadcast and other assets, net	(33)	42	(600)	6,000
Operating loss	(19,404)	(2,367)	(20,819)	(2,019)
OTHER INCOME (EXPENSE):				
Interest expense	(27,504)	(23,699)	(82,711)	(69,329)
Dividends on mandatorily redeemable preferred stock	(17,673)	(15,401)	(51,257)	(44,666)
Interest income	687	646	1,912	2,120
Other income (expense), net	(372)	1	3,089	1,101
Loss on extinguishment of debt				(6,286)
Gain on modification of program rights obligations	123	370	864	1,111

Loss before income taxes	(64,143)	(40,450)	(148,922)	(117,968)
Income tax (provision) benefit	(7,965)	(3,293)	19,909	(11,609)
Net loss	(72,108)	(43,743)	(129,013)	(129,577)
Dividends and accretion on redeemable and convertible preferred stock	(33,096)	(14,291)	(113,818)	(37,464)
Net loss attributable to common stockholders	$ (105,204)	$ (58,034)	$ (242,831)	$ (167,041)
Basic and diluted loss per common share	$ (1.51)	$ (0.85)	$ (3.51)	$ (2.46)
Weighted average shares outstanding	69,485,376	68,372,183	69,155,101	68,017,200

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

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PAXSON COMMUNICATIONS CORPORATION
CONSOLIDATED STATEMENT OF STOCKHOLDERS DEFICIT
For the Nine Months Ended September 30, 2005 (Unaudited)
(in thousands)

	Common Stock		Common Stock Warrants and Call Option	Additional Paid-In Capital	Deferred Stock-Based Compensation	Accumulated Deficit	Total Stockholders Deficit
	Class A	Class B					
Balance at January 1, 2005	$ 61	$ 8	$ 66,663	$ 542,138	$ (10,687)	$ (1,925,524)	$ (1,327,341)
Stock-based compensation					3,989		3,989
Forfeitures of deferred stock-based compensation, net				(392)	392		
Stock optons exercised for unvested shares	2			(11)			(9)
Stock options exercised	2			4			6
Dividends and accretion on redeemable and convertible preferred stock						(113,818)	(113,818)
Net loss						(129,013)	(129,013)
Balance at September 30, 2005	$ 65	$ 8	$ 66,663	$ 541,739	$ (6,306)	$ (2,168,355)	$ (1,566,186)

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

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PAXSON COMMUNICATIONS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	For the Nine Months Ended September 30,	
	2005	2004
Cash flows from operating activities:		
Net loss	$ (129,013)	$ (129,577)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	28,044	32,224
Stock-based compensation	2,911	5,994
Loss on extinguishment of debt		6,286
Restructuring charges (stock-based compensation expense) and related accretion	1,493	(5)
Program rights amortization	49,479	38,723
Adjustment of programming to net realizable value		4,645
Payments for cable distribution rights	(188)	(111)
Non-cash barter	49	
Program rights payments and deposits	(43,298)	(60,614)
Provision for doubtful accounts	(23)	(23)
Deferred income tax (benefit) provision	(22,798)	11,291
Loss (gain) on sale or disposal of broadcast and other assets, net	600	(6,000)
Dividends and accretion on 14 1/4% mandatorily redeemable preferred stock	51,257	44,666
Accretion on senior subordinated discount notes	41,060	36,457
Gain on modification of program rights obligations	(864)	(1,111)
(Increase) decrease in operating assets:		
Accounts receivable	13,802	(478)
Amounts due from Crown Media	9,204	10,281
Prepaid expenses and other current assets	(921)	757
Other assets	44	4,626
Increase (decrease) in operating liabilities:		
Accounts payable and accrued liabilities	(9,473)	(3,431)
Accrued restructuring charges	22,109	
Accrued interest	(561)	(5,102)
Obligations to CBS	(13,926)	(14,675)
Net cash used in operating activities	(1,013)	(25,177)
Cash flows from investing activities:		
Decrease in short-term investments	5,993	6,985
Refund of (deposits for) programming letters of credit	24,603	(10,971)
Purchases of property and equipment	(8,875)	(12,279)
Proceeds from sale of broadcast assets		9,988
Proceeds from sale of property and equipment	67	14
Additions to intangible assets	(3,622)	(57)
Net cash provided by (used in) investing activities	18,166	(6,320)
Cash flows from financing activities:		

Borrowings of long-term debt		365,000
Repayments of long-term debt	(49)	(335,672)
Payments of loan origination costs		(11,432)
Payments of employee withholding taxes on exercises of stock options, net	(9)	
Proceeds from exercise of common stock options, net	6	3
Proceeds from stock subscription notes receivable		408
Net cash (used in) provided by financing activities	(52)	18,307
Increase (decrease) in cash and cash equivalents	17,101	(13,190)
Cash and cash equivalents, beginning of period	82,047	97,123
Cash and cash equivalents, end of period	$ 99,148	$ 83,933

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

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PAXSON COMMUNICATIONS CORPORATION
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. GENERAL

Nature of the Business

Paxson Communications Corporation (together with its subsidiaries, collectively, the Company), a Delaware corporation, was organized in 1993. The Company is 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 the Company s stations serve. The Company provides network programming seven days per week, 24 hours per day, through its broadcast television station group and pursuant to distribution arrangements with cable and satellite distribution systems.

The Company s business operations presently do not provide sufficient cash flow to support its debt service and to pay cash dividends on its preferred stock. The Company continues to consider strategic alternatives that may arise, which may include the sale of all or part of the Company s assets, finding a strategic partner who would provide the financial resources to enable the Company to redeem, restructure or refinance the Company s debt and preferred stock, or finding a third party to acquire the Company through a merger or other business combination or through a purchase of the Company s equity securities, and to endeavor to improve its core business operations and increase its cash flow.

Basis of Presentation

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. The accompanying financial statements, footnotes and discussions should be read in conjunction with the financial statements and related footnotes and discussions contained in the Company s Amendment No. 1 to Annual Report on Form 10-K/A for the fiscal year ended December 31, 2004 (the Fiscal 2004 Form 10-K) and the definitive proxy statement for the annual meeting of stockholders of the Company held on June 10, 2005, both of which were filed with the United States Securities and Exchange Commission. Certain reclassifications have been made to the prior period financial statements to conform to the 2005 presentation.

The financial information contained in the financial statements and notes thereto as of September 30, 2005 and for the three and nine month periods ended September 30, 2005 and 2004 is unaudited. In the opinion of management, all adjustments necessary for the fair presentation of such financial information have been included. Except for the adjustments pertaining to the $28.6 million restructuring charge, $34.8 million net income tax benefit resulting from the IRS settlement and recognition of asset retirement obligations in the amount of $0.7 million, which are more fully described in notes 2, 6 and 10, respectively, these adjustments are of a normal recurring nature. The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

For the three and nine months ended September 30, 2005 and 2004, the amounts of net loss and comprehensive loss were the same.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company believes the most significant estimates involved in preparing the Company s financial statements include estimates related to the net realizable value of programming rights, barter revenue recognition, accounting for leases, allowance for doubtful accounts and impairment of long-lived assets and Federal Communications Commission (FCC) licenses. The Company bases its estimates on historical experience and various other assumptions it believes are reasonable. Actual results could differ from those estimates. The Company s significant accounting policies are described in Note 1. Nature of the Business and Summary of Significant Accounting Policies in the notes to the Company s consolidated financial statements included in the Company s Fiscal 2004 Form 10-K and as follows:

Accounts Receivable

The Company carries accounts receivable at the amount it believes to be collectible. Accordingly, the Company provides allowances for accounts receivable it believes to be uncollectible based on management s best estimates. In

determining the necessary allowance for doubtful accounts receivable, the Company analyzes its historical bad debt experience, the credit worthiness of its customers and the aging of its accounts receivable. If the allowance for doubtful accounts were to increase by 10%, it would

have resulted in additional expense of approximately $43,000 for the nine months ended September 30, 2005. The amounts of accounts receivable that ultimately become uncollectible could vary significantly from the Company s estimates.

Revenue Recognition

Revenue is recognized as commercial spots or long form programming are aired and, for the majority of network commercial spots only, as ratings guarantees to advertisers are achieved. Net revenues, therefore, have been recorded net of the change in the liability for shortfalls in ratings guarantees, exclusive of the effect of any cash refunded to advertisers. For the three months ended September 30, 2005 and 2004, the liability for shortfalls in ratings guarantees decreased by $4.7 million and $0.2 million, respectively. For the nine months ended September 30, 2005 and 2004, the liability for shortfalls in ratings guarantees decreased by $2.1 million and $1.7 million, respectively. Included in deferred revenues in the accompanying consolidated balance sheets are liabilities for ratings shortfalls as of September 30, 2005 and December 31, 2004 amounting to $2.5 million and $5.2 million, respectively.

Long-Lived Assets

The Company reviews long-lived assets and reserves for 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 the Company s analysis indicates that a possible impairment exists, the Company is required to then estimate the fair value of the asset determined either by third party appraisal or estimated discounted future cash flows. If the fair value of the asset is determined to be less than the asset s carrying value, an impairment charge is recorded for the excess of the asset s carrying value over its fair value.

The Company holds 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, upon the later of 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. Committees within the United States Senate and the House of Representatives have approved legislation that would establish April 7, 2009 and December 31, 2008, respectively, 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 the 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, which remain pending. The Company cannot predict when it will abandon, by private agreement, or as required by law, the broadcast service of its stations occupying the 700 MHz spectrum. It is possible that the estimated life of certain long-lived assets will be reduced significantly in the near term due to the anticipated industry migration from analog to digital broadcasting. If and when the Company becomes aware of such a reduction of useful lives, depreciation expense will be adjusted prospectively to ensure assets are fully depreciated upon migration. As of September 30, 2005, the aggregate net book value of the Company s assets which may have limited or no use as a result of the future migration from analog to digital was approximately $16.0 million.

2. RESTRUCTURING

During the nine months ended September 30, 2005, the Company adopted a plan to substantially reduce or eliminate the sales of spot advertisements that are based on audience ratings and to focus its sales efforts on long form paid programming, non-rated spot advertisements and sales of blocks of air time to third party programmers. In connection with this plan the Company:

notified all of its joint sales agreements (JSA) partners, other than NBC Universal, Inc. (NBCU), that the Company was exercising its right to terminate the JSAs, effective June 30, 2005;

exercised its right to terminate all of its network affiliation agreements, effective June 30, 2005;

notified NBCU that the Company was removing, effective June 30, 2005, all of its stations from its national sales agency agreement with NBCU, pursuant to which NBCU sold national spot advertisements for 49 of the Company s 60 stations; and

reduced personnel by 68 employees.

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The Company and NBCU have entered into a number of agreements affecting the Company s business operations, including an agreement under which NBCU provided network sales, marketing and research services. Pursuant to the terms of the JSAs between the Company s stations and NBCU s owned and operated stations serving the same markets, the NBCU stations sold all non-network spot advertising of the Company s stations and received commission compensation for such sales. Certain Company station operations, including sales operations, were integrated with the corresponding functions of the related NBCU station and the Company reimbursed NBCU for the cost of performing these operations. For the three months ended September 30, 2004, the Company incurred $5.2 million for commission compensation and cost reimbursements to NBCU in connection with these arrangements, with a de minimis amount incurred during the three months ended September 30, 2005. For the nine months ended September 30, 2005 and 2004, the Company incurred $11.2 million and $16.2 million for compensation and cost reimbursements to NBCU in connection with these arrangements. Other than sales support services with respect to network advertising sold prior to July 2005 which the Company has yet to air, NBCU no longer provides services to the Company under these agreements. The Company expects that the performance of the Company s business during 2005 will be affected by the costs of terminating these arrangements, including the possible disruption of the Company s network advertising sales efforts resulting from the transfer of this function from NBCU to the Company s own employees.

For the three months ended September 30, 2005 and 2004, the Company incurred $38,000 and $5.3 million, respectively, for commission compensation and cost reimbursement to non-NBCU JSA partners. For the nine months ended September 30, 2005 and 2004, the Company incurred $10.5 million and $16.2 million, respectively, for commission compensation and cost reimbursement to non-NBCU JSA partners.

In connection with the termination of the Company s JSAs, the Company expects to relocate up to 22 of its station master controls which are currently located in its JSA partner s facility. The Company expects the relocation of the station master controls to require a total cash outlay of between $5.0 million and $7.0 million, primarily for new equipment and moving expenses. As of September 30, 2005, the Company has spent $1.2 million in connection with the relocation of its station master controls, approximately $1.0 million of which was recorded as property and equipment. The Company expects that the performance of its business during 2005 will be affected by the terms on which it is able to effect some or all of the remaining relocations.

The Company accounts for restructuring costs pursuant to Statement of Financial Accounting Standards (SFAS) No. 146, Accounting for Costs Associated with Exit or Disposal Activities . SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, as opposed to when there is a commitment to a restructuring plan. Through the third quarter of 2005, the Company recorded a restructuring charge in the amount of $28.6 million in connection with the aforementioned restructuring activities. The restructuring charge consists primarily of the recognition of a liability in the amount of $24.2 million for costs that will continue to be incurred under the remaining term of a contract that no longer provides any economic benefit to the Company, one-time termination benefits in connection with personnel reductions at the Company (including $1.1 million in stock-based compensation expense) and personnel reductions for the Company s JSA partners and NBCU.

The Company shortened the amortizable lives of certain leasehold improvements at JSA locations to coincide with the termination of the related JSA agreements. Included in depreciation and amortization for the nine months ended September 30, 2005 is $1.4 million of amortization expense associated with leasehold improvements at JSA locations.

Restructuring charges are reflected in a separate line item in the accompanying consolidated statements of operations. The following summarizes the activity in the Company s restructuring accrual for the nine months ended September 30, 2005 (in thousands):

	Balance December 31, 2004	Amounts Charged to costs and expenses	Accretion	Cash Payments	Balance September 30, 2005
Contractual obligations and other costs	$	$ 24,377	$ 373	$ (2,268)	$ 22,482
Employee termination costs		3,095		(3,095)	
		27,472	373	(5,363)	22,482
Stock-based compensation expense		1,120			